Katten
Katten Muchin Rosenman LLP

CORPORATE & FINANCIAL
WEEKLY DIGEST

September 26, 2014 Volume IX, Issue 38

SEC/CORPORATE

SEC Releases Strategic Plan for 2014–2018

Last week, the Securities and Exchange Commission released its Strategic Plan for fiscal years 2014 through 2018, as required by the Government Performance and Results Act Modernization Act of 2010. In the Strategic Plan, the SEC identified four main strategic goals:

- Establishing and maintaining an effective regulatory environment;
- Fostering and enforcing compliance with the federal securities laws;
- Facilitating access to the information investors need to make informed investment decisions; and
- Enhancing the SEC's performance through effective alignment of human, information and financial capital.

The SEC also identified various strategic objectives related to these goals, as well as several initiatives that it intends to undertake to achieve its strategic goals and objectives, including:

- Improving the quality and usefulness of registrants' disclosure;
- Modernizing beneficial ownership reporting to address, among other things, disclosure obligations relating to the use of equity swaps and other derivatives;
- Enhancing the technological resilience of securities markets to ensure the development of adequate procedures with regard to automated systems and to guard against technological failures;
- Enhancing oversight of derivatives, including rulemaking for mutual fund use of derivatives;
- Improving oversight of small capitalization issuers to assure appropriate investor protections and promote market efficiency;
- Improving its management of tips, complaints and referrals to spot trends and patterns about potential issues or violations; and
- Designing and implementing enhancements to EDGAR and SEC.gov to facilitate access to, and utilization of, disclosure documents and other information.

A copy of the Strategic Plan is available here.

House Passes Bill H.R. 5405 "Promoting Job Creation and Reducing Small Business Burdens Act"

On September 16, the House of Representatives passed H.R. 5405 "Promoting Job Creation and Reducing Small Business Burdens Act." The bill addresses a number of Jumpstart Our Business Startups Act (JOBS Act)-related matters, and is also intended to make technical corrections to the Dodd-Frank Wall Street Reform and Consumer Protection Act. The bill packaged 11 stand-alone bills, six of which had previously passed the House, into one piece of legislation. It is unclear if the bill will gain traction in the Senate before the completion of midterm elections this November. The full text of H.R. 5405 can be found here.

Noteworthy sections of the bill from a corporate and securities perspective include the following:

Title III – Holding Company Registration Threshold Equalization Act

- This title would provide that the registration and registration termination thresholds under Section 12(g) of the Securities Exchange Act of 1934 (Exchange Act) provided for under the JOBS Act that currently apply to banks and bank holding companies would similarly apply to savings and loan holding companies.
- Generally, a bank or bank holding company becomes subject to the registration requirements of the Exchange Act if it has total assets exceeding $10 million and a class of equity securities (other than exempted securities) held of record by 2,000 or more persons, and such registration requirements terminate if the number of record holders is reduced to less than 1,200 persons.

Title IV – Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act

- This title would provide an exemption from registration with the Securities and Exchange Commission for persons effecting securities transactions solely in connection with the transfer of ownership of a specified smaller private company (regardless of whether such person acts on behalf of a seller or buyer) through the purchase, sale, exchange, issuance, repurchase or redemption of, or a business combination involving, securities or assets of such smaller private company, if such person reasonably believes that upon consummation of any such transaction, the acquiring person will control such smaller private company (i.e., would have the power, directly or indirectly, to direct the management or policies of such smaller private company, whether through ownership of securities, by contract or otherwise).
- Under this title, generally, a smaller private company would be an issuer without any class of securities registered with the SEC and that, in the immediately preceding fiscal year, had either (i) earnings before interest, taxes, depreciation and amortization (EBITDA) of less than $25 million or (ii) gross revenues of less than $250 million.
- Under this title, a person would not be exempt from registration if such person (i) in connection with the control transaction receives, holds, transmits or has custody of the funds or securities to be exchanged by the parties to the transaction or (ii) engages on behalf of an issuer in a public offering of any class of securities that is registered, or is required to be registered, with the SEC.

Title V – Small Cap Liquidity Reform Act

- This title would create a five-year liquidity pilot program allowing an emerging growth company (EGC) with annual gross revenues of less than $750 million during its most recently completed fiscal year to elect to have its securities quoted using a minimum increment (i.e., “tick size”) of $0.05 or $0.10, instead of the standard penny.
- Under this title, the securities of a covered EGC would need to trade above $1.00 at the effective date to be eligible to be quoted at a minimum increment of $0.05 or $0.10. In addition, such securities would no longer be eligible if the average trading price for any 90-day period falls below $1.00.
- Proponents have argued that a penny tick size is too small for market makers to be sufficiently profitable in small cap stocks, resulting in them leaving the market, and that a larger tick size would encourage market makers to return to the market, improving trading activity for small cap issuers and, as a result, increasing liquidity for such small cap issuers such as EGCs covered by this title.

Title VI – Improving Access to Capital for Emerging Growth Companies Act

- This title would reduce the number of days an EGC must have a confidential registration statement on file with the SEC before its “road show” from 21 days to 15 days and would clarify certain financial disclosure requirements of Form S-1 as applicable to EGCs.
- This title would also provide for a one-year grace period for an issuer initially filing a registration statement as an EGC to complete its initial public offering, even though such issuer no longer qualifies as an EGC for purposes of the federal securities laws.

Title VII – Small Company Disclosure Simplification Act

- This title would exempt EGCs and other smaller companies from eXtensible Business Reporting Language requirements for financial statements and other financial information in periodic reports required to be filed with the SEC.
- Issuers qualifying as smaller companies eligible for the exemption provided for under this title would be those with total annual gross revenues of less than $250 million.

Title X – Disclosure Modernization and Simplification Act

- This title would require the SEC to issue regulations to permit an issuer to include a summary page in its annual report on Form 10-K, but only if each item in such summary is cross-referenced to the more detailed discussion in the Form 10-K. There is currently no provision in Form 10-K prohibiting an issuer from using such a summary.
- This title would also require the SEC to scale back or eliminate requirements of Regulation S-K to reduce the burden on EGCs, accelerated filers, smaller reporting companies and other smaller issuers, "while still providing all material information to investors."

Title XI – Encouraging Employee Ownership Act

- This title would require the SEC to amend Rule 701 by increasing, from $5 million to $10 million, the amount of securities a company can sell in any 12-month period before the company is required to provide the following additional disclosures to investors: summaries of the plan(s) pursuant to which the offerings are made, information about the risks associated with investing in the securities sold pursuant to the plan(s) and financial statements.
- Rule 701 under the Securities Act of 1933 (Securities Act) provides a safe harbor from registration under the Securities Act for grants of equity securities by a non-reporting company to its employees and certain other persons under a written compensatory benefit plan or written compensation contract.

BROKER-DEALER

FINRA Board Approves Several Rulemaking Items Including Proposed Rule Changes Regarding Algorithmic Trading and Enhanced Transparency for OTC Transactions

The Financial Industry Regulatory Authority, Inc. announced on September 19 that the FINRA Board of Governors (Board) approved several new rule initiatives. Among the initiatives, FINRA will seek comment from members on a rule proposal that would require registration of associated persons of member firms involved in the preparation of algorithmic strategies and those responsible for supervising such persons. The Board also authorized FINRA to issue a Regulatory Notice reminding firms of their existing supervisory obligations with regard to the development and deployment of algorithmic trading strategies.

Another rulemaking initiative approved by the Board involved rules to increase transparency for over-the-counter (OTC) transactions in equity securities. The proposal would expand FINRA's recent rules that disclose alternative trading system (ATS) volume. FINRA will propose to publish each market participant's non-ATS OTC volume reported to FINRA's equity trade reporting facility. Volume information would be published on the FINRA website on a two- or four- week delayed basis in accordance with the time frames specified for ATS volume publication. The Board also authorized FINRA to solicit comments on a proposal to identify OTC trades in National Market System stocks reported more than two seconds following trade execution as "out of sequence" and not "last sale" eligible.

Among the other equity trading initiatives were the following:

(i) a proposal to decrease the allowable drift from synchronization of member clocks with the National Institute of Standards and Technology atomic clock;
(ii) a proposal to require ATSs to report order book information via the Order Audit Trail System;
(iii) a proposal to require members to report the identity of non-member broker-dealers after receiving orders from them; and
(iv) a proposal to adopt new registration categories for securities trader and securities trader principal registration to replace the equity trader classification.

Among the fixed income initiatives were the following:

(i) a proposal that ATSs report fixed income quotation information;
(ii) a proposal that members provide confirmation disclosure of pricing for same-day principal fixed income trades of retail size; and

(iii) a proposal to require members to identify transactions with affiliated entities in FINRA's Trade Reporting and Compliance Engine.

Finally, the Board authorized FINRA to seek comment from members on a proposal that would require a recruiting firm to provide a FINRA-created education communication to former retail customers of a transferring representative who are considering transferring assets to that firm.

The FINRA announcement is available here.

DERIVATIVES

CFTC Provides Time-Limited Relief to SEFs for Block Trades

On September 19, the Commodity Futures Trading Commission's Division of Market Oversight (DMO) provided time-limited no-action relief to swap execution facilities (SEFs) from the requirement in CFTC Regulation 43.2 that block trades occur away from the SEF's trading system or platform. The no-action position was adopted in order to facilitate compliance with CFTC regulations regarding pre-execution screening and prompt clearing of transactions.

As explained by DMO, CFTC Regulation 1.73 requires a futures commission merchant (FCM) that is also a clearing member of a derivatives clearing organization (DCO) to (i) establish risk-based limits for all proprietary and customer accounts and (ii) screen orders for compliance with such limits before an order is executed on or subject to the rules of a SEF or a designated contract market. The Regulation applies to all orders, including block trades which, by definition, are not effected by or through a SEF's trading system or platform. Additionally, CFTC Regulation 37.702(b) requires a SEF to have rules and procedures to facilitate prompt and efficient straight-through processing by DCOs, including facilitating pre-execution credit checks by each clearing FCM on an order-by-order basis. DMO acknowledged that, given the current state of technology, SEFs and FCMs may face challenges in facilitating pre-execution credit checks of block trades that occur away from a SEF's trading system or platform. The no-action relief is designed to permit FCMs to conduct pre-execution credit checks of block trades by permitting trades that are executed on SEF trading systems or platforms to be traded as block trades under CFTC Regulation 43.2.

The relief is subject to the following conditions: (i) block trades cannot be executed on a SEF's order book, as defined in CFTC Regulation 37.3(a)(3); (ii) the SEF must adopt rules for cleared block trades that indicate the SEF is relying upon this relief and require each cleared block trade to comply with the notional size and other requirements of CFTC Regulation 43.2; (iii) the FCM must complete a credit check at the time the order enters the SEF trading system or platform; and (iv) the block trade is subject to void *ab initio* requirements if the trade is rejected for clearing on the basis of credit.

CFTC Letter 14-118 is available here. This time-limited no-action relief will expire on December 15, 2015.

London Metal Exchange Provides Revised Guidance on Structure, Terminology and Order Execution

On September 22, the London Metal Exchange (LME) provided revised guidance on the structure of LME, market terminology and order execution. As with previous versions, the revised guidance explains that LME recognizes two types of contracts: client contracts between customers and certain types of LME members and exchange contracts between LME members. The guidance reminds LME members that all LME contracts are between parties acting as principals and that members cannot trade exchange contracts if a member is acting as an agent for a customer. The revised guidance also addresses different methods by which LME members may trade and describes several different order types on LME.

Of particular importance, the guidance highlights certain clearing arrangements of the LME's new clearing house, LME Clear, that are intended to comply with the client segregation requirements created by the European Market Infrastructure Regulation. LME members that enter into client contracts are required to offer clients a choice between an omnibus or individually segregated account at LME Clear. Client contracts registered on the LME matching system (LMEsmart) must align with the specified omnibus or individually segregated account. Additionally, when a client wishes to transfer positions from an account maintained at an LME member that has

experienced an event of default, as defined in the LME rules, to a solvent LME member, the client must notify LME Clear in a manner consistent with LME Clear rules. Failure to adhere to LME Clear rules will result in the client's positions being closed out.

The revised guidance is available here.

LITIGATION

SEC Obtains Asset Freeze of Turks and Caicos Company Conducting Ponzi Scheme

The Securities and Exchange Commission has obtained an emergency asset freeze of a Turks and Caicos company that allegedly ran a Ponzi scheme in Florida.

According to the SEC's complaint, between November 2004 and May 2014, Joseph Laurer and his company, Abatement Corp. Holding Company Limited, defrauded 50 people of approximately $4.6 million. The SEC alleged that Laurer promised prospective investors that the fund would invest in government bonds. Laurer further informed prospective investors that the fund would pay a guaranteed fixed return, with no risk to principal, and that investments were insured by the Federal Deposit Insurance Corporation and/or the Securities Investor Protection Corporation. By early 2007, the SEC alleged, Laurer was running a Ponzi scheme, investing no money in securities and using funds to pay investor withdrawals and personal expenses. According to the SEC, Laurer's personal expenses included $456,560 real estate purchased in his wife's name and $594,000 paid directly to his wife.

Securities and Exchange Commission v. Abatement Corp. Holding Company Limited, No. 1:14-cv-23336 (N.D. Fla.).

Think Tanks Ask Supreme Court to Clarify Definition of "Foreign Official" in FCPA

Two think tanks, the Washington Legal Foundation and the Independence Institute, have filed an *amicus* brief in the Supreme Court on behalf of petitioners Joel Esquenazi and Carlos Rodriguez, who were recently convicted of violating the Foreign Corrupt Practices Act (FCPA). The *amici* seek clarity of the definition of "foreign official" in the FCPA.

The FCPA prohibits certain persons or entities, including US businesses, from paying a "foreign official" for the purpose of obtaining or retaining business. The FCPA defines "foreign official" to include "any officer or employee of a foreign government or any department, agency, or instrumentality thereof."

Esquenazi and Rodriguez were executives of Terra Telecommunications Corp., a Florida company that purchased phone time from foreign vendors and resold the time to US customers. Terra conducted business with Haiti-owned vendor Telecommunications D'Haiti S.A. (Haiti Teleco). Prosecutors argued that Esquenazi and Rodriguez made payments to Haiti Teleco officers to obtain lower rates. To determine whether Haiti Teleco was an "instrumentality" under the FCPA, the trial court instructed the jury to consider whether the company "provided services to the citizens and inhabitants of Haiti," and whether it was majority owned by the Haitian government. Defendants were convicted, and Esquenazi was sentenced to 15 years' imprisonment and Rodriguez received seven years' imprisonment. The US Court of Appeals for the Eleventh Circuit affirmed, finding that an "instrumentality" is "an entity controlled by the government of a foreign country that performs a function the controlling government treats as its own," and setting forth a list of factors.

Amici contend that the business community needs concrete guidance in this undeveloped area. They argue that the Eleventh Circuit's definition is overly broad because (1) Haiti Teleco was never designated a government entity; (2) Haiti Teleco issues common stock, and the government was not an initial stockholder; and (3) Haiti Teleco, as a telephone service provider, does not perform a traditional government function.

Brief for Esquenazi and Rodriguez as Amici Curiae Supporting Petitioners, Esquenazi, et al. v. U.S., Sup. Ct. No. 14-189 (Aug. 14, 2014).

EU DEVELOPMENTS

Update on ESMA Clearing Obligations for Credit Default Swaps

On September 24, the European Securities and Markets Authority (ESMA) published on its website the public responses to its Consultation Paper on the draft regulatory standards (RTS) for Clearing Obligation No. 2 concerning credit default swaps (CDS). The consultation period closed on September 18. ESMA received nearly 30 responses from various industry participants.

ESMA, once it considers the responses to its consultations for the draft RTS on CDS, will issue final RTS, which are then required to be endorsed by the European Commission before the RTS becomes effective, which is expected to be December 2014 to February 2015.

ESMA intends to adopt a phased-in implementation schedule from the date on which the RTS for CDS come into force to encourage an orderly process of application as follows:

- Category 1 – Clearing members of at least one European Market Infrastructure Regulation (EMIR)-authorized central counterparty that clears the specified CDS products subject to the clearing obligation, six months;
- Category 2 – Non-clearing members that are financial counterparties (as defined under EMIR) or alternative investment funds (AIFs) (as defined under the Alternative Investment Fund Managers Directive) which qualify as non-financial counterparties above the EMIR clearing threshold, 18 months; and
- Category 3 – Non-clearing members that are non-financial counterparties above the clearing threshold as defined under EMIR (excluding AIFs), three years.

Category 1 entities, therefore, are expected to begin to clear CDS around June to August 2015; Category 2, around June to August 2016 and Category 3, around December 2017 to February 2018.

The Consultation Paper and the public responses can be found here.

OECD Publishes Initial Recommendations on BEPS

On September 16, the Organisation of Economic Co-operation and Development (OECD) published a set of recommendations for a coordinated approach to fight tax avoidance by multinational enterprises under the Base Erosion and Profit Sharing (BEPS) project. The purpose behind these recommendations is to create a single set of international tax rules, or building blocks, which seek to end the practice of erosion of tax bases and the artificial shifting of profits to jurisdictions to avoid paying tax.

The first elements include:

- a report on the tax challenges of the digital economy (Action 1);
- draft rules intended to neutralize hybrid mismatch arrangements (Action 2);
- an interim report on harmful tax practices (Action 5);
- draft rules intended to prevent treaty abuse (Action 6);
- draft rules regarding transfer pricing (Action 8 and Action 13); and
- a final report on the feasibility of a multilateral instrument to amend bilateral tax treaties (Action 15).

Collective investment schemes and special purpose vehicles that currently utilize strategies relying on double tax treaty claims to receive dividend and interest income free from withholding tax will need to focus more closely on these proposed rules as they evolve. While the OECD has acknowledged that more work is required before the final model treaty to prevent abuse of tax treaties is published, managers should understand the potential impact of the draft rules on their business models.

FINANCIAL REGULATORY BLOG

Katten Launches New *Bridging the Week* Blog for Financial and Regulatory Updates

Katten is pleased to inform *Corporate and Financial Weekly Digest* subscribers that the firm has launched an additional financial services resource called *Bridging the Week*, a weekly blog authored by special counsel Gary DeWaal—both in written and video formats—that recaps and discusses top international financial and regulatory news in a concise, interesting and non-technical way. The blog is updated every Monday morning and is supplemented by periodic "Between Bridges" breaking news recaps. Articles are chosen based on Gary's assessment of their relevance to businesspersons as well as legal and compliance personnel in financial services.

Bridging the Week aims to complement Katten's *Corporate and Financial Weekly Digest* by identifying the potential impact of key global issues in the financial services arena. The blog also provides brief summaries of regulatory rulings and litigation developments, often supplemented by Gary's insightful commentary as a financial services industry veteran with more than 30 years of experience on legal and regulatory matters.

Before joining Katten, Gary was a senior managing director and group general counsel for Newedge—a subsidiary of Société Générale—where he oversaw the worldwide Legal, Compliance, Financial Crimes Prevention (including AML) and Regulatory Developments departments. He has also worked for the US Commodity Futures Trading Commission's Division of Enforcement in New York.

To subscribe to *Bridging the Week*, click here.

For more information, contact:

SEC/CORPORATE

David S. Kravitz	+1.212.940.6354	david.kravitz@kattenlaw.com
Thomas F. Lamprecht	+1.312.902.5367	thomas.lamprecht@kattenlaw.com
Mark J. Reyes	+1.312.902.5612	mark.reyes@kattenlaw.com
Mark D. Wood	+1.312.902.5493	mark.wood@kattenlaw.com

FINANCIAL SERVICES

Janet M. Angstadt	+1.312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	+1.212.940.6615	henry.bregstein@kattenlaw.com
Kimberly L. Broder	+1.212.940.6342	kimberly.broder@kattenlaw.com
Wendy E. Cohen	+1.212.940.3846	wendy.cohen@kattenlaw.com
Guy C. Dempsey Jr.	+1.212.940.8593	guy.dempsey@kattenlaw.com
Kevin M. Foley	+1.312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	+1.212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	+1.312.902.5241	arthur.hahn@kattenlaw.com
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Kathleen H. Moriarty	+1.212.940.6304	kathleen.moriarty@kattenlaw.com
Ross Pazzol	+1.312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	+1.312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	+1.212.940.8720	fred.santo@kattenlaw.com
Christopher T. Shannon	+1.312.902.5322	chris.shannon@kattenlaw.com
Peter J. Shea	+1.212.940.6447	peter.shea@kattenlaw.com
James Van De Graaff	+1.312.902.5227	james.vandegraaff@kattenlaw.com
Robert Weiss	+1.212.940.8584	robert.weiss@kattenlaw.com
Lance A. Zinman	+1.312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	+1.312.902.5334	krassimira.zourkova@kattenlaw.com

LITIGATION

Bruce M. Sabados	+1.212.940.6369	bruce.sabados@kattenlaw.com
Margaret J. McQuade	+1.212.940.6664	margaret.mcquade@kattenlaw.com

EU DEVELOPMENTS

Barry E. Breen	+44.20.7776.7635	barry.breen@kattenlaw.co.uk
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Sanjay Mehta	+44.20.7776.7623	sanjay.mehta@kattenlaw.co.uk

* Click here to access the *Corporate and Financial Weekly Digest* archive.

Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

©2014 Katten Muchin Rosenman LLP. All rights reserved.

Katten

Katten Muchin Rosenman LLP www.kattenlaw.com

AUSTIN | CENTURY CITY | CHARLOTTE | CHICAGO | HOUSTON | IRVING | LONDON | LOS ANGELES | NEW YORK | ORANGE COUNTY | SAN FRANCISCO BAY AREA | SHANGHAI | WASHINGTON, DC

Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997).

London: Katten Muchin Rosenman UK LLP.