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SEC/CORPORATE

Proxy Advisory Firms Release Policy Updates for 2016

Institutional Shareholder Services (ISS) and Glass Lewis, two leading proxy advisory firms, recently published their 2016 proxy voting guidelines, which include updates applicable to the 2016 proxy season.

Institutional Shareholder Services

Key policy updates for US companies reflected in ISS's 2016 proxy voting guidelines (the proposals of which were previously discussed in a prior edition of *Corporate & Financial Weekly Digest*) include:

Overboarding: Beginning in 2017, ISS will issue negative vote recommendations for non-CEO directors who sit on more than five public company boards (down from six under the current policy). For CEOs, the outside directorship limit will remain at two. In 2016, ISS will note in its analysis whether a director is serving on more than five public company boards.

Unilateral Board Actions: For established public companies, ISS will continue its policy of generally recommending that shareholders withhold votes (in uncontested elections) from directors who have unilaterally adopted a classified board structure, implemented supermajority vote requirements to amend the bylaws or charter or otherwise adopted charter or bylaw amendments that diminish the rights of shareholders. The negative recommendation would continue in subsequent years until the unilateral action is reversed or approved by stockholders. For newly public companies that have taken action to diminish shareholder rights prior to or in connection with an IPO, directors may be subject to negative vote recommendations under the updated policy, determined on a case-by-case basis (with significant weight given to shareholders' ability to change the governance structure in the future through a simple majority vote and their ability to hold directors accountable through annual director elections).

Compensation of Externally Managed Issuers: The updated "Problematic Pay Practice" policy provides that an externally managed issuer's failure to provide sufficient disclosure for shareholders to reasonably assess the compensation practices and payments made to executive officers on the part of the external manager will be deemed a problematic pay practice, and will generally warrant a recommendation to vote against the issuer's "say-on-pay" proposal.

For a complete overview of the 2016 updates to ISS's proxy voting guidelines, click here. ISS also recently updated both its Equity Plan Scorecard frequently asked questions (FAQs) and QuickScore 3.0 (the prior versions of which were previously discussed in the *Corporate & Financial Weekly Digest* here and here, respectively). The updated 2016 US Equity Plan Scorecard FAQs, effective for meetings on or after February 1, 2016, can be found here, and QuickScore 3.0 can be found here.

Glass Lewis

Significant policy updates to Glass Lewis's 2016 proxy season guidelines include:

Conflicting Management and Shareholder Proposals: Going forward, Glass Lewis will consider the following factors when it is analyzing and determining whether to support conflicting management and shareholder proposals: (1) the nature of the underlying issue; (2) the benefit to the shareholders from implementation of the proposal; (3) the materiality of the differences between the management and shareholder proposals; (4) the appropriateness of the provisions in light of the company's shareholder base, corporate structure and other relevant circumstances; and (5) a company's overall governance profile and, specifically, its responsiveness to previous shareholder proposals and its adoption of "progressive" shareholder rights provisions.

Exclusive Forum Provisions: Glass Lewis will no longer automatically recommend a "withhold" vote against the chairman of the nominating and corporate governance committee of a company that adopts exclusive forum provisions in connection with its initial public offering. Instead Glass Lewis will weigh exclusive forum provisions in a newly public company's governing documents with other provisions that Glass Lewis believes unduly limit shareholder rights (e.g., supermajority vote requirements, classified board and/or a fee shifting bylaw). Glass Lewis will continue, however, to recommend voting against the chairman of the nominating and corporate governance committee when a company adopts an exclusive forum provision without shareholder approval outside of an IPO, merger or spin-off.

Nominating Committee Performance: Glass Lewis may consider recommending shareholders vote against the chair of the nominating committee where the board's failure to ensure the board has directors with relevant experience—either through periodic director assessment or board refreshment—has contributed to a company's poor performance. Notably, Glass Lewis does not define "poor performance."

Overboarding: Beginning in 2017, consistent with ISS's policy update described above, Glass Lewis will generally recommend voting against (1) any director who serves on more than five public company boards and (2) any executive officer of a public company who serves on a total of more than two public company boards. Like ISS, during 2016, Glass Lewis may note a concern where a director serves on (x) more than five total boards for directors who are not also executives, and (y) more than two boards for a director who serves as an executive officer of a public company.

For a complete overview of Glass Lewis's 2016 proxy voting guidelines, click here.

Register for Our 2016 Proxy Season Update Webinar

On Wednesday, December 9 at 12:00 p.m. (CT), please join Katten Muchin Rosenman LLP, Ernst & Young LLP and Georgeson Inc. for a webinar discussion of key developments and trends impacting public companies in the 2016 annual report and proxy season.

Further details are available here; click here to register.

BROKER-DEALER

SEC Approves Changes To Reduce the Waiting Period for the Release of Information Reported on Form U5 Through BrokerCheck

Effective as of December 12, the Securities and Exchange Commission has approved a change to Financial Industry Regulatory Authority Rule 8312 (FINRA BrokerCheck Disclosure) to reduce the waiting period from 15 to three business days for the release of certain information reported on the Form U5 (Uniform Termination Notice for Securities Industry Registration) through BrokerCheck. FINRA believes that a three-business-day waiting period is sufficient time to provide brokers the opportunity to comment on the reported disclosure event and it allows investors to more quickly access information reported on Form U5.

For more information, click here.

FINRA Issues Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets

In light of the increasing use of automated markets for equity securities and standardized options, and recent advances in trading technology and communications in the fixed income markets, the Financial Industry Regulatory Authority issued Regulatory Notice 15-46 to: (1) restate the best execution obligations applicable to firms when they receive, handle, route or execute customer orders in equities, options and fixed income securities; and (2) remind firms of the obligation to repeatedly and thoroughly examine execution quality likely to be obtained from the different markets trading a security.

The best execution obligations iterated in Regulatory Notice 15-46 include the obligation for members in any transaction to use reasonable diligence to determine the best market for the subject security and to buy or sell in such market. The determination as to whether a firm exercised reasonable diligence includes a facts and circumstances analysis, including factors such as the size and type of transaction, accessibility of the quotation, and the terms and conditions of the order.

The obligation to regularly and rigorously review for best execution has been incorporated into FINRA Rule 5310. FINRA believes that developments in routing technology have made it possible for firms to conduct order-by-order analysis and review of execution quality, and such order-by-order analysis is required of firms for any order they decide to execute internally. FINRA is requiring firms that route orders to have procedures in place to ensure that they periodically, at least quarterly, conduct a regular and rigorous review of execution quality for those orders.

Regulatory Notice 15-46 is available here.

DERIVATIVES

See "No-Action Relief Granted to Foreign Branch of US Swap Dealer for Transaction-Level Requirements" in the CFTC section and "Clearing To Commence in the European Union in June 2016" in the EU Developments section.

CFTC

No-Action Relief Granted to Foreign Branch of US Swap Dealer for Transaction-Level Requirements

In a recently released no-action letter, the Commodity Futures Trading Commission indicated it would not seek enforcement action against a US swap dealer and its counterparties where a foreign branch of the US swap dealer proposed not to comply with CFTC transaction-level requirements in limited circumstances. Specifically, Wells Fargo represented that it only conducts swap activity outside the United States through one branch in London. It requested relief from transaction-level requirements with respect to swaps entered into by that branch with non-US person clients that are (1) not guaranteed or conduit affiliates and (2) located outside of jurisdictions for which the CFTC has made substituted compliance determinations. Instead, Wells Fargo indicated that it and its counterparties would comply with requirements relevant to such clients in the applicable foreign jurisdictions. The relief granted was premised on the fact that the aggregate notional value of the swaps entered into by Wells Fargo with such clients does not exceed 5 percent of the aggregate notional value of all of Wells Fargo's swaps. Wells Fargo will be required to maintain information to verify the aforementioned 5 percent threshold and to address any significant risk arising from the fact that it will not comply with CFTC transaction-level requirements in these circumstances.

The no-action letter can be found here.

NFA Releases Guidance for Those Operating Under an Exemption or Exclusion From CPO or CTA Registration

On December 1, the National Futures Association (NFA) released guidance pertaining to the annual affirmation requirement for persons or entities that claim an exemption or exclusion from commodity pool operator (CPO) registration under Commodity Futures Trading Commission Regulation 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3) or 4.13(a)(5), or from commodity trading advisor (CTA) registration under CFTC Regulation 4.14(a)(8). Such persons

or entities must affirm applicable exemptions or exclusions electronically through the NFA's exemption system by February 29, 2016. Failure to affirm will result in the applicable exemption or exclusion being withdrawn on March 1, 2016. If a registered CPO or CTA fails to affirm an exemption or exclusion that it relies upon, the entity will become subject to the CFTC's Part 4 Requirements even if the entity remains eligible for such exemption or exclusion. Non-registrants that fail to affirm an exemption or exclusion may face enforcement action by the CFTC. The renewal or withdrawal of an exemption or exclusion will be reflected on the NFA's Background Affiliation Status Information Center (BASIC) system.

The NFA's guidance can be found here.

BANKING

Federal Reserve Announces Final Rule on Emergency Lending

On November 30, the Board of Governors for the Federal Reserve System approved a final rule specifying its procedures for emergency lending under Section 13(3) of the Federal Reserve Act. Since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the Federal Reserve's authority to engage in emergency lending has been limited to programs and facilities with "broad-based eligibility" that have been established with the approval of the Secretary of the Treasury. The Dodd-Frank Act also prohibited lending to entities that are "insolvent" and imposed certain other limitations. According to the Federal Reserve, the final rule "incorporates a number of changes from the original proposal made in response to comments received on the proposal." In its earlier proposal, the Federal Reserve had been criticized for not being restrictive enough in determining which entities could be offered relief in the event of a crisis. Notably, Senators David Vitter and Elizabeth Warren had, in response to the Federal Reserve proposal, sponsored legislation which would require the agency to be more restrictive than the language in its original proposal contemplated. While not going as far as the Vitter-Warren legislation would have gone, the final rule did tighten the criteria for federal assistance, in what some commentators have categorized as bowing to political pressure. For its part, and while not referring to the Vitter-Warren bill, the Federal Reserve commented on changes to the proposal, stating the following:

> The final rule defines "broad-based" to mean a program or facility that is not designed for the purpose of aiding any number of failing firms and in which at least five entities would be eligible to participate….[T]he final rule also broadens the definition of insolvency to cover borrowers who fail to pay undisputed debts as they become due during the 90 days prior to borrowing or who are determined by the Board or lending Reserve Bank to be insolvent.

The Federal Reserve, through Chair Janet Yellen, took the opportunity to remind the public that "[e]mergency lending is a critical tool that can be used in times of crisis to help mitigate extraordinary pressures in financial markets that would otherwise have severe adverse consequences for households, businesses and the US economy." Notably, various critics of the agency took the position that the Federal Reserve lacked the authority to take the actions it took in 2008 under Section 13(3). The result, in part, was the more restrictive language engrafted onto current Section 13(3).

Despite the changes to the rule, it is uncertain, in the event of another financial crisis, whether the new rule will actually prevent the Federal Reserve from taking the action it deems necessary to prevent catastrophe.

The final rule will take effect January 1, 2016.

The final rule is available here.

OCC Announces Updated Risk Assessment System Guidance

On December 3, the Office of the Comptroller of the Currency (OCC) announced in Bulletin 2015 – 48 that it has updated its risk assessment system (RAS) guidance. These updates are reflected in the "Bank Supervision Process," "Community Bank Supervision," "Federal Branches and Agencies Supervision," and "Large Bank Supervision" booklets of the *Comptroller's Handbook* and in internal guidance for examiners.

The OCC stated that its updated RAS guidance is a response to the recommendations in "An International Review of OCC's Supervision of Large and Midsize Institutions" (an international peer review report) and supports the agency's mission of ensuring a safe and sound federal banking system. The principles contained in the RAS guidance apply to examinations of all national banks, federal savings associations, and federal branches and agencies.

The updated RAS guidance:

- clarifies the relationship between the RAS and capital adequacy, assets, management capability, earnings, liquidity and sensitively (CAMELS) rating, including the forward-looking elements of each;
- revises the definition of banking risk to be the same for all risk categories, and broadens the concept of risk to include its impact on a bank's current or projected financial condition and resilience;
- expands the "quality of risk management" assessment to include a new category—"insufficient"—to better stratify and communicate concerns; and
- expands strategic and reputation risk assessments to include both quantity of risk and quality of risk management.

The "Bank Supervision Process" handbook is available here.

The "Community Bank Supervision" handbook is available here.

OCC Announces Calendar Year 2016 Fees and Assessments Structure

On December 1, the Office of the Comptroller of the Currency (OCC) announced in Bulletin 2015 – 47 the fees and assessments that will be charged by the OCC for calendar year 2016. The bulletin becomes effective January 1, 2016, and announces the following to all banks:

- For the 2016 assessment year, there will be no inflation adjustment to assessment rates.
- Assessments are due March 31 and September 30, based on call report information as of December 31, 2015, and June 30, 2016, respectively. The assessments cover the six-month periods beginning January 1 and July 1, respectively. For example, the assessment due March 31 covers the period January 1 through June 30.
- The marginal rates of the OCC's general assessment schedule remain unchanged from last year.
- The OCC sends the assessment invoice, which includes the calculated assessment fee due, and drafts the fee amount on March 31 and September 30. The OCC provides seven business days' notice of the amount to be drafted from an institution's designated account. The institution is responsible for ensuring that the account is funded properly on the due dates.
- The OCC continues to charge interest on all payments received after the due date. The interest rate charged is the US Department of the Treasury's current value of funds rate published quarterly in the *Federal Register*.
- National banks, federal savings associations, and federal branches and agencies of foreign banks that are no longer subject to OCC supervision on or before December 31, 2015, or June 30, 2016, are not subject to the semiannual assessment for the period beginning January 1 or July 1, respectively. Only those institutions leaving the federal banking system before the close of business on those dates avoid paying the semiannual assessment for the period beginning January 1 or July 1, as applicable.

The OCC's assessment schedule continues to include a surcharge for national banks, federal savings associations, and federal branches and agencies of foreign banks that require increased supervisory resources. The surcharge ensures that fees reflect the increased cost of supervision applying to those national banks, federal savings associations, and federal branches and agencies of foreign banks rated 3, 4, or 5 under the Uniform Financial Institutions Rating System. The surcharge also ensures that fees reflect the increased cost of supervision for these same banks under the Risk Management, Operational Controls, Compliance, and Asset Quality Rating System. The surcharge will be determined in tandem with the asset-based assessment on December 31, 2015, and June 30, 2016. Increases or decreases in ratings after December 31, 2015, and June 30, 2016, will be reflected in the subsequent assessment period. The surcharge is to be applied to all components of an institution's assessment, including book assets, assets under management (for independent trust banks), and receivables attributable (for independent credit card banks). National banks, federal savings associations, and federal branches and agencies of foreign banks subject to the surcharge calculate the surcharge by multiplying

the sum of the general assessment (based on the institution's book assets up to $40 billion) and the independent trust bank assessment or the independent credit card bank assessment by 50 percent for 3-rated institutions and 100 percent for 4- and 5-rated institutions.

The bulletin is available here.

Agencies Announce Threshold for Smaller Loan Exemption From Appraisal Requirements for Higher-Priced Mortgage Loans

On November 25, the Consumer Financial Protection Bureau, Board of Governors for the Federal Reserve System and Office of the Comptroller of the Currency announced that the threshold for exempting loans from special appraisal requirements for higher-priced mortgage loans during 2016 will remain $25,500. The threshold amount will be effective January 1, 2016, and is the same threshold that applied in 2015--based on the annual percentage decrease in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) as of June 1, 2015.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 amended the Truth in Lending Act to add special appraisal requirements for higher-priced mortgage loans, including a requirement that creditors obtain a written appraisal based on a physical visit to the home's interior before making a higher-priced mortgage loan. The rules implementing these requirements contain an exemption for loans of $25,000 or less and also provide that the exemption threshold will be adjusted annually to reflect increases in the CPI-W. If there is no annual percentage increase in the CPI-W, the agencies will not adjust this exemption threshold from the prior year.

The press release is available here.

EU DEVELOPMENTS

European Parliament Publishes Press Release on Delay to MiFID II Implementation

On November 27, the European Parliament published a press release clarifying its stance on a potential delay of implementation of the Markets in Financial Instruments Directive (MiFID II) and, by default, the Markets in Financial Instruments Regulation (MiFIR), which expands on the principles in MiFID II and provides detailed rules.

In the press release, Parliament states that its MiFID II negotiation team has informed the European Commission (EC) that it is ready to accept a one-year delay for MiFID II implementation. However, this is subject to the following conditions:

- the EC must adopt the Level 2 measures required under MiFID II as soon as possible;
- the EC and the European Securities and Markets Authority need to develop a clear roadmap for implementation, in particular, for the establishment of the necessary information technology systems, the complexity of which are the rationale for the one-year's delay; and
- the EC should report regularly to Parliament on the progress toward implementation, including reporting timelines and key milestones.

It now seems highly likely that the entire suite of MiFID II and MiFIR legislation will be deferred by a full year, moving implementation to January 3, 2018.

A copy of the press release is available here.

Clearing To Commence in the European Union in June 2016

On December 2, the European Securities and Markets Authority issued a press release stating that clearing as required under the European Market Infrastructure Regulation would commence on June 21, 2016. This date follows the publication of the first technical standards on the clearing obligation in the *Official Journal of the European Union* on December 1.

The first clearing obligation will cover the following classes of over-the-counter interest rate derivatives denominated in EUR, GBP, JPY and USD: (1) fixed-to-float interest rate swaps; (2) float-to-float swaps; (3)

forward rate agreements; and (4) overnight index swaps. This initial clearing obligation will be phased in across four categories of market participants. For further details, see the *Corporate and Financial Weekly Digest* edition of August 7.

A copy of the press release can be found here.

A copy of the technical standards 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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