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CFTC

CFTC Issues No-Action Relief to FCMs Relating to Enhanced Customer Protection Rules

The Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) issued two no-action letters granting relief to futures commission merchants (FCMs) from certain requirements of the enhanced customer protection regulations (Customer Protection Rules) that went into effect on January 13.

First, in Letter 14-02, DSIO provided time-limited no-action relief from the provisions of CFTC Regulations 1.20, 22.2 and 30.7 that prohibit the commingling of customer segregated funds, cleared swaps customer collateral and 30.7 funds. In the *Federal Register* release accompanying the Customer Protection Rules, the CFTC explained that these provisions would not prevent an FCM from accepting a single wire transfer to margin transactions in multiple account origins, provided (i) the funds were first deposited into the customer's account that holds funds used to margin transactions in futures executed on designated contract markets, and (ii) the FCM simultaneously recorded a book-entry credit to the customer's cleared swaps collateral and/or foreign futures secured amount accounts, as appropriate. This relief provides additional time for FCMs to establish and implement the operational procedures necessary to comply with the simultaneous book-entry credit recording requirement and other provisions of the Customer Protection Rules relating to the prohibition on commingling customer funds. Concurrently, DSIO has committed to assess the operational feasibility of the requirement for simultaneous book-entry credit. An FCM relying on this relief must maintain sufficient funds in its segregated funds, foreign futures secured amount and cleared swaps collateral customer accounts in amounts at least equal to the net liquidating equities of all of the FCM's customers in each of those accounts at all times. The relief expires on April 14.

Second, in Letter 14-03, DSIO established a procedure pursuant to which an FCM could comply with the requirements of CFTC Regulation 30.7(c), which provides that an FCM may not hold in jurisdictions outside of the United States customer funds deposited to margin, guarantee or secure foreign futures and foreign options transactions (30.7 Funds) in excess of 120 percent of customer margin requirements, including prefunding requirements established by a foreign board of trade, foreign clearing organization or foreign broker. Pursuant to the no-action letter, an FCM will be deemed to be in compliance with this requirement if: (i) the FCM identifies by noon each business day whether 30.7 Funds held for customers as of the close of the preceding business day exceed the 120 percent limit, (ii) the FCM initiates a transfer of any such excess funds from foreign depositories to US depositories on the same business day and (iii) such excess funds are received by the FCM's US depositories within two business days after initiating the transfer of such excess funds.

CFTC Letter 14-02 is available here.

CFTC Letter 14-03 is available here.

LITIGATION

Eleventh Circuit Upholds Directors' Affirmative Defenses Based on FDIC's Post-Receivership Conduct

The US Court of Appeals for the Eleventh Circuit recently issued the first appellate decision holding that, in actions brought by the Federal Deposit Insurance Corporation (FDIC), the officers and directors of failed banking institutions can assert affirmative defenses relating to the FDIC's post-receivership conduct.

Integrity Bank (the Bank) was forced to close in 2008 after incurring losses in excess of $70 million on certain acquisition, construction and development loans. The FDIC was appointed as the Bank's receiver and, in that role, the agency brought claims against the Bank's former officers and directors for ordinary negligence, gross negligence and breach of fiduciary duty. The FDIC alleged that the defendants were negligent in pursuing an unsustainable growth strategy, engaging in high-risk lending practices and approving the failed loans.

In response, the Bank's officers and directors asserted the affirmative defenses of failure to mitigate damages, reliance, and estoppel, all of which were based on the FDIC's post-receivership conduct (*e.g.*, failure to collect on accounts, improper disposal of assets, etc.). The FDIC moved to strike these defenses on the ground that, under well-accepted principals of common law, it owed no duty to the officers and directors of a failed bank. The US District Court for the Northern District of Georgia denied the FDIC's motion.

On appeal, the Eleventh Circuit affirmed the lower court's denial. The court found that, to the extent any relevant federal common law existed, it stood "at most for the proposition that a bank's officers and directors cannot assert tort claims against the FDIC because the FDIC owes them no duty" and did not address the issue of affirmative defenses. The court declined "to extend a purported federal common law rule to a new and significantly different context."

Fed. Deposit Ins. Corp. v. Skow et al., Case No. 12-15878 (11th Cir. 2013).

Delaware Chancery Analyzes Scienter Requirement in Insider Trading Claim

In a derivative action alleging insider trading, the Delaware Court of Chancery recently held that demand was excused as futile where the stockholder plaintiff alleged that a majority of the corporation's board members sold stock while in possession of non-public information indicating that physicians were reluctant to prescribe the company's newly approved drug due to concerns over Medicare reimbursement.

On April 29, 2010, after fifteen years of testing, nominal defendant Dendreon Corporation (Dendreon) obtained and then publicly disclosed US Food and Drug Administration (FDA) approval for Provenge, a new drug designed to treat advanced prostate cancer. Shortly thereafter, several officers and directors sold significant quantities of stock. More than one year later, Dendreon disclosed that Provenge sales were slower than expected due to the fact that some physicians had expressed concern over Medicare reimbursement for Provenge prescriptions. Following that announcement, Dendreon's stock price declined 67 percent.

Plaintiff brought a *Brophy* insider trading claim alleging that Dendreon's officers and directors knew of the "reimbursement risk" and its potential impact on Provenge sales at the time of the FDA approval and the ensuing stock sales. Prior to bringing the suit, plaintiff obtained documents from Dendreon pursuant to a "books and records" demand and thereby was able to provide sufficient detail such that the Chancery Court concluded that the claims were adequately particularized and demand was excused.

In finding that the complaint adequately pleaded scienter, the court focused on the timing and size of the trades, 70 percent of which occurred within one day of FDA approval. Although the court noted that there are "entirely legitimate reasons" for such sales, (i) the absence of similar trading activity following previous milestones, (ii) the similarity of trades by insiders who possessed the same information and (iii) the failure to disclose that information to the market, all supported a reasonable inference of scienter.

Silverberg v. Gold et al., C.A. No. 7646-VCP (Del. Ch. Dec. 31, 2013).

BANKING

Agencies Retreat on TruPS CDOs

Following the filing of a lawsuit by the American Bankers Association (ABA) and others, on January 14, five federal agencies approved an interim final rule to permit banking entities to retain interests in certain collateralized debt obligations backed primarily by trust preferred securities (TruPS CDOs) from the investment prohibitions of Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, known as the Volcker rule. Under the interim final rule, the agencies permit the retention of an interest in, or sponsorship of, covered funds by banking entities if the following qualifications are met:

- the TruPS CDO was established, and the interest was issued, before May 19, 2010;
- the banking entity reasonably believes that the offering proceeds received by the TruPS CDO were invested primarily in Qualifying TruPS Collateral; and
- the banking entity's interest in the TruPS CDO was acquired on or before December 10, 2013, the date the agencies issued final rules implementing Section 619 of the Dodd-Frank Act.

The interim final rule defines Qualifying TruPS Collateral as any trust preferred security or subordinated debt instrument that was:

- issued prior to May 19, 2010, by a depository institution holding company that as of the end of any reporting period within 12 months immediately preceding the issuance of such trust preferred security or subordinated debt instrument had total consolidated assets of less than $15 billion; or
- issued prior to May 19, 2010, by a mutual holding company.

Section 171 of the Dodd-Frank Act provides for the grandfathering of trust preferred securities issued before May 19, 2010, by certain depository institution holding companies with total assets of less than $15 billion as of December 31, 2009, and by mutual holding companies established as of May 19, 2010. The TruPS CDO structure was the vehicle that gave effect to the use of trust preferred securities as a regulatory capital instrument prior to May 19, 2010, and was part of the status quo that Congress preserved with the grandfathering provision of Section 171. The interim final rule also provides clarification that the relief relating to these TruPS CDOs “extends to activities of the banking entity as a sponsor or trustee for these securitizations and that banking entities may continue to act as market makers in TruPS CDOs.”

The interim final rule was approved by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission, and the Securities and Exchange Commission, the same agencies that issued final rules to implement Section 619. The agencies will accept comment on the interim final rule for 30 days following publication of the interim final rule in the *Federal Register*.

Following issuance of the interim final rule, the ABA dropped its request for emergency relief, but indicated that the lawsuits will remain pending, while the association consults with its membership on the “impact and implications” of the interim final rule, according to a statement by ABA president and CEO Frank Keating.

Read more.

OCC Proposes Risk Guidelines for Large Banks; Plans to Apply Part 30 to Federal Savings Institutions

On January 16, the Office of the Comptroller of the Currency (OCC) released a proposal setting forth new standards based on the agency’s heightened expectations program for large national banks and federal savings associations that would be enforceable under part 30 of its regulations.

The proposed standards would apply to any insured national bank, insured federal savings association or insured federal branch of a foreign bank with average total consolidated assets of $50 billion or more. The proposal would reserve the OCC’s authority to apply the guidelines to an institution with less than $50 billion in assets if the OCC determines that it is “highly complex” or “otherwise presents a heightened risk.”

The proposed guidelines set forth the minimum standards for the design and implementation of an institution's risk governance framework and provide minimum standards for oversight of that framework by the board of directors. The guidelines include provisions regarding:

- The roles and responsibilities of those organizational units that are fundamental to the design and implementation of the risk governance framework. These units are front line units, independent risk management and internal audit. Together, these units should establish an appropriate system to manage risk taking.
- A comprehensive written statement that articulates the bank's risk appetite, which serves as a basis for the risk governance framework. This statement should include both qualitative components and quantitative limits.
- Board of directors' oversight of a bank's compliance with safe and sound banking practices. The board should ensure that the bank establishes and implements an effective risk governance framework that complies with the guidelines.
- Active board oversight of a bank's risk-taking activities. This includes establishing accountability for management's adherence to the risk governance framework. The board should also evaluate management's recommendations and decisions by questioning, challenging and, when necessary, opposing, management proposals that could lead to excessive risk taking or pose a threat to safety and soundness.
- Composition of the board of directors. A board of directors should have at least two independent members who are not part of the bank's or the parent company's management.

If a bank or savings association fails to meet a prescribed standard, the OCC "may require the institution to submit a plan specifying the steps it will take to comply with the standard" or "may issue an enforceable order under section 8 of the FDIA, 12 U.S.C. § 1818(b), if the institution, after being notified that it is in violation of a safety and soundness standard, fails to submit an acceptable compliance plan or fails materially to comply with an OCC-approved plan."

As part of the agency's efforts to integrate the former Office of Thrift Supervision's regulations, the OCC is also requesting comment on its proposal to make part 30 and all of its appendices applicable to federal savings associations and to remove part 170, which contains comparable regulations that apply to federal savings associations.

The guidelines are available here.

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