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CORPORATE & FINANCIAL
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SEC/CORPORATE

SEC Issues Additional Guidance on Emerging Growth Companies

On September 28, the Division of Corporation Finance of the Securities and Exchange Commission published an additional set of frequently asked questions (FAQs) regarding Title I of the Jumpstart Our Business Startups Act (JOBS Act), which was enacted on April 5. Title I of the JOBS Act includes reforms intended to facilitate capital raising by "emerging growth companies" (EGCs), such as allowing EGCs to submit draft registration statements on a confidential basis to the SEC. Title I of the JOBS Act became operative upon enactment.

Which companies can qualify as EGCs?

Generally, the analysis of whether an issuer is determined to be an EGC focuses on whether the issuer meets EGC requirements and not on the issuer's parent. However, if it appears that the issuer or its parent is engaging in a transaction for the purpose of converting a non-EGC into an EGC or obtaining EGC status benefits indirectly, the SEC may question the issuer's EGC status.

If an issuer that was once a reporting company under the Securities Exchange Act of 1934 (the Exchange Act) but is no longer required to file Exchange Act reports would qualify as an EGC but for the fact that its initial public offering occurred on or before December 8, 2011, then the issuer may qualify as an EGC. However, if it appears that the issuer ceased to be a reporting company for the purpose of becoming an EGC, the SEC may question the issuer's EGC status.

An issuer's most recently completed fiscal year is used to determine whether an issuer qualifies as an EGC, regardless of whether the issuer presents financial statements for that year in its registration statement.

The Division of Corporation Finance provided additional guidance with respect to the application of the $1 billion annual revenues test, the five-year anniversary test, the $1 billion issued debt test and the large accelerated filer test for companies involved in forward acquisitions and reverse mergers with operating companies.

How should an EGC make its filings with the SEC and communicate with investors?

An EGC may use the confidential submission process under Section 6(e) of the Securities Act of 1933 (the Securities Act) to submit a draft registration statement for an exchange offer or merger that constitutes its initial public offering of its common equity securities. If an EGC uses the confidential submission process with respect to an exchange offer, it must publicly file the registration statement (including the confidential submission) at least 21 days before the road show or anticipated effective date of the registration statement, but no later than the date of commencement of the exchange offer. Such EGC must also make the required filings under the Securities Act and the Exchange Act for test-the-waters and pre-commencement tender offer communications and must file a tender offer statement on Schedule TO on the date of commencement of the exchange offer. In a merger where an EGC is acquiring a target company subject to Regulation 14A or 14C and the EGC's registration statement includes a prospectus that serves as the target company's proxy or information statement, the same timing applies with respect to filing the registration statement, and the EGC must make the required filings under the Securities Act and the Exchange Act for test-the-waters communications and soliciting material.

Upon public filing of an initial confidential submission of a draft registration statement, the public filing is not required to be signed by the issuer or its officers or directors, and is not required to include consents of auditors or other experts.

EGCs may use test-the-waters communications with qualified institutional buyers and institutional accredited investors in connection with exchange offers or mergers, but must make any required filings under the Exchange Act for such written communications.

What are the financial statement disclosure requirements applicable to EGCs?

An EGC that is not a shell company and presented only two years of financial statements in its registration statement may present only two years of financial statements for a target company that does not qualify as a smaller reporting company in the EGC's registration statement for the exchange offer or merger.

An EGC that is not a shell company that presented only two years of financial statements in its registration statement for its initial public offering, and has not yet filed three years of financial statements in a Form 10-K, may present in a Form 8-K only two years of financial statements for an acquired business.

Section 7(a)(2)(A) of the Securities Act, which permits inclusion of only two years of financial statements, applies only to registration statements for initial public offerings of common equity securities. If an EGC that has not done an initial public offering of common equity securities is required to register securities under Section 12(g) of the Exchange Act, it must present three years of financial statements in its registration statement on Form 10 or Form 20-F. Likewise, if an EGC that has not done an initial public offering of common equity securities does a public offering of debt securities, it also may not rely on Section 7(a)(2)(A).

If an issuer loses its EGC status, it is not required to present selected financial data or a ratio of earnings to fixed charges in subsequently filed registration statements and periodic reports for periods prior to the earliest audited period presented in its initial registration statement.

Click here to read the FAQs.

CFTC

Exchanges Withdraw Proposed Revisions to Position Limit Rules Following Court Order Vacating CFTC Position Limit Rules

On September 28, the United States District Court for the District of Columbia vacated the Commodity Futures Trading Commission’s revised position limit rules for futures and swaps. The revised rules, which were scheduled to become effective on October 12, would have expanded the scope of the federal position limits by establishing speculative limits for futures, options and swaps tied to 28 physical commodities.

The revised rules originated from Section 4a(a)(1) of the Commodity Exchange Act (CEA) as revised by the Dodd-Frank Wall Street Reform and Consumer Protection Act, which allows the CFTC to establish position limits if it finds that they are necessary to diminish, eliminate or prevent excessive speculation. The CFTC interpreted this provision of the CEA as a Congressional mandate to impose position limits without a specific finding that such rules are necessary. he court disagreed, stating that the language of CEA Section 4a(a)(1) clearly and unambiguously requires the CFTC to make a finding of necessity prior to imposing position limits. The court’s decision does not affect the CFTC’s previously adopted position limit rules set forth in Part 150 of the CFTC’s regulations (which apply solely to futures contracts and options on futures contracts on grains and cotton) or exchange-set speculative position limits.

Following the decision, the Chicago Mercantile Exchange (CME), Chicago Board of Trade and New York Mercantile Exchange withdrew an exchange rule submission, which reflected changes necessary to conform to the CFTC’s vacated position limits rule and which had been scheduled to become effective on October 12.

ICE Futures U.S. (ICE) also withdrew portions of a previously submitted rule filing that were intended to conform to the vacated rule. Other amendments to the ICE position limit rules, relating to bona fide hedging exemptions, risk management exemptions and reporting requirements for contracts that are cash-settled based on a commodity or contract traded on another venue, were not withdrawn and will become effective on October 12.

The CME Market Regulation Advisory Notice is available here.

The ICE Exchange Notice is available here.

See description of the court's decision below under "LITIGATION."

NFA Issues Guidance on Financial Reporting Requirements

On October 1, the National Futures Association (NFA) provided additional guidance on how to fulfill its recently adopted financial reporting obligations. NFA Financial Requirements Section 16, which became effective on September 1, requires futures commission merchants (FCMs) to submit certain financial related information to NFA on a monthly, semi-monthly or daily basis. While NFA will obtain most of the required information from other regular filings, FCMs holding customer segregated and secured amount funds must report information that is not already included in the firms' monthly or semi-monthly filings. Beginning with the report for the month ending September 30, affected FCMs will provide the additional information in either the "Supplementary Information" section of the Form 1-FR or the "Exchange Supplementary" section of the Form 1-FR or FOCUS Report. The NFA notice includes specific instruction on how to report information regarding the FCM's use of leverage, depositories used to hold customer segregated and secured amount funds, and the residual interest target amounts for those funds.

More information is available here.

CFTC Issues Guidance on Segregated and Secured Funds Maintained in a Combined Omnibus Account

The Commodity Futures Trading Commission's (CFTC) Division of Swap Dealer and Intermediary Oversight has issued guidance clarifying that futures commission merchants (FCMs) may not maintain customer segregated funds (i.e., customer funds deposited to margin contracts traded on US-designated contract markets) and secured funds (i.e., customer funds deposited to margin contracts traded on foreign boards of trade) in a single customer omnibus account with a carrying FCM. CFTC Rules 1.20 and 30.7 require an FCM to hold customer segregated funds and secured funds in separate omnibus accounts, with each account properly titled as required under CFTC Rule 1.20 or Rule 30.7, respectively. FCMs must also obtain account acknowledgement letters for each account.

The CFTC guidance letter is available here.

NYMEX Expands Block Trading

On October 1, the New York Mercantile Exchange (NYMEX) issued an advisory notice regarding an amendment to its block trading rules. Subject to Commodity Futures Trading Commission review, NYMEX will expand the list of products eligible for block trading to include 494 additional energy products, effective October 15. Block trades in existing NYMEX and Commodity Exchange, Inc. (COMEX) block-eligible products must continue to be reported within five minutes, but the reporting time from for the additional 494 products will be fifteen minutes. In addition, NYMEX intends to reduce the block trade minimum threshold in certain core energy contracts and eliminate eligibility for block trading in certain other energy products.

A complete list of products that are eligible for block trading on NYMEX and COMEX, including the corresponding quantity thresholds for such products, is available here.

The NYMEX Market Regulation Advisory Notice is available here.

LITIGATION

ISDA and SIFMA Win Summary Judgment on Challenge to CFTC Position Limits Rule

The United States District Court for the District of Columbia granted summary judgment for plaintiffs International Swaps and Derivatives Association (ISDA) and Securities Industry and Financial Markets Association (SIFMA), holding that a recent rulemaking by the Commodity Futures Trading Commission setting position limits on futures contracts, options contracts and swaps tied to 28 physical commodities (the Position Limits Rule) was not authorized. The court ordered that the rule, which had not yet taken effect, must be vacated. As the court acknowledged, both parties believe that the Position Limits Rule "is a significant and unprecedented change in the operation of the commodity derivatives market," and therefore the court's decision to vacate and remand—when it could have remanded without vacatur—is significant.

Prior to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Commodities Exchange Act of 1936 (the CEA) permitted, but did not require, the CFTC to set position limits on futures and options contracts. The CFTC asserted that it was now "required" by amendments that the Dodd-Frank Act made to the CEA to set position limits for certain physical commodity derivatives. Plaintiffs disagreed and argued that the CFTC misinterpreted the impact of the Dodd-Frank Act on the CEA and that the setting of such position limits was still discretionary and therefore required a finding of necessity. Plaintiffs also argued that the CFTC's reading of the Dodd-Frank Act on this point was internally inconsistent, as it resulted in the CFTC having discretion to set position limits as to certain commodities but not others, despite the fact that the relevant provision of the CEA never distinguishes among commodities.

The court ultimately agreed with the plaintiffs after applying the two-part *Chevron* deference test. First, the court found that there were at least two plausible readings of the CEA as amended by the Dodd-Frank Act, and thus the court could not uphold the CFTC's interpretation of the Dodd-Frank Act amendments under *Chevron* Step One. Second, the court agreed with the CFTC concession that it was not entitled to deference under *Chevron* Step Two. As it was unable to uphold the CFTC's interpretation of the Dodd-Frank amendments to the CEA, the District of Columbia vacated the Position Limits Rule and remanded the matter back to the CFTC for further rulemaking.

Int'l Swaps & Derivatives Assoc., et al. v. US Commodity Futures Trading Comm'n, Civil Action No. 11-cv-2164 (RLW) (D.D.C. September 28, 2012).

Court Enters Judgment Against Colorado Ponzi Scheme Perpetrator

The United States District Court for the District of Colorado recently entered a judgment against Larry Michael Parrish (Parrish), who had operated a Ponzi scheme that raised approximately $9.2 million from at least 70 investors in three different states. To obtain investors, Parrish promised 30% annual returns and claimed that the securities were "extremely low risk." The Securities and Exchange Commission filed a complaint against Parrish in March of 2011, alleging violations of the Securities Act of 1933 (Securities Act), the Securities Exchange Act of 1934 (Exchange Act) and the Investment Advisers Act of 1940 (Advisers Act). The District of Colorado ultimately found Parrish in violation of securities registration, anti-fraud, broker-dealer registration and broker-dealer bar provisions of those acts.

Based on the court's finding of Parrish's liability, the court granted the SEC's requested relief of an injunction, disgorgement and a civil penalty. Based on the nature of Parrish's violations and the fact that he had already been barred by the SEC for operating a prior investment scheme, the court permanently enjoined Parrish from future violations of certain provisions of the Securities Act, Exchange Act and Advisers Act. In addition, the court ordered Parrish to disgorge his "ill-gotten gains." In the context of a Ponzi scheme, these "ill-gotten gains" consist of subtracting the total distributions to investors from the total contributions from investors. For Parrish, the total disgorgement was $4,139,858 plus pre-judgment interest. Finally, the court also believed that a significant "third-tier" penalty was appropriate. Due to the substantial investor loss that Parrish's Ponzi scheme caused, Parrish's promises of 30% returns and characterization of his investment as "low-risk," and Parrish's use of some of the investor's money for his own personal benefit, the court imposed a civil penalty equal to the total disgorgement amount: $4,987,777.26.

SEC v. Parrish, Civil Action No. 111-cv-00558-WJM-MJW (D. Colo. Sept. 25, 2012).

BANKING

OCC Switches Consideration of BSA/AML Findings for Banks and Foreign Banking Organizations

On September 28, the Office of the Comptroller of the Currency (OCC), which regulates national banks and federal savings associations (collectively, banks), issued a bulletin that changes how deficiencies in Bank Secrecy Act and Anti-Money Laundering (BSA/AML) examination findings are assessed by examiners. This bulletin summarizes refinements to the Federal Financial Institutions Examination Council's (FFIEC) Uniform Rating Systems and the OCC's risk assessment system (RAS) for banks, and the risk management, operational controls, compliance and asset quality (ROCA) ratings and RAS for federal branches and agencies of foreign banking organizations.

OCC's guidance stated that "these refinements reflect the OCC's longstanding policy that weaknesses in a bank's BSA/AML program are serious safety and soundness concerns that require management's prompt attention," and further stated:

> *Consumer Compliance Rating*
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> Effective July 18, 2012, examiners **no longer** consider BSA/AML examination findings when assigning a rating under the FFIEC Uniform Interagency Consumer Compliance Rating System. This change aligns the OCC's policy with those of the other federal banking agencies.
>
> *Management Component Rating*
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> In keeping with current policy, examiners consider BSA/AML examination findings in a safety and soundness context when assigning the management component of the FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). Serious deficiencies in a bank's BSA/AML compliance create a presumption that the bank's management component rating will be adversely affected because its risk management practices are less than satisfactory.
>
> *Risk Management and Compliance Component Ratings of ROCA*
>
> In keeping with current policy, examiners consider BSA/AML examination findings in a safety and soundness context when assigning the risk management component of the ROCA rating system for federal branches and agencies. Serious deficiencies in a branch or agency's BSA/AML compliance create a presumption that the branch or agency's risk management component rating will be adversely affected because its risk management practices are less than satisfactory. Examiners also continue to consider BSA/AML examination findings when assigning the compliance component rating of ROCA. This treatment is consistent with the other federal banking agencies and reflects that the compliance component of ROCA is not limited to consumer compliance but rather compliance with all regulatory requirements.
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> *Risk Assessment System*
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> While examiners no longer consider BSA/AML examination findings when assigning the interagency consumer compliance rating, BSA/AML findings are still considered when assessing compliance risk under the OCC's RAS. Compliance risk reflects a bank's compliance with all applicable laws and regulations. The overall quantity of risk and quality of risk management related to BSA/AML compliance, as well as the four pillars of a bank's BSA/AML program, are considered in assessments of compliance risk. BSA/AML examination findings should also continue to be reflected in assessments of reputation, strategic, and operational risks, as warranted.

Read more.

EU DEVELOPMENTS

Commission Publishes Report of Expert Group on EU Bank Reform

On October 2, the European Commission published the report of the High-Level Expert Group on Reforming the Structure of the EU Banking Sector chaired by Erkki Liikanen, Governor of the Bank of Finland and a former member of the European Commission.

The report recommends:

- Mandatory legal separation of proprietary trading and other high-risk trading activities from deposit-taking banks in the same group;
- Possible additional separation of activities conditional on the recovery and resolution plan;
- Possible amendments to the use of bail-in instruments as a resolution tool;
- A review by the European Commission of capital requirements on trading assets and real estate related loans; and
- A strengthening of the governance and control of banks. This should build on corporate governance reforms currently under consideration and in addition to the proposals referred to above should (i) strengthen boards and management; (ii) promote the risk management function; (iii) rein in compensation; (iv) facilitate market monitoring; and (v) strengthen enforcement by regulatory authorities.

Read more.

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