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SEC/CORPORATE

SEC Staff Releases Analysis Related to Pay Ratio Disclosure Rules

On June 4, the staff of the Securities and Exchange Commission (Staff) released analysis related to its proposed rules for pay ratio disclosure, which analysis evaluates the potential effects of excluding different percentages of employees from the pay ratio calculation. In announcing the issuance of this analysis, the SEC stated that its Staff "believes that the analysis will be informative for evaluating the potential effects on the accuracy of the pay ratio calculation of excluding different percentages of certain categories of employees, such as employees in foreign countries, part-time, seasonal, or temporary employees as suggested by commenters." The pay ratio disclosure rules were proposed by the SEC in September 2013, as discussed in the edition of *Corporate & Financial Weekly Digest* published on September 20, 2013.

For a link to the analysis, click here.

States Challenge Blue Sky Preemption Under Regulation A+

On May 27, the Federal Court of Appeals for the District of Columbia combined lawsuits filed by the commonwealth of Massachusetts and the state of Montana against the Securities and Exchange Commission. The lawsuits seek to enjoin the implementation of new Regulation A+ prior to its June 19 effective date. Both Montana and Massachusetts contend that Regulation A+ exceeded the SEC's congressional mandate by pre-empting state "blue sky" review of Tier 2 offerings under Regulation A+.

Tier 2 under Regulation A+ will permit eligible issuers to offer and sell up to $50 million of securities in any 12-month period, without complying with state blue sky laws, provided that the offering is qualified by the SEC. Issuers engaging in Tier 2 offerings also will be subject to ongoing reporting obligations and other requirements under the SEC's new rules. Blue sky pre-emption is critical to the viability of Regulation A+, and the need to comply with blue sky laws (along with a $5 million offering size limit) is one of the principal reasons that the currently existing Regulation A is rarely used.

Accordingly, the resolution of the combined lawsuits may have significant implications for the development of a Regulation A+ market.

BROKER-DEALER

FINRA Proposes Revised BrokerCheck Hyperlink Rule

On May 27, the Financial Industry Regulatory Authority filed a revised rule proposal with the Securities and Exchange Commission to amend FINRA Rule 2210. Specifically, the revised proposal would require each member firm's website to include a readily apparent reference and hyperlink to FINRA's BrokerCheck on: (1) the initial webpage that the member firm intends to be viewed by retail investors; and (2) any other webpage that includes a professional profile of one or more registered persons who conduct business with retail investors. The revised proposal would not apply to a member firm that does not provide products or services to retail investors or

to a directory or list of registered persons limited to names and contact information. FINRA first proposed the hyperlink rule in January 2013, but withdrew it after industry groups raised concerns.

Subsequent to the SEC's review and approval, FINRA will announce the implementation date of the proposed rule in a Regulatory Notice.

The text of the proposed rule change is available here.

CFTC

NFA Proposes to Enhance Risk Management, Capital, Collateral and Disclosure Requirements for FDMs

National Futures Association has proposed amendments to NFA Compliance Rule 2-36 and Financial Requirements Sections 11 and 12 and adoption of the Interpretative Notice entitled NFA Compliance Rule 2-36: Risk Management Program for Forex Dealer Members (FDMs).

Under the proposals, FDMs would be subject to risk management program requirements similar to futures commission merchants (FCMs) and swap dealers; FDMs would be subject to increased capital requirements; FDMs would be required to collect security deposits from eligible contract participants (ECPs) and prohibited from acting as counterparty to an ECP acting as a dealer unless that dealer collects and maintains from its customer and ECP counterparties similar security deposits; FDMs would be required to make public disclosures similar in nature to those required of FCMs; and FDMs would be subject to a chief compliance officer annual report requirement similar to that which is required under Commodity Futures Trading Commission Regulation 3.3.

As amended, NFA Compliance Rule 2-36 and the corresponding Interpretive Notice would require all FDMs, including FCMs that engage in retail forex transactions, to adopt a risk management program designed to monitor and manage the risks associated with their forex activities. Each FDM would also be required to make publicly available information similar to the public disclosures required of FCMs under CFTC Regulation 1.55. An FDM would be required to publish that information on its website and update that information at least annually. FDMs would also be required to disclose any material risks associated with the FDM acting as counterparty to ECPs, including any risks created by the FDM's affiliates acting as dealers.

The amendments to Financial Requirements Section 11 would impose a capital charge of 10 percent of FDM liabilities owed to (1) affiliated ECP counterparties that are not acting as dealer, and (2) non-affiliated ECP counterparties that are acting as dealer (excluding certain banks and trust companies). Revised Section 11 would also include a 10 percent capital charge on liabilities that affiliated ECP counterparties that are acting as dealer owe to the FDM's customers, including ECP customers. Finally, revised Section 11 would require an FDM to include liabilities to non-affiliated ECP counterparties that are not acting as dealers when calculating the already-required 5 percent capital charge on liabilities that exceed $10 million owed to customers.

Financial Requirements Section 12 would be amended to require FDMs to collect and maintain security deposit amounts from ECP counterparties in the same manner as an FDM already is required to collect and maintain from customers that are not ECPs, and would be prohibited from acting as a counterparty to a dealer that does not collect and maintain the same security deposits from its customers and ECP counterparties that would be required of such FDM.

The NFA rule submission letter is available here.

NFA Proposes Amendments to Its Articles of Incorporation

On May 29, the National Futures Association provided notice to its members of the unanimous approval by the NFA Board of Directors (Board) of proposed amendments to NFA's Articles of Incorporation. Subject to approval by NFA's membership, the changes reduce the size of the Board, remove special voting rules for actions of the Board, allow non-NFA member nomination of public directors and provide that only public directors (as opposed to all directors) may elect public directors' representatives to the executive committee.

The Board currently has 35 directors, and was scheduled to be increased to 37 directors in February 2016. The Board approved a reduction to 29 directors, to be made effective in February 2016.

To accomplish this reduction, the representation of futures commission merchants will elect five, rather than seven, directors. Swap dealers, major swap participants and retail foreign exchange dealers collectively will similarly be reduced from seven to five directors. Each group will be composed of two directors from large firms, two directors from small firms and one at-large director. In addition, the number of commodity pool operator/commodity trading advisor directors will be reduced from five to four, and the number of public directors will be reduced from 13 to 10.

Finally, the Board approved the removal of special voting rules that were adopted when swap participants were integrated into NFA's governance in 2012 and which required the approval of classes of directors, as opposed to a simple majority of the Board.

NFA has mailed ballots to all of its members and these must be completed and returned by June 19.

NFA Notice I-15-15 is available here.

CFTC Requests Public Comment on a Petition from ASX Clear (Futures) Pty Limited for Exemption From Registration as a DCO

The Commodity Futures Trading Commission has requested public comment on a petition by ASX Clear (Futures) Pty Limited for exemption from registration as a derivatives clearing organization (DCO).

The petition seeks exemption under Section 5b(h) of the Commodity Exchange Act, which permits the CFTC to exempt a clearing organization from DCO registration requirements if there is comparable, comprehensive supervision in the clearing organization's home country. The CFTC has not previously considered or approved a petition of this nature.

Comments are to be submitted on or before June 17, 2015.

More information is available here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Proposes Rules to Modernize and Enhance Information Reported by Investment Companies and Investment Advisers

On May 20, the Securities Exchange Commission proposed changes to rules affecting the reporting and disclosure obligations of registered investment companies and advisers.

Investment Company Proposals*:* The SEC proposal, if adopted, would require registered investment companies to file, among other things (1) a new monthly reporting on Form N-PORT related to the pricing of securities, repurchase agreements, counterparty exposure, securities lending, derivative contract terms and fund risk measurement; and (2) an annual report on a new Form N-CEN replacing the current form N-SAR, which would include census-type information. Investment company financial statements would also be required to contain prominent information about use of derivatives. Under the new rule, such reporting would need to be presented in a structured data format to allow for easier analysis by the SEC. In addition, the new rules, if adopted, would permit investment companies to provide reports to shareholders by making them accessible on a website.

Additional information and a copy of the proposals is available here.

Investment Adviser Proposals*:* The SEC is proposing amendments to the investment adviser registration and reporting form (Form ADV), which would require investment advisers to provide additional information on, among other things, separately managed accounts, their use of social media and their branch office operations so that investors and the SEC can better understand the risk profile of individual advisers.

Additional information and a copy of the proposals is available here.

The proposals will be published on the SEC website and in the *Federal Register*. The comment period for the proposed rules will be 60 days after publication in the *Federal Register*.

LITIGATION

Tenth Circuit Affirms Clawback From Unsuspecting Recipient of Funds Under Uniform Fraudulent Transfer Act

The US Court of Appeals for the Tenth Circuit recently upheld the grant of summary judgment for the receiver of a business that was alleged to have participated in a Ponzi scheme, finding that the clawback of funds was appropriate even from a recipient who was unaware of the fraud. After the Commodity Futures Trading Commission sued Winsome Investment Trust and its founder for running a Ponzi scheme in violation of the Commodity Exchange Act (CEA), the US District Court for Utah appointed a receiver to manage Winsome's assets. In his investigation of Winsome's operations, the receiver identified several payments that could be recovered under the CEA or the state Uniform Fraudulent Transfer Act (UFTA), including a total of $90,000 to a Houston-based law firm. From 2006 to 2007, the firm represented a friend of Winsome's founder in criminal proceedings in New Hampshire, the receiver sued the law firm to recover these legal fees, and the lower court granted summary judgment in favor of the receiver. On appeal, the Tenth Circuit rejected the law firm's argument that Winsome was the alter-ego of its founder and thus the receiver lacked standing to bring its claim, finding that because Winsome was so completely "possessed" or controlled by its founder, it qualified as a defrauded creditor and was entitled to the remedies provided by the UFTA. The Tenth Circuit also rejected the law firm's jurisdictional defense, finding that due to the CEA's provision for nationwide service of process, the traditional "minimum contacts" test of jurisdiction did not apply, and that the law firm had failed to demonstrate that Utah was so inconvenient a forum as to merit dismissal. Further, the Tenth Circuit found that all evidence indicated that Winsome was engaged in a Ponzi scheme, and that the law firm's ignorance of Winsome's fraud provided no protection from the UFTA. As a related point, the court noted that the law firm was not a subsequent transferee and could not take advantage of the UFTA's reasonably equivalent value defense. Lastly, the court rejected the defendant's statute-of-limitations claim since the plaintiff filed the claim within one year of discovery.

Klein v. Cornelius et al., Case No. 14-4024 (10th Cir. May 27, 2015).

Senator Elizabeth Warren Criticizes SEC Chair Mary Jo White for "Extremely Disappointing" Leadership

In a letter dated June 2, 2015, Senator Elizabeth Warren described several "promises" that Mary Jo White, chair of the Securities and Exchange Commission, had allegedly broken. Senator Warren focused on (1) the SEC's failure to finalize Dodd-Frank rules requiring disclosure of the ratio of CEO pay to that of the median worker; (2) settlement of enforcement actions without requiring admissions of wrongdoing; (3) grants of waivers to well-known seasoned issuers (WKSIs) found to have violated securities laws; (4) Chair White's recusals due to her prior employment and her husband's continuing employment at Wall Street defense firms; (5) the lack of proposed rulemaking to address disclosure of corporate campaign spending; (6) the "watered down" Rule ABII governing disclosures for asset-backed securities; and (7) new rules for small business capital formation that preempt state consumer protection laws. In particular, Senator Warren highlighted statements that Chair White made in various personal meetings about the timeline to finalize CEO pay disclosure rules, and cited several statistics concerning admissions of wrongdoing, waivers to WKSIs, and recusals. For example, in 520 settlements, the SEC required admissions of guilt in only 19 cases, and 11 of those involved only factual admissions. Under Chair White, the SEC granted 20 of 38 waiver requests. Chair White reportedly has recused herself from nearly 50 investigations due to her prior employment and has recused herself from approximately 10 investigations due to her husband's current employment. Senator Warren closed the letter with demands for detailed information concerning the CEO pay rule, settlements and admissions of guilt, waivers, recusals, and campaign finance disclosures.

A copy of the letter is available here.

UK DEVELOPMENTS

The FCA Publishes Its Bi-Annual Hedge Fund Survey

On June 2, the Financial Conduct Authority (FCA) published its bi-annual hedge fund survey (Survey) concerning the investment activities of hedge funds managed by a sample of hedge fund managers operating in the United Kingdom and supervised by the FCA. The FCA has been reporting on similar surveys since October 2009.

The purpose of the Survey is to inform the FCA with respect to its supervisory activity, with the aim of ensuring the efficient operation of markets, the promotion of market integrity and the assessment of systemic risk posed by the investment activities of hedge funds (and in this regard, the FCA is also working closely with the Bank of England's Financial Policy Committee and the International Organisation of Securities Commissions to gain greater understanding of possible risks posed).

Data reported in the Survey was collected as of September 2014 from 52 hedge fund management firms (Managers) pertaining to the structure and investment activities of 132 hedge funds managed by them during the preceding six-month period (none of which were domiciled in the United Kingdom). To qualify for inclusion in the Survey, any hedge fund managed by a Manager (together with any managed account managed using a consistent strategy) had to demonstrate a net asset value of at least $500 million and be managed (at least in part) from the United Kingdom. As of September 2014, the Managers collectively managed $265 billion of assets from the United Kingdom (and $623 billion globally).

The Survey sets out key trends and risks identified by the FCA, focusing on the size of the global hedge fund industry (based on assets under management (AuM)), the proportion (by AuM) that the hedge fund industry comprises of the alternative investment management industry generally, industry concentrations, investor profiles, fund strategies (including identifying those strategies which had received the highest rate of net subscriptions and those which had suffered the highest net losses) and performance levels. The Survey also reports on derivative transaction data connected to hedge funds, leverage and risk profiles. While there is some overlap between the data collected for the Survey and the new reporting requirements set by the Alternative Investment Fund Managers Directive (AIFMD), based on the finding from the Survey, the FCA is of the view that this overlap is limited (only two of the top 10 funds (by net asset value) provided the same information for the purposes of the Survey and for AIFMD reporting purposes, largely as a consequence of management (for AIFMD purposes) being outside the United Kingdom). As a consequence, the FCA anticipates a continued need going forward to capture information for the largest hedge funds in a smaller, more targeted manner by way of tailored studies such as the Survey.

A copy of the Survey can be found here.

FCA Provides Comments to European Commission on Proposed EU Capital Markets Union

On May 28, the Financial Conduct Authority (FCA) published its paper, which it had provided to the European Commission (Commission) in response to the Commission's green paper on building a capital markets union (CMU) within the European Union (which was published in February 2015).

The FCA comments:

> Although EU capital markets have developed over recent decades we agree that fragmentation persists with a strong national bias and a smaller pool of funding available for investment in the EU than in the US. In addition, many EU domestic capital markets lack scale or competitiveness compared to the US. Completing the single market in capital and breaking down barriers to cross-border capital flows will help diversify risk, create larger economies of scale and thereby enable more efficient allocation of capital.

To achieve this the FCA identifies that action will be needed to:

- increase the supply of investor finance into capital markets;
- ensure competitive, fair and effective intermediation at a proportionate cost; and
- facilitate increased use of capital market finance by corporations and others.

The FCA has commented that it welcomes the Commission's initiative, but it believes that the CMU could only be achieved by focusing on all three of the foregoing. The FCA paper then focuses on what the FCA sees as critical elements which would enable the development of CMU to be as effective as possible. These critical elements include:

- Greater supply of investor finance: This will require appropriate investor protections and the FCA believes there isn't any trade-off between measures to promote market access and investor protection and instead these must come together.

- Focus on effective implementation of existing and already planned legislation: The European Union already has a large amount of legislation, which promotes a single capital market in the European Union—meaning that much of the work has already been done.
- Consistent supervision: The functioning of integrated capital markets requires consistent application and supervision of the single rulebook across EU countries (which, many commentators might argue, is not currently the case and would have to work properly for a CMU to work).
- New technology: Advances in technology should be embraced by regulatory authorities (as it is by investors), despite perceived difficulties with cybersecurity, data protection, investor protection and maintaining fair competition—each of which will need to be considered and incorporated into the CMU mechanisms.
- Global landscape: The European markets have to be part of and work with the global finance landscape. The initiative should not be focused exclusively on the European Union and the Commission should make sure that any new EU legislation (whether relating to the CMU or not) is aligned with wider global standards.

The FCA's paper is available online here.

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