

CORPORATE & FINANCIAL

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SEC/CORPORATE

SEC's Office of Investor Education and Advocacy Releases Alert on Identifying Fraudulent Private Placements

On August 4, the Securities and Exchange Commission's Office of Investor Education and Advocacy issued an Investor Alert to assist investors in identifying potentially fraudulent private placements. In the Alert, the Office of Investor Education and Advocacy warned investors to be cognizant of common signs of potential fraud when considering investing in an unregistered offering, including:

- claims of high returns with minimal risks;
- securities being offered by unregistered investment professionals;
- aggressive sales tactics, including those that create a false sense of urgency on behalf of the investor;
- "sloppy offering documents" or the absence of any offering documents;
- offerings that do not request investors' net worth, which is required information for many types of private securities offerings;
- offerings in which no person other than the sales person seems to be involved;
- issuers of securities that have offices or mailing addresses in states in which they have no legitimate business operations;
- failure of the issuer to be in good standing in its state of incorporation or formation;
- unsolicited investment offers; and
- suspicious or unverifiable biographies of managers or promoters.

The Office of Investor Education and Advocacy also advised prospective investors in private placements to take the following steps to protect themselves:

- check the background of the investment professional proposing the investment, either via the [Investment Adviser Public Disclosure website](#) or [Financial Industry Regulatory Authority, Inc.'s BrokerCheck website](#);
- understand the investment and the business strategy;
- beware of con-artists using high-pressure sales tactics; and
- ask questions about the promoter and the investment, making sure to obtain clear answers—including through researching unbiased resources—before making an investment.

Issuers and their agents should consider the guidance set forth in the Alert when undertaking private offerings of securities in order to avoid raising investor concerns.

[Read more.](#)

CFTC

ICE Futures U.S. Issues Amendments to EFRP Rule and FAQs

On August 8, ICE Futures U.S. revised its rule and frequently asked questions related to exchange of futures for related position (EFRP) transactions. The amendments codify the requirements regarding the simultaneous transfer of a cash market commodity or legally binding contract between the parties. The revisions also prohibit EFRP transactions that are contingent upon execution of a second EFRP or related position transaction but continue to allow inventory financing arrangements in which one party to an EFRP transaction grants its counterparty the nontransferable right—but not the obligation—to effectuate a second transaction reversing the original EFRP. The amendments also prohibit EFRP transactions between commonly controlled accounts with different beneficial owners.

The revisions expressly provide that an immediately offsetting EFRP transaction is not permitted in any product other than foreign currency. The rules will continue to permit commodity trading advisors and other account controllers to transact in the foreign currency market as principals, but with the added condition that the account controller produce to the exchange, upon request, an agreement or other document substantiating that the risk of loss on the cash or over-the-counter component would be borne by the customer of the account controller if the EFP were void as a consequence of the futures leg not clearing.

The amendments requiring account controllers to produce documentation regarding immediately offsetting EFRPs and the risk of a failed EFRP will become effective October 1. The other amendments will become effective on September 5.

The rule filing is available [here](#).

DIGITAL ASSETS AND VIRTUAL CURRENCIES

Consumer Financial Protection Bureau Releases Virtual Currency Advisory

The US Consumer Financial Protection Bureau (CFPB) released an advisory on the risks of virtual currencies. The advisory was issued two months after the Government Accountability Office requested that the CFPB look more closely at the virtual currency industry. The CFPB has also begun accepting complaints from virtual currency users regarding such products and services. Among other risks, the advisory discussed virtual currency's lack of protections provided by traditional government-insured banks, the threat from hackers and other fraudsters, and the costs and security measures needed to use such virtual currencies. The virtual currency advisory was issued as part of the CFPB's overarching mandate, which includes the consideration of consumer protection issues related to emerging technologies.

Click [here](#) to read the advisory.

LITIGATION

District Court Considers Prior SEC Complaint Evidence to Establish Scienter Under PSLRA

The US District Court for the Southern District of New York recently denied a defendant's motion to dismiss a securities fraud class action, accepting as sufficient factual allegations of scienter that were drawn from a Securities Exchange Commission civil action, which a defendant had settled without admitting liability.

In 2009 and 2010, Keyuan Petrochemicals, Inc. allegedly purchased raw materials from entities owned by its chairman of the board. Keyuan became a publicly listed company in the United States in May 2010. The company first disclosed the transactions in its October 2011 Form 10-K filing. The transactions were not disclosed in offering materials distributed in connection with private sales of Keyuan shares in 2010 or in prior regulatory filings. In February 2013, the SEC brought a civil fraud action against Keyuan and its CFO Aichun Li, in part for nondisclosure of the related-party transactions. Li agreed to a consent judgment with the SEC without admitting or

denying the SEC's allegations. As a result, Li was enjoined from future violations of the securities laws and paid a \$25,000 penalty. Keyuan shareholders later brought the current case.

Li filed a motion to dismiss claiming, among other things, that the plaintiffs failed to allege that she knowingly failed to disclose the transactions. Li argued that the plaintiffs could not rely on allegations taken from the SEC complaint to establish that she knew of the transactions. The District Court held that there was no absolute rule barring plaintiffs from relying on government pleadings, and that even if the evidence was not admissible at trial it was enough to defeat Li's motion to dismiss.

Vanleeuwen v. Keyuan Petrochemicals, Inc., No. 13 Civ. 6057 (PAC) (S.D.N.Y. Aug. 8, 2014).

Delaware Court of Chancery Dismisses Derivative Suit Brought by Expired Trust

The Delaware Court of Chancery recently held that the trustee of an expired trust does not have capacity to pursue a derivative suit unless authorized by state law, or in the trust instrument.

In April 2009, shareholders of Jenzabar, Inc. brought derivative and direct claims against the company. Most claims were dismissed, and in March 2012, the remaining claims settled as to the named plaintiff. Jenzabar shareholders had a right to intervene and oppose the motion to dismiss for the rest of the class. The only intervener was a trust governed under Massachusetts law, the only asset of which was Jenzabar stock. The trust held approximately four percent of the total equity in the company. According to the terms of the trust instrument, the trust terminated in May 2002. Jenzabar moved to dismiss, claiming, in part, that the trustee lacked capacity to sue.

The court held that under Massachusetts law, the powers of a trustee of an expired trust are limited to those necessary to preserve trust assets pending distribution, and any powers explicitly provided for in the trust instrument. The trustee did not allege that the litigation was necessary to preserve trust assets, and the trust instrument only granted the trustee the ability to contest claims affecting the trust's property, which the court held did not empower the trustee to initiate litigation. The court also opined that if the trust authorized the trustee to bring litigation, it was unlikely that the trustee, who was charged with winding up the affairs of the trust, was a suitable stockholder representative. The derivative action was of nominal value to the trust. Thus, the court granted Jenzabar's motion to dismiss.

In re Jenzabar, Inc. Derivative Litig., Civil Action No. 4521-VCG (Del. Ch. July 30, 2014).

BANKING

OCC Increases Semiannual Assessment for Larger National Banks and Federal Savings Associations

On August 11, the Office of the Comptroller of the Currency (OCC) issued a final rule that increases the OCC's semiannual assessment on national banks and federal savings associations (banks) with more than \$40 billion in assets. The final rule does not change the assessment amounts for banks with \$40 billion or less in assets. The final rule was published in the *Federal Register* on July 9.

The final rule raises the marginal assessment rate on bank assets in excess of \$40 billion by 14.5 percent. The effective increase in the assessment amount for an individual bank depends on its total assets, with increases ranging from between 0.32 percent and 14 percent. The increase in assessments is effective for the assessment due on September 30.

The final rule makes a conforming amendment to 12 CFR 8, "Assessment of Fees," to make 12 CFR 8 consistent with the increase in assessments. The rule also amends 12 CFR 8 by adding a reference to Section 318 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which reaffirms the OCC's broad discretion to set assessments and to determine the assessment methodology. The final rule also updates 12 CFR 8.8, "Notice of the Comptroller of the Currency Fees," to reflect the current title of the "Notice of Fees and Assessments."

[Read more.](#)

OCC Issues Lease Financing Booklet of the *Comptroller's Handbook* and Rescinds Earlier Publication

On August 12, the Office of the Comptroller of the Currency (OCC) issued the “Lease Financing” booklet of the *Comptroller's Handbook*. This updated booklet replaces a similarly titled booklet issued in January 1998. The booklet also replaces Section 219, “Leasing Activities,” issued in June 1999 as part of the Office of Thrift Supervision’s *Examination Handbook* for the examination of federal savings associations. This booklet provides an overview of the leasing business, its associated risks and sound risk management processes. It also provides examiners with expanded examination procedures and other tools that can be utilized in supervisory activities that target this type of financing.

The OCC’s “Lease Financing” booklet:

- provides an overview of the leasing business, including the legal framework for leasing, a description of various lease types, and accounting and financial reporting requirements;
- describes the risks associated with lease financing, sound risk management processes and regulatory risk rating guidelines;
- discusses the commonality and differences in the laws and regulations unique to national banks and federal savings associations and among the various types of lease financing products; and
- has an expanded examination procedures section that includes an internal control questionnaire and verification procedures.

[Read more.](#)

UK DEVELOPMENTS

FCA Uses Product Intervention Powers for the First Time

On August 5, the UK Financial Conduct Authority (FCA) issued temporary product intervention rules introducing restrictions on the ability of authorized persons to distribute contingent convertible instruments (CoCos) to retail investors. In its first use of new consumer protection powers, the FCA has underscored the complex nature of, and risks associated with, CoCos.

The temporary rules restrict all authorized persons from selling, promoting or intermediating transactions in CoCos (specifically those that are eligible as Additional Tier 1 or Tier 2 capital under Regulation (EU) No. 575/2013 (CRR)), where such transactions result in retail investors owning the CoCos. The rules will not impact the distribution of CoCos to professional or institutional clients, or to exempt persons. These new rules will apply from October 1, and will last for 12 months.

The FCA intends to publish a consultation paper about proposed permanent rules on CoCos in the fall.

For more information about the risks of these instruments, click [here](#) and [here](#).

For more information about the FCA’s temporary product intervention rules, click [here](#).

EU DEVELOPMENTS

ESMA Publishes Guidelines on Reporting Obligations Under the AIFMD

On August 8, the European Securities and Markets Authority (ESMA) published official translations of its Guidelines on Reporting Obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the Alternative Investment Fund Managers Directive (AIFMD) (Guidelines) in various EU languages. The reporting obligations apply to (1) EU alternative investment fund managers (AIFMs), (2) non-EU AIFMs managing EU funds and (3) those non-EU AIFMs which register in EU countries in order to be eligible to market their funds under the AIFMD.

ESMA’s intent for the Guidelines is ensuring that there is a common, uniform and consistent application of the reporting obligations by each of the EU regulators (which the Guidelines refer to as “national competent authorities” or NCAs). The Guidelines clarify the specific information that AIFMs must report to applicable NCAs,

the timing of such reports and the procedures to be followed when AIFMs move from one reporting frequency to another (such as where an AIFM with a smaller asset under management (AUM), which might be reporting on a semi-annual basis, launches a new fund or otherwise has increased AUM in its existing funds such that it passes through the relevant threshold and has to commence reporting on a calendar quarter basis).

In publishing the official EU translations, ESMA has now started the EU's procedural two-month timeframe within which NCAs are required to confirm to ESMA whether or not they intend to comply with the Guidelines or, if they will not, to explain their rationale for non-compliance. The Guidelines will apply from the end of this two-month period (i.e., from October 8).

The English version of the Guidelines is available [here](#).

Katten will provide a more detailed update on the Guidelines from a UK perspective once the Financial Conduct Authority (as UK NCA) confirms if it will comply with the Guidelines or otherwise publishes final rules on AIFMD reporting requirements in the United Kingdom.



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DIGITAL ASSETS AND VIRTUAL CURRENCIES

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