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CORPORATE & FINANCIAL
WEEKLY DIGEST

May 13, 2016 | Volume XI, Issue 19

SEC/CORPORATE

SEC Approves PCAOB Rules Requiring Disclosure of Audit Participants

On May 9, the Securities and Exchange Commission adopted the proposed new rules and related amendments to auditing standards (Rules). As reported in the January 8 edition of *Corporate and Financial Weekly Digest*, the Public Company Accounting Oversight Board (PCAOB) adopted and proposed the Rules for SEC approval to provide investors with more information about who participates in public company audits.

The Rules require auditors to disclose the following information: (1) the name of the engagement partner; (2) the name, location and extent of participation for each additional accounting firm that took part in the audit whose work represented 5 percent or more of the total audit hours; and (3) the number and aggregate extent of participation of all other accounting firms participating in the audit whose individual participation constituted less than 5 percent of the total audit hours. This information will be available through a searchable database on the PCAOB's website.

The Rules, with respect to disclosure of the engagement partner, are effective for audit reports issued on or after January 31, 2017, and, with respect to disclosure of other auditors, are effective for audit reports issued on or after June 30, 2017.

The PCAOB announced that in the near future it expects to release staff guidance and other tools for firms to use in implementing the Rules.

See the complete text of the order here.

SEC Deputy Chief Accountant Discusses Use of Non-GAAP Measures

In a May 5 speech at the 2016 Baruch College Financial Reporting Conference, Wesley Bricker, deputy chief accountant at the Securities and Exchange Commission, discussed his observations regarding the use of non-generally accepted accounting principles (GAAP) financial measures, the transition to new standards for revenue recognition and leases, and the Financial Accounting Standards Board's (FASB) financial instruments' credit impairment proposal. Mr. Bricker's sentiments regarding certain non-GAAP disclosure practices echo concerns expressed by others at the SEC, including Chair Mary Joe White, Chief Accountant Jim Schnurr and Director of the Division of Corporation Finance Keith Higgins.

Regulation G under the Securities Exchange Act of 1934 (Exchange Act) and Item 10(e)(i) of Regulation S-K generally require that non-GAAP financial measures included in public disclosures by a company with securities registered under the Exchange Act be accompanied by: (1) a presentation of the most directly comparable financial measure calculated in accordance with GAAP; and (2) a reconciliation to such GAAP financial measure. Item 10(e)(i)also requires a statement disclosing why the company's management believes the presentation of the non-GAAP measure provides useful information regarding its financial condition and results of operations; and if material, a statement of any purposes for which the company's management uses the non-GAAP financial measure. Regulation G also prohibits public disclosure of a non-GAAP financial measure that, taken together with the information accompanying that measure and any other accompanying discussion of that measure, contains an

untrue statement of a material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading. The staff of the SEC often issues comments regarding non-GAAP financial measures disclosed in periodic reports and earnings releases, and has objected to certain measures.

In his remarks, Mr. Bricker discussed recent examples of practices related to the use of non-GAAP measures that may be problematic. Mr. Bricker focused on the use of individually tailored accounting principles to calculate non-GAAP earnings, with a particular emphasis on non-GAAP revenue adjustments. According to Mr. Bricker, "revenue adjustments do more than just adjust GAAP: they change the very starting point from which other performance analyses flow." He went on to say that "if you present adjusted revenue, you will likely get a comment; moreover, you can expect the staff to look closely, and skeptically, at the explanation as to why the revenue adjustment is appropriate."

In his speech, Mr. Bricker noted the possibility of future rulemaking with respect to non-GAAP financial disclosures. He also stressed the need for companies to consider how disclosure controls and procedures apply to the disclosure of non-GAAP measures, and for audit committees to focus on the presentation of non-GAAP measures and the process for determining that such disclosure is appropriate. Additionally, Mr. Bricker suggested that Exchange Act reporting companies review their practices in this area and make any necessary changes.

To view a complete transcript of Mr. Bricker's remarks, including his commentary regarding the transition to new standards for revenue recognition and leases and the FASB's financial instruments' credit impairment proposal, click here.

BROKER-DEALER

FINRA Publishes Guidance With Respect to Reporting Large Options Positions

On May 5, the Financial Industry Regulatory Authority released Regulatory Notice 16-17 (Notice), which pertains to large options positions reporting (LOPR) under FINRA Rule 2360(b)(5) and other options exchange rules. The Notice provides an overview of applicable LOPR requirements and consolidates previously issued guidance. Among other things, the Notice reminds member firms of the controls that firms should have in place to achieve compliance with their LOPR obligations. While not an exhaustive list, firms should:

- identify related accounts for in-concert reporting during the account opening process;
- periodically review the accuracy of the firm's in-concert groups;
- periodically review the accuracy of the firm's reported data;
- review any data rejected by The Options Clearing Corporation (OCC) during the reporting process; and
- review over-the-counter products to assess whether such products meet the definition of "option" under FINRA Rule 2360(a)(21) and to determine whether such positions should be reported.

FINRA urges firms to include legal, compliance and trading personnel in the development of these controls and to document and maintain the rationale behind and outcomes of such controls.

The Notice also reemphasizes the requirement to report all accounts under common control as acting in concert where the aggregate number of positions held by such accounts meets or exceeds the 200-contract threshold. Examples of where control is considered to exist include "accounts for which a registered representative has trading authority, accounts of wholly-owned subsidiaries, [and] multiple accounts held by related people or entities that have a common beneficial owner."

As for the population of the "tax number" field, the Notice further clarifies that firms should report foreign tax numbers for foreign accounts where such numbers are known and can be reported. Otherwise, firms should populate the "tax number" field for foreign accounts with all nines.

The Notice can be found here.

CFTC

CFTC Proposes to Amend RTO-ISO Order

The Commodity Futures Trading Commission has proposed to amend its order exempting specified electric energy-related transactions administered by regional transmission organizations (RTOs) and independent system operators (ISOs) from certain provisions of the Commodity Exchange Act (CEA). As set forth in the order, these transactions currently are exempt from all provisions of the CEA with the exception of the CFTC's general anti-fraud and anti-manipulation authority and scienter-based prohibitions under CEA Sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9 and 13, and any regulations promulgated thereunder.

The US Court of Appeals for the Fifth Circuit recently held that the CFTC's RTO-ISO order proscribes private rights of action under Section 22 of the CEA. As a result, the CFTC is proposing to amend its RTO-ISO order to provide that these energy-related transactions are subject to the private rights of action provisions of Section 22.

Public comments on this proposal should be submitted within 30 days after the proposal's publication in the *Federal Register*.

The CFTC's proposal is available here.

EU DEVELOPMENTS

ESMA Publishes Final Report to Amend MiFIR RTS on Transaction Reporting

On May 4, the European Securities and Markets Authority (ESMA) published a final report (Final Report) setting out an amendment to the draft Markets in Financial Instruments Regulation (MiFIR) regulatory technical standards (RTS) on transaction reporting (published in September 2015).

The amendment proposed by ESMA is to correct an inadvertent omission in draft RTS 22. The amendment clarifies that a transfer of collateral is not to be considered a "transaction" subject to reporting obligations under MiFIR. ESMA notes that such transactions are not "susceptible to market abuse" and would create "white noise" for regulator systems.

ESMA notes in the Final Report that the amendment has been submitted to the European Commission (EC), and ESMA expects that it will be considered in the EC's final endorsement of RTS 22.

The Final Report can be found here.

ESMA's accompanying press release can be found here.

FCA Conduct Forum on MiFID II Implementation

On May 10, the Financial Conduct Authority (FCA) published minutes of a conduct forum (Forum) held with trade associations to discuss the implementation of the revised and recast Markets in Financial Instruments Directive and the associated Markets in Financial Instruments Regulation (jointly referred to as MiFID II). The Forum was held specifically to address questions in relation to MiFID II product governance and costs disclosure.

Questions raised on MiFID II product governance covered the FCA's approach to business outside the scope of MiFID II, the application of distributor provisions to execution-only business and the requirements for firms working together to manufacture a product, among others. In terms of MiFID II costs and charges, questions related to the interaction between packaged retail and insurance-based investment products (PRIIPs) requirements, undertakings for collective investments in transferable securities (UCITS) requirements and MiFID II obligations. They also covered the presentation of costs under MiFID II, as well as pre-contractual and ongoing disclosures.

The FCA's MiFID II Forum minutes can be found here.

The FCA also published accompanying slides from the Forum, which can be found here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

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