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SEC/CORPORATE

SEC Denies Motion to Stay Regulation A+

On June 16, the Securities and Exchange Commission denied a motion, filed by Monica J. Lindeen, Montana State Auditor, *ex officio* Commissioner of Securities and Insurance, which sought to stay the effectiveness of new "Regulation A+" (which became effective today, June 19). As noted in the June 5 edition of ***Corporate & Financial Weekly Digest***, Ms. Lindeen, in her capacity as the Montana State Auditor and Commissioner of Securities and Insurance, previously filed a lawsuit with the Federal Court of Appeals for the District of Columbia (DC Circuit), which seeks to enjoin the effectiveness of Regulation A+ on the basis that Regulation A+ exceeded the SEC's congressional mandate by pre-empting state "blue sky" review of Tier 2 offerings under Regulation A+. The lawsuit is currently pending.

In her motion for a stay, Ms. Lindeen argued that the DC Circuit is likely to find that (1) the definition of "Qualified Purchaser" in Regulation A+ is contrary to the plain meaning of the Jumpstart Our Business Startups Act (JOBS Act) and the National Securities Market Improvement Act of 1996 (NSMIA) and (2) the SEC did not adequately analyze the effects that preemption under Regulation A+ would have on investors. Ms. Lindeen also argued that denying a stay would expose issuers and "unsophisticated and unwary consumers to irreparable harm."

In denying the motion, the SEC determined that Ms. Lindeen failed to demonstrate a strong likelihood of success on the merits of either of her claims, and that Ms. Lindeen also failed to show irreparable harm if Regulation A+ is not stayed. The SEC disagreed with Ms. Lindeen's contention that a stay of Regulation A+ "would not result in substantial harm to issuers, investors or any other party." The SEC noted that, in particular, a stay would be against public interest and contravene Congress's will, as a stay would (1) deprive issuers that satisfy Regulation A+ requirements from raising capital through opportunities that are created by Regulation A+, and (2) deprive investors that satisfy the requirements under Regulation A+ of investment opportunities in Regulation A+ offerings.

To view the complete text of the SEC's order denying the stay, click here.

BROKER-DEALER

SEC Requests Public Comment on ETPs

On June 12, the Securities and Exchange Commission announced that it is seeking public comment in connection with its review of the listing and trading of exchange-traded products (ETPs) on national securities exchanges and retail sales of ETPs by broker-dealers.

The request for comment addresses exchange standards for listing novel ETPs, exemptions sought by market participants to trade new or complex ETPs and market pricing and arbitrage mechanisms for ETPs. Specifically, the request seeks to examine the application of Rules 101 and 102 of Regulation M in the context of ETPs, and invites comment on the conditions pertaining to ETPs' exemptions from Section 11(d)(1) of the Securities Exchange Act of 1934 (Exchange Act) and Exchange Act Rules 10b-10, 11d1-2, 14e-5, 15c1-5, and 15c1-6.

In addition, the request asks for comment with respect to selling ETPs to retail investors. In particular, the release addresses investor understanding and use of ETPs, and how broker-dealers meet their obligations to customers when recommending ETPs.

All comments must be received by August 17.

Click here for Release No. 34-75165.

CFTC

CFTC Further Extends Valuation Data Reporting Relief for SDs and MSPs

The Commodity Futures Trading Commission's Division of Market Oversight (DMO) has further extended no-action relief from the valuation data reporting requirements for cleared swaps under CFTC Regulation 45.4(b)(2)(ii). Specifically, swap dealers (SDs) and major swap participants (MSPs) that are reporting counterparties to a cleared swap are not required to report valuation data to the relevant swap data repository.

However, derivatives clearing organizations must continue to report daily valuation data for those cleared swaps in accordance with CFTC Regulation 45.4(b)(2)(i).

This no-action relief, which is set to expire on June 30, 2016, is a continuation of relief that initially was granted in December 2012. DMO indicated that it was extending this relief pending "a more permanent resolution for issues related to valuation data reporting."

CFTC Letter No. 15-38 is available here.

LITIGATION

Eleventh Circuit Upholds Wire Fraud Conviction of Defendant Who Did Not Participate in Sending the Fraudulent Representations

On June 9, the US Court of Appeals for the Eleventh Circuit affirmed a Florida district court's refusal to acquit Linda Deavers, an Indianapolis real estate broker, of four counts of wire fraud. In doing so, the Eleventh Circuit found that Ms. Deavers need not have sent fraudulent statements via email nor even know about the specific wording of the fraudulent statements as long as she supplied the misrepresentations, and it was reasonably foreseeable the substance of them would be transmitted by another person.

Ms. Deavers was charged, in part, with four counts of wire fraud, in violation of 18 U.S.C. § 1343, for causing a broker, Kyle Wilson, to transmit emails to his clients containing misrepresentations about the status of his clients' investments with her. On appeal, Ms. Deavers made two arguments. First, Ms. Deavers argued that she did not send nor have knowledge of the emails at issue. Second, Ms. Deavers argued that Mr. Wilson's emails were not an essential part of a scheme to defraud Floridian investors, and she cannot be held liable for Mr. Wilson's conduct.

The Eleventh Circuit found Ms. Deavers arguments unavailing and affirmed her conviction. The three-judge panel held that evidence established that even if Ms. Deavers did not formally instruct Mr. Wilson to send his clients the misinformation she provided to him about his clients' investments, it was reasonably foreseeable that Mr. Wilson would do so. Ms. Deavers had knowledge that Mr. Wilson frequently communicated investment updates with his clients via email and that Mr. Wilson was under pressure from his clients to see returns on their investments. As a result, the Eleventh Circuit held that the jury reasonably could have concluded that it was foreseeable to Ms. Deavers that her misrepresentations would be sent by Mr. Wilson via email and that was enough.

Additionally, Ms. Deavers attempted to establish that the wire fraud statute requires specific intent to use interstate wires. However, the Eleventh Circuit found this position contrary to its precedent.

US. v. Deavers, No. 14-14586 (11th Cir. Jun. 9, 2015)

California Brokers Plead Guilty to Insider Trading of Ardea Biosciences, Inc. Stock

On June 9, Chad Wiegand and Akis Eracleous, two San-Diego based brokers, pled guilty in California district court to trading in Ardea Biosciences, Inc. stock with inside information.

Mr. Wiegand and Mr. Eracleous, brokers for National Planning Corporation, admitted to trading on inside information in advance of four separate announcements between April 2009 and April 2012. Mr. Wiegand received inside information from his brother-in-law and former Ardea Biosciences employee, Michael Fefferman. Mr. Fefferman tipped Mr. Wiegand material, non-public information, related to pharmaceutical trials of RDEA594, a drug for the treatment of gout; a global agreement with Bayer HealthCare, LLC to license a developmental cancer treatment; and the acquisition of Ardea by AstraZenca PLC. Mr. Wiegand passed along the non-public information to Mr. Eracleous, a friend and business associate.

For these actions, Mr. Wiegand, and Mr. Eracleous were charged by the US Attorney's Office with conspiracy to commit securities fraud in violation of 18 U.S.C. § 371 and could face up to five years in prison and a $250,000 fine. The indictment alleged certain overt acts in furtherance of the conspiracy involving Mr. Wiegand, Mr. Eracleous and four co-conspirators who all worked together to act on the inside information. Mr. Fefferman pled by information and entered into a deferred prosecution agreement with the United States. In return for Mr. Fefferman's cooperation, he will not face prosecution for the term of three years. Even though Mr. Wiegand was a remote tippee, there was no mention in the indictment of the tippee's knowledge of the benefit that Mr. Fefferman received, which would have been required under the US Court of Appeals for the Second Circuit's holding in *Newman. U.S. v. Newman*, 773 F.3d 438 (2d Cir. 2014). The standard set for criminal liability of a remote tippee in *Newman* hasn't been directly addressed by the US Court of Appeals for the Ninth Circuit since that decision.

A parallel case also was brought by the Securities and Exchange Commission. The SEC charged Mr. Wiegand, Mr. Eracleous and Mr. Fefferman with insider trading violations. All parties have agreed to settle the case brought by the SEC under an agreement that calls for a disgorgement of profits, interest payments and penalties to be determined at a later date.

SEC v. Fefferman, No. 15-cv-1276 (MMA)(DHB) (S.D. Cal. Jun. 9, 2015)
U.S. v. Wiegand, No. 15-cr-1462-DMS (S.D. Cal. Jun. 9, 2015)
U.S. v. Fefferman, No. 15-cr-1534-W (Jun. 11, 2015)

BANKING

FDIC Proposes New Premium Assessment System for Small Banks

On June 16, the Federal Deposit Insurance Corporation (FDIC) released a proposal to amend 12 CFR part 327 to refine the deposit insurance assessment system for small banks that have been federally insured for at least five years. In general, a "small bank" is one with less than $10 billion in total assets. The FDIC proposed that a final rule would go into effect the quarter after a final rule is adopted; by their terms, however, the proposed amendments would not become operative until the quarter after the Deposit Insurance Fund (DIF) reserve ratio reaches 1.15 percent, which is not expected to occur until 2016. The proposal, among other things, changes the factors that are relevant to a determination of an institution's total assessment rate.

The FDIC has provided a calculator (a link is provided below) so that institutions can determine just how the proposal will affect their deposit assessments. The FDIC believes that its proposal is revenue neutral and, therefore, would not in total increase the amount of assessments the FDIC collects; however, some banks will pay somewhat more and some somewhat less as suggested above, and would better reflect the actual risk to the FDIC on an institution-by-institution basis. The proposal does not require small banks to report any new data in their Reports of Condition and Income.

To determine how much a bank will pay to the FDIC for its insurance assessment, the FDIC has established risk categories. Most small banks fall into what is known as Risk Category I, which generally consists of banks that are both well-capitalized and have achieved CAMELS ratings of 1 or 2 — the best of the five numerical risk categories. Within Risk Category I, those institutions that pose the least risk are charged a minimum initial assessment rate, and those that pose the greatest risk are charged an initial assessment rate that is four basis points higher than the minimum. All other banks within Risk Category I are charged a rate that varies between these rates. (In contrast, all banks in Risk Category II are charged the same initial assessment rate, which is higher than the maximum initial rate for Risk Category I. A single, higher, initial assessment rate applies to each bank in Risk Category III and another, higher, rate to each bank in Risk Category IV.) Notwithstanding an institution's category, its total assessment rate may vary from an “initial assessment rate” as the result of possible adjustments, including an unsecured debt adjustment, a depository institution debt adjustment, and a brokered deposit adjustment.

The “financial ratios method” currently in use determines the assessment rates for banks in Risk Category I using a combination of weighted CAMELS component ratings and a series of financial ratios and metrics. Here is a comparison of the factors that currently are used and the new factors that FDIC proposes to use; notably, the core deposits/total assets ratio, one-year asset growth and the loan mix index are new.

Comparison of Current and Proposed Measures in the Financial Ratios Method:

Current Risk Category I Financial Ratios Method	**Proposed Financial Ratios Method**
Weighted Average CAMELS Component Rating	Weighted Average CAMELS Component Rating
Tier 1 Leverage Ratio	Tier 1 Leverage Ratio
Net Income Before Taxes/Risk-Weighted Assets	Net Income Before Taxes/Total Assets
Nonperforming Assets/Gross Assets	Nonperforming Loans and Leases/Gross Assets
Adjusted Brokered Deposit Ratio	Other Real Estate Owned/Gross Assets
Net Loan Charge-Offs/Gross Assets	Core Deposits/Total Assets
Loans Past Due 30-89 Days/Gross Assets	One-Year Asset Growth

According to the American Bankers Association, the proposal:

> would introduce a new measure of the loan mix index, measuring the extent to which a bank’s loan portfolio holds higher risk categories – following the industry charge-off rates in the last recession. C&D loans would be most penalized, with lesser impact for C&I loans and leases, consumer loans and loans to foreign governments; rewarded loan categories would include agricultural production and real estate loans and loans to other banks. The proposed rule would also replace the brokered deposit ratio in the financial ratios method and use the ratio of core deposits to total assets instead. Core deposits are defined as domestic office deposits excluding time deposits over the deposit insurance limit and the amount of brokered deposits below $250,000. The FDIC expects that using this ratio instead of the brokered deposit ratio will lower assessments for most small banks. However, it will penalize banks with brokered deposits above $250,000.

Further, the FDIC is requesting comment on alternatives to the proposal that distinguish between banks with CAMELS I and II ratings. The first alternative would lower the maximum initial assessment rate for CAMELS composite I-rated banks from 16 basis points to 12 basis points. In the second alternative, the minimum initial assessment rate applicable to CAMELS composite IV- and V-rated banks would be lowered from 16 basis points to 12 basis points. The FDIC also is specifically requesting comments on the following questions:

- Are there other variables, besides the eight included in the statistical model and proposal, that both predict the likelihood of bank failure with statistical significance and do not have perverse incentive effects?
- Are there variables that can be shown to predict likely losses given failure with statistical significance?
- Should the upper end of the assessment rate range decline from 35 basis points to 30 basis points as proposed, or should higher assessment rates continue to apply to the riskiest banks?

The FDIC has provided an online assessment calculator to measure the effect the new rule would have on an institution’s assessment level. The calculator may be accessed here.

The full proposal may be accessed here.

OCC Revises Residential Real Estate Lending Guidance in Comptroller's Handbook

On June 15, the Office of the Comptroller of the Currency (OCC) issued the "Residential Real Estate Lending" booklet of the *Comptroller's Handbook*. This revised booklet replaces the "Real Estate Loans" booklet issued in March 1990 (and examination procedures issued in March 1998). The revised booklet also replaces section 212, "One- to Four-Family Residential Real Estate Lending," issued in February 2011 as part of the former *Office of Thrift Supervision (OTS) Examination Handbook* for the examination of federal savings associations (FSAs).

The "Residential Real Estate Lending" booklet provides information and examination procedures for residential real estate (RRE) lending activities, in which the majority of the loans are retained by the bank ("held for investment"). The booklet also discusses the different scales and nature of RRE lending activities and the risk management practices deemed appropriate for each level of operations. Expanded residential lending operations may include some mortgage banking operations that warrant reference to, and use of, the procedures in the "Mortgage Banking" booklet. This RRE booklet primarily provides information and examination procedures for first-lien mortgage loans, home equity loans and home equity lines of credit. When appropriate, guidance detailing elevated risk management expectations that has been issued on an interagency basis by the bank regulatory agencies (i.e., the OCC, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System) is incorporated into the booklet.

The revised booklet:

- makes the following applicable to FSAs:
  - Advisory Letter 1997-7, "Affordable Mortgage Portfolios" (August 19, 1997); and
  - OCC Bulletin 2005-3, "OCC Guidelines Establishing Standards for National Banks' Residential Mortgage Lending Practices: Appendix C to 12 CFR Part 30" (February 2, 2005).
- rescinds Thrift Bulletin 85;
- provides updated guidance to examiners on assessing the quantity of risk associated with RRE lending and the quality of RRE lending risk management;
- includes wholesale changes to the functional areas of production, servicing, and collections and foreclosure to incorporate recent lessons learned and regulatory changes; and
- addresses recent amendments to Regulation X and Regulation Z issued by the Consumer Financial Protection Bureau as well as other statutory and regulatory changes, including those directed by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

EU DEVELOPMENTS

The Theme of Corporate Governance in Alternative Investment Funds Continues to be Debated

The theme of corporate governance and effective board oversight within the alternative investment funds industry continues to be debated among investment fund boards, investment managers, institutional investors and regulators alike, with the latest guidance being published by the Central Bank of Ireland on June 16. A copy of the Industry Letter can be found here.

The Central Bank's thematic review requested information from the industry regarding the number of directorships held by individuals on boards of corporate investment funds and fund management companies, and a review of the time allocated by individuals to these directorships. The purpose of the review was to assess the effect that a concentrated group of individual directors holding multiple directorships has on corporate governance.

The letter reiterates the Central Bank's view that each board is expected to assess their effectiveness on an on-going basis, which includes a review of each individual's ongoing time commitment. To that end, the Central Bank has prepared guidance to assist boards in carrying out that review.

The letter specifically highlights "High Risk Directors" as requiring additional considerations during that assessment process. High Risk Directors are those directors having aggregate professional time commitment in excess of 2,000 hours per year, including commitments to at least 20 fund boards. Once an individual reaches these thresholds, the Central Bank believes that there is a higher risk to the quality of performance to those boards by that individual. However, the Central Bank further states that they recognize that there are other factors that have to be considered to determine one's continued effectiveness as a director; thus the stated thresholds are only guidance that needs further analysis once triggered.

Whilst the Central Bank's guidance applies to investment funds and fund management companies domiciled in Ireland, the boards of other investment funds domiciled in other key jurisdictions should read the guidance and consider applying the general principals outlined therein when conducting their own ongoing assessment.

AMF Publishes Reporting Obligations and Position Limits for Derivatives on Agricultural Commodities to Commence July 1

On June 15, the Autorité des Marches Financiers (AMF) published a statement that the reporting obligations position limits for agricultural commodity derivatives proposed in the Separation and Regulation of Banking Activities Act of July 26, 2013, had been approved by a decree of the Minister of the Economy on May 14 (AMF Statement). The reporting obligations and position limits go into effect on July 1.

The reporting obligations apply to anyone holding agricultural commodity derivatives on an AMF-regulated market, a French multilateral trading facility or on a foreign market that permits trading in contracts that result in delivery in France. A holder of a position is not required to report, however, if the position has been reported to the AMF via the clearinghouse.

The position limit obligations apply to financial instruments traded on an AMF-regulated market. These six underlyings are:

- future no. 2 milling wheat;
- future no.3 milling wheat;
- future rapeseed;
- future maize;
- future rapeseed oil; and
- future rapeseed-meal.

The AMF will consider granting an exemption to the position limits provided the relevant person can demonstrate that their position has been held for hedging purposes. The exemption requires the agreement of the clearinghouse and, where necessary, the market operator.

The AMF will publish a weekly aggregate report on the positions traded on an AMF-regulated market or on a French multilateral trading facility being declared daily to the regulator by holders or the clearinghouse.

A copy of the AMF Statement can be found here.

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