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BROKER DEALER

SEC Requests Comment on FINRA Rules

The Securities and Exchange Commission is requesting comments from the public on two proposals from the Financial Industry Regulatory Authority, Inc. First, FINRA proposed to amend FINRA Rule 2210 (Communications with the Public) to (i) exclude from the communications filing requirements any research reports produced by a broker dealer that concern only securities listed on a national securities exchange (other than research reports that must be filed pursuant to Section 24(b) of the Investment Company Act of 1940) and (ii) clarify that free writing prospectuses that are exempt from having to be filed with the SEC are not subject to Rule 2210 filing or content standards. The comment period relating to the amendments to Rule 2210 expires on April 21.

Second, FINRA proposed to adopt FINRA Rule 2243 (Disclosure and Reporting Obligations Related to Recruitment Practices). This rule would establish certain disclosure and reporting obligations that a FINRA member would be required to comply with when a recruited registered representative is contacting his former customers. Such disclosure is aimed at providing former customers of a recruited registered representative with a more complete picture of the factors involved in a decision to transfer assets to a recruiting firm, including special recruitment compensation that has been paid to such customer's registered representative. The comment period relating to the adoption of Rule 2243 expires on April 18.

More information relating to the proposed amendments to FINRA Rule 2210 can be found here, or as reported in the *Corporate and Financial Weekly Digest* edition of March 14, 2014.

More information relating to proposed FINRA Rule 2243 can be found here.

CFTC

CFTC Issues Interpretation Regarding Auditor Independence Standards

On March 28, the Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight issued an interpretive statement regarding the auditor independence standards applicable to futures commission merchants (FCMs) and dually registered FCM/broker dealers (FCM/BDs). The interpretive statement indicates that an FCM, dually registered FCM/BD or auditor that complies with the auditor independence requirements in Securities and Exchange Commission Rule 17a-5 will also be deemed to comply with CFTC Regulation 1.16. The interpretation also clarifies that CFTC Regulation 1.16 does not require an auditor to comply with the ethics and auditor independence provisions relating to tax services and the pre-approval of certain non-audit services set forth in Public Company Accounting Oversight Board Rules 3523, 3524 and 3525 when conducting an audit of a non-issuer FCM or FCM/BD.

The CFTC interpretation is available here.

OTC Derivatives Regulators Group Issues Report to G20

On March 31, the OTC Derivatives Regulators Group (ODRG) issued a report that identifies remaining over the counter (OTC) derivatives cross-border implementation issues. The report indicates that ODRG, which is comprised of representatives of the regulatory authorities from 10 of the G-20 countries, including the Commodity Futures Trading Commission and the Securities and Exchange Commission, is working to: (i) develop approaches to address the treatment of branches and affiliates and the commitment to trade all standardized OTC derivatives on organized trading platforms; (ii) implement understandings regarding equivalence and substituted compliance among ODRG members, clearing determinations, risk mitigation and margin techniques for derivatives that are not centrally cleared and access to data repositories; and (iii) monitor cross-border issues related to risk mitigation techniques for OTC derivatives transactions that are not centrally cleared, access to registrants' books and records and barriers to reporting trades to data repositories.

The ODRG report is available here.

NFA Issues Notice to Members Regarding FATF Update

On April 2, the National Futures Association (NFA) issued a notice to its members informing them that the Financial Action Task Force (FATF) has updated its list of jurisdictions with strategic anti-money laundering and counter terrorism financing (AML/CFT) deficiencies. The updated FATF list includes the following changes: (i) Kenya and Tanzania were removed from the list of high-risk and non-cooperative jurisdictions requiring enhanced due diligence as set forth in the FATF Public Statement; and (ii) Kenya, Tanzania, Papua New Guinea and Uganda were added to the list of high-risk and non-cooperative jurisdictions requiring general due diligence as set forth in FATF's Improving Global AML/CFT Compliance: On-going Process.

The NFA Notice to Members is available here.

A Financial Crimes Enforcement Network Advisory describing the FATF changes is available here.

The FATF Public Statement is available here.

The FATF Improving Global AML/CFT Compliance: On-going Process is available here.

DIGITAL ASSETS AND VIRTUAL CURRENCIES

Texas Department of Banking Issues Guidance on Treatment of Virtual Currency

On April 3, the Texas Department of Banking released a supervisory memorandum on the regulatory treatment of virtual currencies such as bitcoin under the Texas Money Services Act. The guidance clarified that virtual currency was distinguishable from sovereign currency and did not fall under the regulatory definition of "money or monetary value" under the Money Services Act. As such, money transmission licenses generally are not required for most bitcoin and other virtual currency users because virtual currency transactions do not, from a regulatory perspective, involve the transmission of money.

The guidance clarified that certain virtual currency exchange-related activity would be regulated under the Money Services Act due to the payment of sovereign currency in exchange for virtual currency. Specifically, the memorandum cited a centralized virtual currency exchange as requiring money transmission licenses if transactions on such exchange involved (a) an escrow-like third-party intermediary between buyers and sellers of virtual currencies and (b) the exchange of sovereign currency for virtual currency. The guidance also clarified that "bitcoin ATMs" (and their operators) would require money transmission licenses if such ATMs fulfilled orders through a linked virtual currency exchange (rather than through a direct point-of-sale transaction between the user and the owner of the ATM). The supervisory memorandum also provided guidance on capital requirements for applicable money transmission licenses.

The Texas Department of Banking guidance is available here.

LITIGATION

Appropriate Cautionary Language Leads to Dismissal of Investor's Securities Fraud Suit

A California district court recently dismissed Mellanox Technologies Ltd. investors' claims that the company made false statements about both its prominence in the interconnect market and its revenue and growth prospects. The District Court determined that many of the statements were corporate "puffery" protected by the Private Securities Litigation Reform Act and the "bespeaks caution" doctrine because the company's forward-looking representations contained appropriate cautionary language.

Plaintiffs alleged in the complaint that the company made false statements in its revenue projections. Mellanox exceeded its earnings projects by about $4 million in the second and third quarters of 2012, largely because of demand for its InfiniBand computer chips. However, the company missed a projected $150 million revenue baseline by $30 million in the fourth quarter. Plaintiffs claimed that the company knew that much of the growth was not sustainable because it was due to short-term sale boosts attributable to a new platform roll-out. The suit also alleged that Mellanox knew that Intel Corporation was poised to develop its own InfiniBand product, which would detrimentally increase competition in the InfiniBand market in which Mellanox had previously enjoyed a near monopoly.

However, the District Court ruled that the company made clear that the deal with Intel was a one-time opportunity, and that most of the statements at issue were either general assertions of corporate optimism or accompanied by proper disclosures. Plaintiffs argued that the cautionary language was boilerplate and was not specific to Mellanox's projections. The District Court, however, held that the disclaimers did not need to specifically accompany each statement. It stated that "[s]uch cautionary language, coupled with language identifying statements as forward-looking, immunizes the company's forward-looking statements from securities liability."

In Re: Mellanox Technologies Ltd. Securities Litigation, No. 3:13-CV-04909-JST (N.D. CA Mar. 29, 2014)

Sixth Circuit Affirms Dismissal of Securities Class Action for Failure to Properly Plead Scienter

On March 28, the US Court of Appeals for the Sixth Circuit affirmed a lower court's dismissal of a shareholder class action against BioMimetic Therapeutics Inc., finding that plaintiffs had failed to sufficiently allege that the orthopedics company had lied about the progress of Food and Drug Administration (FDA) approval of Augment, a bone injury treatment.

Shareholders alleged that throughout the class period, the company was aware of numerous deficiencies in Augment's clinical trials, but nevertheless spoke optimistically to investors about the device's prospects for FDA approval. Plaintiffs also argued that defendants modified the patient population used to analyze its clinical trial results in a way that allowed the company to report more favorable results than if the original population was used.

The District Court granted BioMimetic's motion to dismiss, finding that under the pleading requirements of the Private Securities Litigation Reform Act (PSLRA), plaintiffs failed to adequately support their claims that BioMimetic had conducted inferior clinical trials and had deceived investors about their progress and results. A plaintiff only clears the high hurdle imposed by the PSLRA if a reasonable person would deem the inference of scienter at least as strong as any opposing inference. The Sixth Circuit affirmed, agreeing that the company could have legitimately believed that the statistical results it achieved in clinical trials would be sufficient to obtain approval by the FDA. It noted that several factors indicated that BioMimetric rightfully expressed optimism about the device's prospects and found that the complaint failed to set forth facts that would prove otherwise.

Kuyat et al. v. BioMimetic Therapeutics Inc. et al., No. 13-5602 (6th Cir. 2014).

BANKING

OCC Issues "Asset-Based Lending" Booklet

On March 27, the Office of the Comptroller of the Currency (OCC) issued a new asset-based lending handbook. This booklet "expands the asset-based lending (ABL) examination fundamentals discussed in the 'Accounts Receivable and Inventory Financing' booklet of the *Comptroller's Handbook*, issued in March 2000, and replaces ABL guidance in Section 214, 'Other Commercial Lending,' issued in October 2009 as part of the Office of Thrift Supervision's (OTS) *Examination Handbook*."

The OCC's "Asset-Based Lending" booklet provides guidance to examiners and bankers regarding ABL activities and risks, prudent credit risk management and underwriting expectations, credit administration and credit risk rating. Risk-based expanded examination procedures are provided to guide ABL examinations. Expanded topics include ABL structures, credit analysis, evaluating borrower liquidity, establishing a borrowing base and prudent advance rates, collateral controls and monitoring systems, and credit risk rating considerations. The booklet also includes transaction examples to guide examiners and bankers in the assessment of credit risk.

The ABL guidance on pages 16–20 of Section 214 of the OTS *Examination Handbook* is rescinded.

The booklet is available here.

Agencies Issue Denial of Service Guidance and Guidance on ATMs

On April 3, the members of the Federal Financial Institutions Examination Council (FFIEC), including the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the State Liaison Committee and the Consumer Financial Protection Bureau (the Members) issued a joint statement to notify financial institutions of the risks associated with the continued distributed denial-of-service (DDoS) attacks and the steps that institutions are expected to take to address these attacks. The joint statement refers institutions to resources to help them mitigate the risks posed by such attacks.

The Members

> expect financial institutions to address DDoS readiness as part of their ongoing information security and incident response plans. Each institution is expected to
>
> - monitor incoming traffic to its public Web site,
> - activate incident response plans if it suspects that a DDoS attack is occurring and
> - ensure sufficient staffing for the duration of the attack, including the use of previously contracted third-party services, if appropriate.

Community banks "should ensure that their in-house information technology units or their service providers are taking appropriate action to mitigate this risk."

Further, the Members issued a joint statement to notify financial institutions of a large-dollar-value automated teller machine (ATM) cash-out fraud characterized as Unlimited Operations by the US Secret Service. The Members "are aware of a recent increase in cyber-attacks on financial institutions launched in connection with this fraud to gain access to, and alter the settings on, ATM Web-based control panels used by small-to-medium-sized financial institutions."

The Members

> expect financial institutions to take steps to mitigate this threat by ensuring that
>
> - each institution's and service provider's management of enterprise risk addresses this type of threat in its risk assessment process and

- controls associated with institution's information technology networks, card issuer authorization systems, systems that manage ATM parameters, and fraud detection and response processes are reviewed for adequacy against this threat.

Community banks with ATMs "should work closely with their service providers and ensure that the providers are taking appropriate action to mitigate this risk."

Read more.

OCC Issues Garnishment Guidance

On April 1, the Office of the Comptroller of the Currency (OCC) issued the "Garnishment of Accounts Containing Federal Benefit Payments" booklet, which is new to the *Comptroller's Handbook*. The booklet contains interagency guidance and examination procedures. On May 29, 2013, the Bureau of the Fiscal Service, US Department of the Treasury; Social Security Administration; US Department of Veterans Affairs; US Railroad Retirement Board; and US Office of Personnel Management adopted as final an interim rule to amend their regulation governing the garnishment of certain federal benefit payments that are directly deposited to accounts at financial institutions. The final rule was effective June 28, 2013.

The "Garnishment of Accounts Containing Federal Benefit Payments" booklet

- establishes procedures that financial institutions must follow when they receive a garnishment order against an account holder who receives certain types of federal benefit payments by direct deposit; and
- requires financial institutions that receive such a garnishment order to determine the sum of such federal benefit payments deposited to the account during a two-month period and ensure that the account holder has access to an amount equal to that sum or to the current balance of the account, whichever is lower.

This booklet "applies to all national banks and federal savings associations. All national banks and federal savings associations, including community banks, should implement procedures to ensure that they appropriately address protected funds in their customers' accounts."

Read more.

Agencies Issue Interim Final TruPs CDOs Rule, Effective April 1

On January 14, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission and the Commodity Futures Trading Commission 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), notwithstanding the investment prohibitions of Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, known as the Volcker Rule.

The interim final rule was published in the *Federal Register* on January 31, and became effective on April 1. The OCC, together with the other rule-writing agencies, solicited comments on the interim final rule through March 3, 2014.

The interim final rule permits banking entities—including national banks, federal savings associations, and federal branches and agencies of foreign banks—to retain an interest in a TruPS CDO 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 when the agencies issued final rules implementing Section 619 of Dodd-Frank.

Qualified TruPS collateral includes any trust preferred security or subordinated debt instrument that was

- issued before May 19, 2010, by a depository institution holding company that, as of the end of any reporting period within the 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 before May 19, 2010, by a mutual holding company.

To help community banks identify which CDO issuances remain permissible, the OCC, the FDIC, and the FRB also have issued a nonexclusive list of TruPS CDOs that meet the requirements of the interim final rule.

Read more.

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