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SEC/CORPORATE

SEC Proposes To Expand "Test-the-Waters" Reforms to All Issuers

On February 19, the Securities and Exchange Commission proposed Rule 163B under the Securities Act of 1933, which would permit any issuer, and any underwriter or other person acting on an issuer's behalf, to communicate with qualified institutional buyers (QIBs) and institutional accredited investors (IAIs) regarding a potential public offering prior to or following the filing of a registration statement for the offering. These so-called "test-the-waters" communications are intended to help issuers gauge interest in possible public offerings before issuers incur the costs of filing a registration statement with the SEC.

Proposed Rule 163B (and related rule amendments) would complement Section 5(d) of the Securities Act, which was enacted in 2012 as part of the Jumpstart Our Business Startups Act (JOBS Act) and permits only emerging growth companies (EGCs), which are issuers with less than $1.07 billion in annual revenues, to engage in test-the-waters communications with qualified prospective investors in a contemplated securities offering. The proposal follows the extension of another JOBS Act reform—allowing confidential submission of certain filings with the SEC by non-EGCs—and is consistent with the SEC's apparent desire to encourage more companies to go public in the United States.

If adopted, Rule 163B would exempt written and oral communications by or on behalf of any issuer with QIBs and IAIs from the "gun-jumping" restrictions of Section 5 of the Securities Act. In addition, compliant test-the-waters communications would be excluded from the definition of "free writing prospectus," would not need to be filed with the SEC and would not need to bear any specific legends. Nevertheless, the communication would still be subject to certain existing rules:

1. A test-the-waters communication would be considered an "offer," and would be subject to anti-fraud laws under the Securities Act;

2. Information in a test-the-waters communication could not conflict with material information in the related registration statement; and

3. Test-the-waters communications could trigger disclosure under Regulation FD (though an issuer could have the recipient enter into a non-disclosure agreement to mitigate the need for public disclosure).

SEC chairman Jay Clayton noted in the SEC's press release announcing the proposed rule that "[e]xtending the test-the-waters reform to a broader range of issuers is designed to enhance [the issuer's] ability to conduct successful public securities offerings and lower their cost of capital, and ultimately to provide investors with more opportunities to invest in public companies."

The SEC is soliciting public comment on the proposed rule, and the comments period expires 60 days after publication the *Federal Register*.

The SEC's proposed rule is available here.

The SEC's press release is available here.

DERIVATIVES

See “CFTC To Hold an Open Commission Meeting on March 7” in the CFTC section and “Statement Published on Post-Brexit Continuity of Derivatives Trading and Clearing Measures” in the UK Developments section.

CFTC

CFTC To Hold an Open Commission Meeting on March 7

The Commodity Futures Trading Commission will hold a meeting on March 7 at 10:00 a.m. ET, which will be open to the public. The meeting will cover the following topics:

- Amendment to the Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants;
- Comparability Determination for Australia: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants;
- National Futures Association (NFA) Proposal to Amend Certain NFA Compliance Rules and Interpretive Notices to Incorporate Swaps;
- Notice of Revised Registration Form 7-R;
- Final Rule Amending Regulations on Segregation of Assets Held as Collateral in Uncleared Swap Transactions; and
- System of Records Notices for CFTC Privacy Act Systems CFTC-12 (NFA Applications Suite), CFTC-45 (Comments Online) and CFTC-53 (Contact Lists).

The meeting will take place at the CFTC headquarters, and a live webcast will be offered. More information is available here.

CFTC Announces Technology Advisory Committee Meeting

The Commodity Futures Trading Commission has announced that its Technology Advisory Committee (TAC) will hold a meeting on Wednesday, March 27. The meeting will be held in the Conference Center at the CFTC headquarters from 10:00 a.m.–3:30 p.m. ET. Representatives of several TAC subcommittees, including Automated and Modern Trading Markets, Distributed Ledger Technology and Market Infrastructure, Virtual Currencies, and Cyber Security will make presentations. The CFTC’s Division of Market Oversight will also report on its research on automated orders in the futures and options markets. The meeting is open to the public on a first-come, first-served basis and is accessible by telephone.

Additional information regarding the TAC meeting is available here.

LITIGATION

Sen. Chuck Grassley Leads Effort to Improve Transparency of Third-Party Financing in Civil Litigation

On February 13, US Senators Chuck Grassley, Thom Tillis, John Cornyn and Ben Sasse, all members of the Senate Judiciary Committee, introduced legislation requiring disclosure of third-party litigation financing agreements to the court and named parties to (1) any class action lawsuit filed in federal court, and (2) any claim that is aggregated into a federal multi-district litigation proceeding. Currently, the existence and terms of third-party litigation financing agreements, whereby hedge funds and other lenders finance the cost of civil litigation with the

expectation of sharing in a portion of any recovery, are rarely disclosed to the court or opposing parties, creating the potential for conflicts of interest.

If enacted, the Litigation Funding Transparency Act of 2019 would require counsel to disclose the identity of any enterprise (other than a class member or class counsel) that has a right to receive payment that is contingent on the receipt of the monetary disposition of the case. According to the Judiciary Committee, the primary purpose of the Act is to enhance transparency and oversight in the litigation finance markets, which are currently operating largely without regulation. According to Sen. Grassley, "[a] healthy dose of transparency is needed to ensure that profiteers aren't distorting our civil justice system for their own benefit." Sen. Grassley goes further to say, "[o]ur bill strikes the appropriate balance in getting certain information out in the open while allowing courts to craft necessary protections."

The disclosure obligations contemplated by the Act may be limited by stipulation or order by the court to protect certain information, and will require assessing the varying interests of the parties to a particular case.

A complete copy of the proposed Act is available here.

UK DEVELOPMENTS

Statement Published on Post-Brexit Continuity of Derivatives Trading and Clearing Measures

On February 25, the Bank of England (BoE), the UK Financial Conduct Authority (FCA) and the US Commodity Futures Trading Commission published a joint statement on measures intended to ensure the continuity of UK-US derivatives trading and clearing activities following the United Kingdom's withdrawal from the European Union (Brexit).

The BoE, FCA and CFTC have agreed to coordinate with each other on the following measures by the end of March 2019 to provide continuity, where necessary:

1. Continued supervisory cooperation—The BoE and CFTC will update their memorandum of understanding (MoU) to reflect the United Kingdom's forthcoming recognition of CFTC-registered central counterparties (CCPs). The FCA and CFTC are also updating their MoUs covering certain firms in the derivatives and the alternative investment fund industry;

2. Extension of existing CFTC relief and comparability for the United Kingdom—The CFTC intends to extend to UK firms regulatory relief that it already grants to EU (including UK) firms following Brexit. The CFTC staff will issue new no-action letters to UK market participants, confirming the continued application of existing no-action letters directed at other EU market participants. The CFTC also intends to grant new substituted compliance and exemption orders, confirming that existing orders benefitting EU market participants will be accompanied by new orders benefitting UK market participants. Additionally, the CFTC has confirmed that UK CCPs currently registered with the CFTC will be able to continue to provide services in the United States on the same basis as they do now;

3. UK equivalence for the United States:

    - US trading venues, firms and CCPs will be able to continue to provide services in the United Kingdom. HM Treasury has confirmed that the European Commission's decisions declaring the CFTC regulatory framework as equivalent in relation to risk mitigation requirements (including margin requirements for uncleared derivatives) and in relation to trading venues will continue to apply as a matter of UK law following Brexit.

    - HM Treasury, the BoE and the CFTC are also cooperating to make equivalence and recognition decisions relating to CFTC-registered CCPs, known as "derivatives clearing organizations" (DCOs). HM Treasury intends to find equivalent those clearing regimes that have already been found equivalent by the European Commission. HM Treasury and the BoE expect to announce decisions on the CFTC regime and CFTC-registered DCOs as a matter of priority. The joint statement also notes that, if there is a Brexit without a withdrawal agreement between the United Kingdom and the European Union (also referred to as a "no-deal Brexit"), US DCOs

providing services in the United Kingdom and to UK firms will be able to continue to do so using the temporary recognition regime (TPR) for non-UK CCPs (see the July 27, 2018 edition of *Corporate and Financial Weekly Digest*). To date, four CFTC-registered DCOs have notified the BoE of their intention to enter the TPR.

The joint statement is available here.

FCA Publishes Speech on Firms' Progress To Transition From LIBOR to Alternative Risk-Free Rates

On February 21, the UK Financial Conduct Authority (FCA) published a speech by Megan Butler, the executive director of supervision—Investment, Wholesale and Specialists at the FCA, on firms' progress in transitioning from the London Interbank Offered Rate (LIBOR) to overnight risk-free rates (RFRs).

The FCA and the UK Prudential Regulation Authority (PRA) are in the process of analyzing firms' responses to their Dear CEO letter in which they requested a comprehensive assessment of the potential prudential and conduct impacts associated with the LIBOR transition being carried out (as reported in the September 28, 2018 edition of *Corporate and Financial Weekly Digest*).

The FCA and PRA's initial observations are that UK banks and insurers are at different stages of being prepared for the transition. Although the FCA and PRA noted that most firms have provided good evidence about their transition work, some firms did not hold their first transition leadership meetings until after receiving the Dear CEO letter. The rate of transition has also been lower on the buy-side than on the sell-side. In the derivatives markets, the FCA believes that some of the reasons they have heard for the delay in moving to alternative RFRs are not justifiable, such as waiting for liquidity to develop, waiting for term rates to be produced based on new overnight RFRs and dealing costs.

The FCA therefore encourages asset managers to:

1. Conduct due diligence to identify their LIBOR exposures, including hedging strategies using LIBOR-referencing interest rate derivatives, and investments in bonds or other securities in which interest payments refer to LIBOR;

2. Transition their hedges and positions to the Sterling Overnight Index Average reference rate (SONIA) before LIBOR disappears and before liquidity in LIBOR derivatives begins to decline; and

3. Plan for LIBOR to discontinue at the end of 2021 across all of its tenors and currencies, and review or re-paper contracts. Firms can adopt different approaches to this as the FCA has not prescribed a specific approach.

The FCA's speech is available here.

EU/BREXIT DEVELOPMENTS

EBA Publishes Final Report on Outsourcing Guidelines

On February 25, the European Banking Authority (EBA) published its final report setting out guidelines on outsourcing.

In its report, the EBA updates and replaces the guidelines on outsourcing that the EBA's predecessor, the Committee of European Banking Supervisors (CEBS), issued in 2006. The CEBS guidelines applied exclusively to credit institutions, but the new EBA guidelines aim to establish a more harmonized framework for all financial institutions that are within scope of the EBA's mandate, including credit institutions, investment firms and payment institutions.

The guidelines in the EBA's report set out specific provisions for the governance frameworks of financial institutions within its scope regarding their outsourcing arrangements and the related supervisory expectations and processes. Of significance:

1. Each financial institution’s management body will remain responsible for that institution and all of its activities at all times. Therefore, the management body will have to ensure that sufficient resources are available to provide appropriate support and ensure the performance of those responsibilities, including overseeing all risks and managing the outsourcing arrangements;

2. Financial institutions that outsource to service providers located in third countries will be expected to ensure that EU legislation and regulatory requirements will be complied with and that the relevant competent authority is able to effectively supervise financial institutions regarding critical or important functions outsourced to service providers;

3. The guidelines set out in which arrangements with third parties are considered as outsourcing and detail the criteria for identifying critical or important functions that have a strong impact on a financial institution’s risk profile or on its internal control framework, in which case stricter requirements will apply to those particular outsourcing arrangements;

4. Competent authorities will have to effectively supervise financial institutions’ outsourcing arrangements, including identifying and monitoring the concentration of risk at individual service providers and assessing whether such concentrations could pose a risk to the financial system’s stability; and

5. The EBA has integrated its 2017 recommendations on outsourcing to cloud service providers into its new guidelines and aim at overcoming the high level of uncertainty regarding supervisory expectations on outsourcing to such providers.

The EBA’s guidelines will become effective on September 30. The CEBS’ 2006 guidelines and the EBA’s 2017 recommendations on outsourcing to cloud service providers will be repealed on the same date.

The EBA’s final report is available here.

European Parliament and Council of the European Union Reach Agreement on Investment Firms Regulation and Directive

On February 26 and 27, the Council of the European Union and the European Parliament issued statements, respectively, announcing that they had reached a political agreement on the proposed Investment Firms Regulation (IFR) and the proposed Investment Firms Directive (IFD).

Until the text of the finalized legislation is published, the specific impact remains to be seen for third-country financial institutions, but the statements set out the proposed package of measures, the most significant of which are the following:

1. Equivalence—The IFR will amend the Markets in Financial Instruments Regulation (MiFIR) to strengthen the equivalence regime applicable to third-country investment firms. The European Commission (EC) will also be required to assess capital requirements applicable to financial institutions that provide bank-like services to ensure that those requirements are equivalent to those applicable in the European Union.

   The new regime would also allow the EC to apply specific operational conditions to an equivalence decision. This would ensure that the European Securities and Markets Authority (ESMA) and national competent authorities would have the necessary tools to prevent regulatory arbitrage and monitor the activities of third-country financial institutions, if their activities would be likely to be of systemic importance.

2. Tick-size regime—The text agreed to by the Council of the European Union and the Parliament complements the framework of the revised Markets in Financial Instruments Directive and MiFIR by extending the “tick-size” regime to systematic internalizers (SIs), therefore enhancing the level playing field between SIs and trading venues.

3. Disclosure requirements—Investment firms will be subject to greater transparency requirements about their investments and their voting behavior during shareholder meetings.

The European Parliament and the Council of the European Union intend to adopt the legislation at first reading.

The Council of the European Union's statement is available here.

The European Parliament's statement is available here.

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

For more information, contact:

SEC/CORPORATE		
Jonathan D. Weiner	+1.212.940.6349	jonathan.weiner@kattenlaw.com
Mark D. Wood	+1.312.902.5493	mark.wood@kattenlaw.com
FINANCIAL SERVICES		
Janet M. Angstadt	+1.312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	+1.212.940.6615	henry.bregstein@kattenlaw.com
Wendy E. Cohen	+1.212.940.3846	wendy.cohen@kattenlaw.com
Guy C. Dempsey Jr.	+1.212.940.8593	guy.dempsey@kattenlaw.com
Gary DeWaal	+1.212.940.6558	gary.dewaal@kattenlaw.com
Kevin M. Foley	+1.312.902.5372	kevin.foley@kattenlaw.com
Mark D. Goldstein	+1.212.940.8507	mark.goldstein@kattenlaw.com
Jack P. Governale	+1.212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	+1.312.902.5241	arthur.hahn@kattenlaw.com
Christian B. Hennion	+1.312.902.5521	christian.hennion@kattenlaw.com
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Fred M. Santo	+1.212.940.8720	fred.santo@kattenlaw.com
Christopher T. Shannon	+1.312.902.5322	chris.shannon@kattenlaw.com
Robert Weiss	+1.212.940.8584	robert.weiss@kattenlaw.com
Lance A. Zinman	+1.312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	+1.312.902.5334	krassimira.zourkova@kattenlaw.com
UK DEVELOPMENTS		
John Ahern	+44.20.7770.5253	john.ahern@kattenlaw.co.uk
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Neil Robson	+44.20.7776.7666	neil.robson@kattenlaw.co.uk
Nathaniel Lalone	+44.20.7776.7629	nathaniel.lalone@kattenlaw.co.uk

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