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SEC/CORPORATE

SEC Proposes Amendments to Rules 147 and 504

On October 30, the Securities and Exchange Commission proposed amendments to modernize: (1) Rule 147, promulgated under the Securities Act of 1933 (Securities Act) as a safe harbor exempting intrastate offerings from federal registration under the Securities Act, to further facilitate intrastate offerings and capital formation in light of recently-adopted crowdfunding provisions under state securities laws; and (2) Rule 504 of Regulation D under the Securities Act, which permits companies that are not SEC reporting companies to sell securities to an unlimited number of persons without regard to wealth or sophistication (and, if certain conditions are met, to engage in general solicitation and issue freely tradable securities), to increase the amount of securities that may be sold pursuant to the rule.

The proposed amendment to Rule 147 would permit an issuer to raise capital from in-state investors without federal registration of its offers and sales. It would eliminate restrictions on offers, though the rule would still require that sales be made only to residents of the issuer's state or territory. The proposed amendment would also redefine "intrastate offering" and ease some of the issuer eligibility requirements to make the rule available to more issuers seeking intrastate financing, including by eliminating any requirement related to an issuer's state of incorporation or organization and instead focusing only on an issuer's "principal place of business." The proposed amendment would limit the availability of the exemption to offerings that are either (1) registered in the state in which all of the purchasers reside or (2) conducted under a state-law exemption from registration that caps the amount of securities an issuer may sell to $5 million in a 12-month period and imposes an investment limitation on investors.

The proposed amendment to Rule 504 would increase the dollar amount of securities permitted to be sold under the rule in any 12-month period from $1 million to $5 million. Such increase could give state securities regulators additional flexibility in implementing coordinated review programs to facilitate regional offerings. The proposed amendment would also disqualify certain bad actors from participation in Rule 504 offerings, allowing for greater consistency across Regulation D.

Comments on the amendments to Rule 147 and Rule 504 are due within 60 days following the publication of the proposed rule in the *Federal Register*.

Read the press release here.

SEC Adopts Final Crowdfunding Rules, Completing JOBS Act Rulemaking

On October 30, the Securities and Exchange Commission adopted "Regulation Crowdfunding," which consists of final rules that will enable eligible companies to raise up to $1 million in capital in any 12-month period by offering securities through SEC registered intermediaries in crowdfunding transactions on the Internet. The long-awaited crowdfunding rules implement the exemption from registration under the Securities Act of 1933 (Securities Act) provided by Section 4(a)(6) of the Securities Act, which was adopted pursuant to the Jumpstart Our Business Startups (JOBS) Act. The exemption will be available to US issuers, other than reporting companies under the Securities Exchange Act of 1934 (Exchange Act), certain investment companies, blank check companies or companies that have indicated that their business plan is to engage in a merger or acquisition with an unidentified company, companies that have failed to comply with annual reporting requirements under Regulation Crowdfunding within two years prior to a proposed offering, and issuers that are disqualified under "bad actor" provisions.

The crowdfunding rules outline limitations on the aggregate amount any person may invest in in all crowdfunding offerings in any 12-month period. An individual investor with an annual income *or* net worth of less than $100,000 will only be permitted to invest up to the greater of (1) $2,000 and (2) 5 percent of the lesser of his or her annual income or net worth. If an individual investor has an annual income *and* net worth greater than or equal to $100,000, he or she may invest up to 10 percent of the lesser of his or her annual income or net worth. Regardless of an investor's annual income or net worth, an individual investor will not be permitted to purchase more than $100,000 worth of securities in offerings under Regulation Crowdfunding in any 12-month period.

The crowdfunding rules outline disclosure requirements that issuers must satisfy in connection with an offering and in annual reports, which an issuer will be required to file after completing an offering in reliance on the crowdfunding exemption. In connection with a crowdfunding offering, an issuer will be required to file a "Form C" with the SEC and provide to potential investors and the applicable intermediary disclosure regarding the issuer and the offering, including the price for the security (or the method for determining the price), the target offering amount (as well as the deadline for reaching the target, and whether the issuer will accept investments in excess of the target), information relating to: (1) the use of proceeds from the offering; (2) the officers, directors and owners of 20 percent or more of the company; (3) related party transactions; (4) the company's business and financial condition; and (5) the company's financial statements, which must be audited in certain circumstances (as discussed below).

The financial statements provided to the SEC, investors and the applicable intermediary in connection with an offering under the crowdfunding rules must: (1) be prepared in accordance with US generally accepted accounting principles; (2) cover the two most recently completed fiscal years of the issuer (or shorter period since the inception of the issuer, if applicable); and (3) be certified (and accompanied by tax returns), reviewed or audited, depending upon the aggregate amount of securities offered by the issuer during the preceding 12-month period. Specifically:

- In the case of an issuer offering $100,000 of securities or less in reliance upon the crowdfunding rules during the applicable 12-month period, financial statements must be certified by the principal executive officer of the issuer to be true and complete in all material respects, and must be accompanied by disclosure of the amount of total income, taxable income and total tax, as reflected in the issuer's federal income tax return (in lieu of filing a copy of the tax return), and such disclosure must be certified by the principal executive officer of the issuer to accurately reflect the information in such return.
- In the case of an issuer offering more than $100,000, but not more than $500,000, of securities in reliance upon the crowdfunding rules during the applicable 12-month period, financial statements must be reviewed (but not audited) by an independent public accountant.
- In the case of an issuer offering more than $500,000 of securities in reliance upon the crowdfunding rules during the applicable 12-month period, financial statements must be audited by an independent public accountant, except that (in contrast to the SEC's proposed crowdfunding rules) under the final rules, a company offering more than $500,000 of securities pursuant to the crowdfunding exemption for the first time would be permitted to provide reviewed rather than audited financial statements.

In each of the above cases, however, audited financial statements must be provided if financial statements that have been audited by an independent public accountant are available.

Companies relying on the crowdfunding exemption will be required to offer their securities through a registered SEC intermediary, which may be an online "funding portal" or a broker dealer. Issuers will only be entitled to register with one intermediary in any 12-month period. The funding portals will be required to register with the SEC, utilizing Form Funding Portal and become members of the Financial Industry Regulatory Authority, which has also proposed a set of seven rules and related forms that will govern the registration of crowdfunding portals with FINRA. Intermediaries will be subject to various regulatory requirements, many of which impose a "gatekeeping" function on the portals. Specifically, crowdfunding portals will be required to furnish educational materials to prospective investors, provide communication channels for the "crowd" to discuss offerings, take measures to reduce fraud (including measures to form a reasonable basis for believing that an issuer complies with Regulation Crowdfunding), make information that a company is required to disclose available to the public on the portal's platform throughout the offering period and for a period of at least 21 days before any security may be sold in the offering, and establish a reasonable basis for believing each investor complies with applicable investment limitations.

Holders of securities sold in a crowdfunding offerings will generally be required to hold all securities purchased for a least one year before engaging in sales. Holders of securities sold under the crowdfunding rules will not be counted for purposes of determining whether an issuer is required to register under Section 12(g) of the Exchange Act, so long as the issuer is current in its annual reporting, has less than $25 million in total assets as of the end of its most recently completed fiscal year and engages a transfer agent.

The newly adopted rules are effective 180 days after publication in the *Federal Register*. Funding portals may begin the registration process with the SEC on January 29, 2016.

Click here to view a complete text of the SEC's adopting release with respect to the final rules.

DERA Publishes Study of Unregistered Offering

On October 29, the Division of Economic and Risk Analysis (DERA) of the Securities and Exchange Commission published the results of a study that analyzed the market for unregistered securities offerings during the period from 2009–2014. The study found that private placements outpaced the level of capital formation through registered securities offerings during recent years, totalling more than $2 trillion during 2014. Regulation D offerings accounted for approximately $1.3 trillion of the capital raised, of which approximately 99 percent was sold in reliance upon Rule 506. The study also found that Rule 506(c) offerings (i.e., private placements that are offered by means of general solicitation and advertising) represented only approximately 2 percent, or $33 billion, of the capital raised in Regulation D offerings. According to the study, the median size for Regulation D offerings conducted by non-financial issuers (i.e., issuers other than pooled investment funds and issuers that are not, according to their Form Ds, in the commercial banking, insurance, investing, investment banking, or other banking or financial services industry) was less than $2 million, suggesting that Regulation D remains a critical tool for small businesses to raise capital.

Click here to view the complete text of the DERA study.

BROKER-DEALER

Director of SEC's Enforcement Division Speaks About Market Structure Enforcement

On November 2, Andrew Ceresney, the director of the Securities and Exchange Commission's Enforcement Division (Division), gave a speech highlighting the sweeping changes that have occurred in equity market structure over the past 10 years and how SEC enforcement actions have kept pace with those changes. The Division's job has been complicated in recent years by the proliferation of exchanges and other trading venues, the increased use of technology and automation with respect to trading, and the increased competition for order flow. Mr. Ceresney gave valuable insight into issues the Division has been and will continue to be committed to addressing, which include lack of fairness in trading venues, the misuse of confidential customer order information, inadequate risk controls by those with direct market access and high-volume manipulative trading.

To ensure fairness in trading venues, Mr. Ceresney noted that the Division focuses on a trading venue's approach to executing, reporting and regulating trading as well as operational issues. The Division has brought an increasing number of proceedings against exchanges and off-exchange venues. In particular, Mr. Ceresney noted that the SEC imposed a $14 million penalty against two Direct Edge exchanges (to date, the largest penalty the SEC has imposed against an exchange) where certain order types did not comply with rules the SEC has approved for Direct Edge and where Direct Edge selectively disclosed how those order types worked.

In order to preserve customer trust, Mr. Ceresney indicated that the Division takes a harsh view of the misuse of confidential customer order information. He detailed a case recently brought by the Division where a firm misused such information to benefit the firm's proprietary trading scheme. In that case, the firm was required to disgorge $2 million in trading profits and pay an additional $18 million in the form of a penalty.

Enforcement of the market access rule (SEC Rule 15c3-5) has also been a priority of the Division. That rule requires broker-dealers with market access to have systems and procedures to manage financial and regulatory risks associated with direct market access. Mr. Ceresney reiterated the obligation of firms with market access to design controls over their automated trading systems that anticipate mistakes and limit the potential harm caused by those mistakes. Finally, he touted the Division's enforcement of the market access rule as well as its dedication to curtailing market manipulation by mentioning several cases successfully brought by the Division that resulted in multi-million dollar penalties.

The speech is available here.

SEC Grants Exemptive Relief With Respect to the Large Trader Rule

The Securities and Exchange Commission recently granted exemptive relief with respect to the large trader rule (SEC Rule 13h-1) (hereinafter referred to as the Rule) that (1) delays the implementation of certain requirements under the Rule until November 1, 2017, and (2) grants relief that may limit the obligations of certain options traders under the Rule.

Recordkeeping and reporting requirements under the Rule have been implemented in phases. Phases one and two have already been implemented and impose some of the recordkeeping and reporting requirements contemplated by the Rule. Phase three will implement the Rule's remaining recordkeeping and reporting requirements, including the requirement to report execution time on trades for categories of persons not covered in the first two phases. The exemptive relief delays the compliance date for phase three by two years, until November 1, 2017. It should be noted that the exemptive relief granted by the SEC does not affect requirements implemented under phases one and two, where there is still a requirement to comply.

The SEC found the delay to be appropriate due to implementation challenges raised by market participants and the uncertainty associated with SEC Rule 613. Under SEC Rule 613, self-regulatory organizations have submitted a plan to create a consolidated audit trail of activity in NMS securities, and the SEC anticipates that Rule 613 may, in some respects, supersede Rule requirements. Until the plan under SEC Rule 613 is finalized, the SEC noted it was hesitant to impose phase three requirements on broker-dealers.

In addition, certain options traders are provided exemptive relief from the Rule's self-identification requirements provided specified conditions are met. Self-identification requirements include: (1) filing an initial Form 13H with the SEC as well as periodic updates to the form; (2) obtaining a large trader identification number; and (3) providing that number to brokers. In order to determine whether self-identification requirements are applicable, a person must determine whether it meets or exceeds identifying activity levels set forth in the Rule. The calculation of identifying activity levels includes daily and monthly share volume and fair market value thresholds. The Rule specifics that the fair market value for equity option transactions should be calculated based on the value of securities that underly the option. The exemptive relief allows option traders to value equity options transactions based on the gross premiums paid for the options. This relief is intended to focus self-identification requirements on options traders whose trading activity could have a material market impact. Persons who have previously fulfilled the self-identification requirements, but who no longer meet identifying activity thresholds based on the exemptive relief, may file for inactive status with the SEC.

The exemptive order is available here.

PRIVATE INVESTMENT FUNDS – TAX

IRS Issues New Partnership Audit Procedures

Included as a revenue offset in the budget legislation (H.R. 1314) signed by President Obama are provisions that simplify the procedure for the Internal Revenue Service to audit and collect adjustments from partnerships. The new rules, which are generally effective beginning 2018, permit the IRS to send the bill for a prior year's tax deficiency to the partnership, which would then have the obligation to pay the deficiency, unless the partnership elects an alternative payment procedure. The alternative payment procedure permits partnerships to pass the adjustments and related taxes back to the applicable partners, who will pay this additional tax in the year they are notified of the deficiency and will not be required to amend their prior years' federal returns. (Partners will still be obligated to report the adjustments on amended state tax returns, unless the applicable state adopts similar procedures.) The details for making this election will be set forth in forthcoming US Treasury regulations.

It is expected that hedge funds will elect to make this election, so that current partners do not bear the cost of taxes associated with income and gain earned by other partners in prior years. Investment funds should review their fund documents to determine whether they provide the necessary flexibility to permit the funds to make and implement this election.

Partnerships with fewer than 100 partners each of which is either an individual, a C corporation, an S corporation or an estate of a deceased partner, may elect out of these new rules. Most hedge funds have trusts (e.g. pension trusts) or other partnerships as partners, and therefore will be subject to the new audit procedures.

The IRS is expected to issue guidance implementing the new rules.

DERIVATIVES

See "CFTC Extends Time-Limited Relief to SEFs for Block Trades"and "CFTC Staff Publishes Responses to Frequently Asked Questions Regarding Commission Forms CPO-PQR and CTA-PR" in the CFTC section.

CFTC

CFTC Extends Time-Limited Relief to SEFs for Block Trades

The Division of Market Oversight of the Commodity Futures Trading Commission has extended no-action relief for swap execution facilities (SEFs) from certain block trade requirements. Specifically, CFTC Letter No. 15-60 extends the relief previously granted to SEFs in CFTC Letter No. 14-118 from the requirement in CFTC Regulation 43.2 that block trades occur away from the SEFs' trading system or platform. CFTC Letter No. 15-60 extends the relief until November 15, 2016, at 11:59 p.m. (ET).

More information on CFTC Letter No. 14-118 is available in the *Corporate & Financial Weekly Digest* edition of September 26, 2014.

CFTC Letter No. 15-60 is available here.

CME Group Issues Notice Regarding Position Limits and Accountability Levels

On November 4, CME Group issued Market Regulation Advisory Notice RA1518-5 (Notice) to provide regulatory guidance to market participants concerning CME Group Exchanges' rules on position limits and exemptions, and position accountability. The Notice also provides interpretative guidance related to each Exchange's osition limit, position accountability and reportable level table in the Interpretations section at the end of chapter 5 of each Exchange's rulebook.

The Notice addresses questions regarding: (1) differences among position limits, accountability and reportable levels; (2) differences among spot-month, second spot-month, single month and all months for purposes of position limits and position accountability levels; (3) limits for holding delivery instruments; (4) the impact of deliveries in the spot month for purposes of compliance with spot month position limits; (5) aggregation; (6) how to count options on futures for purposes of position limits; (7) diminishing balance contracts; (8) exemptions from position limits; (9) intraday effectiveness of position limits; (10) positions established as a result of trading at settlement, trading at marker or basis trade at index close; (11) orders that have been placed but not executed; and (12) situations where clients or market participants exceed a limit.

The Notice is available here.

CME Group Issues Notice Related to Employee Supervision

On November 2, CME Group issued Market Regulation Advisory Notice RA1517-5 (Notice) related to the supervision of employees and agents conducting business on the CME Group Exchanges. The Notice reminds Exchange members that they are strictly liable for the acts of employees or agents acting within the scope of their employment, including any automated trading system operated by any party. Therefore, all members should ensure that they have adopted and effectively execute appropriate supervisory procedures.

The Notice is available here.

CFTC Staff Publishes Responses to Frequently Asked Questions Regarding Commission Forms CPO-PQR and CTA-PR

On November 5, the Division of Swap Dealer and Intermediary Oversight of the Commodity Futures Trading Commission published responses (Responses) to frequently asked questions regarding Forms CPO-PQR and CTA-PR (Forms). The Responses address many questions, including: (1) who is required to complete and file the Forms; (2) how should total assets under management be calculated for purposes of determining classification as a mid-sized or large commodity pool opporator (CPO); (3) where each series of a multi-series pool has its own set of financial statements, is it acceptable for the CPO to report each series as a separate pool on the Form CPO-PQR; (4) how is "weighted average tenor" defined for the Form CPO-PQR; (5) what happens if a commodity trading advisor submits its Form CTA-PR after the due date; (6) does a sub-advisor to an advisor, both of which are registered CTAs, need to report separately on Form CTA-PR; and (7) how should a CTA report Master-Feeder Arrangements on Form CTA-PR.

The Responses are available here.

UK DEVELOPMENTS

FCA Publishes MiFID II Conference Materials for Wholesale Firms

On October 30, the UK Financial Conduct Authority (FCA) published a webpage with detailed information regarding its October 19 conference on the revised and recast Markets in Financial Instruments Directive (MiFID) and its associated regulation (MiFID II) for wholesale firms.

MiFID II is slated to come into effect across all 28 EU member states on January 3, 2017. MiFID II amends existing EU legal provisions on authorization (i.e., licensing), conduct of business and organizational requirements for providers of investment services. These rules aim at strengthening the protection of investors, through the introduction of new requirements on product governance, independent investment advice and cross-selling. These rules also extend existing rules to structured deposits and improve requirements in several areas, including the responsibility of management bodies, inducements, information and reporting to clients, remuneration of staff, and best execution. Additionally, MiFID II specifies requirements in relation to the authorization and the organizational rules applicable to different types of trading venues, among them a specific new type of trading venue known as an organized trading facility. MiFID II also contains the regulatory tools intended to improve supervision of EU commodity derivatives markets.

A wholesale firm in FCA terminology means an FCA authorized firm that does not have permission to engage with, deal with, advise or act for retail clients and captures most hedge fund managers, private equity fund managers, proprietary trading firms (to the extent they are already authorized by the FCA) and some investment advisers.

The FCA's new webpage contains links to videos of each of the conference sessions, covering the following range of topics:

- MiFID II: The road ahead
- Investor protection under MiFID II
- Panel session: Implementing MiFID II across Europe
- Trading venues
- Post-trade transparency/ reporting

- Microstructural issues
- Changes to best execution requirements
- Non-equity transparency
- Transaction reporting
- Conduct of business
- Commodities
- Data publications

The webpage also contains links to FCA updates on MiFID II:

- **Authorization timescales** –confirmation that the draft MiFID II application forms for those firms that need to get authorized/ licensed by the FCA will be posted on the FCA's website in the first quarter of 2016 (with further guidance and information on the application process).
- **Implementation timetable** – the FCA aspires to publish a consultation paper on market issues in December followed by a conduct issues consultation paper in March 2016. The FCA also hopes to open a "MiFID Authorizations gateway" in April 2016 and publish finalized rules and a policy statement in June 2016.

The FCA's MiFID II wholesale conference webpage is available here.

FCA Publishes Policy Proposals and Handbook Changes Related to the Market Abuse Regulation

On November 5, the UK Financial Conduct Authority (FCA) published a consultation paper (Consultation Paper), which sets out the FCA's proposal for the necessary changes to the FCA Handbook to implement the Market Abuse Regulation (2014/596/EU) (MAR). MAR, which will apply from July 3, 2016, updates the civil market abuse framework originally detailed in the Market Abuse Directive (MAD).

The Consultation Paper is directed at any firm or individual that directly or indirectly deals in, or any firm that issues, any financial instruments that are traded on a regulated market, multilateral trading facility, organized trading facility, or the price or value of which depends on or has an effect on the price or value of a financial instrument.

The FCA is seeking comments in two areas. The first area presents alternative options for public disclosure of inside information and the transaction thresholds over which a person discharging managerial responsibilities must report a transaction. The second area concerns the step change from having the market abuse regime change from a directive under MAD to a regulation under MAR. Because MAR effectively repeals MAD on July 3, 2016, changes are required to the United Kingdom's existing domestic regime to ensure its national law complies with MAR. The Consultation Paper addresses which sections of the FCA Handbook will need to be deleted where MAR contains an equivalent provision, while retaining any existing guidance that is compatible with MAR.

Responses to the Consultation Paper must be submitted by February 4, 2016.

A copy of the Consultation Paper can be found here.

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UK DEVELOPMENTS

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