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SEC/CORPORATE

California Adopts Law Regarding Female Representation on Boards of Directors of Publicly Held Companies

On September 30, California Governor Jerry Brown signed into law California Senate Bill 826 (SB 826), which requires a publicly held corporation with shares listed on "a major United States stock exchange" and whose principal executive offices are located in California (as reported on the corporation's annual report on Form 10-K) (Covered Corporations) to have at least one female director serving on its board of directors by December 31, 2019. By December 31, 2021, a Covered Corporation must have at least (a) three female directors if its board consists of six or more members, (b) two female directors if its board consists of five members or (c) one female director if its board consists of four or fewer members. Under SB 826, a female is defined as any individual who self-identifies as a woman, regardless of such individual's designated sex at birth.

SB 826 also (1) requires the California secretary of state to publish reports concerning compliance with SB 826 and (2) authorizes the California secretary of state to adopt regulations to implement SB 826, including regulations that impose fines on Covered Corporations of: (A) $100,000 for failure to timely file required information with the California secretary of state (as specified in one or more future regulations) and (B) $100,000 for a Covered Corporation's first violation and $300,000 for each subsequent violation. A violation occurs for each director seat on the board of directors of a Covered Corporation that, under SB 826, is required to be, but is not, held by a female during at least a portion of the applicable calendar year.

SB 826 includes various findings by the California Senate, including, among other things, that:

- More women directors serving on boards of directors of publicly held corporations will boost the California economy, improve opportunities for women in the workplace and protect California taxpayers, shareholders and retirees, including retired California state employees and teachers whose pensions are managed by CalPERS and CalSTRS; and

- Numerous independent studies have concluded that publicly held companies perform better when women serve on their boards of directors.

Notwithstanding the California Senate's findings in support of SB 826, commentators expect that the law is likely to be challenged in court, including under (1) the equal protection clauses of the California Constitution (which prohibits disqualifying a person from employment on the basis of such person's sex) and the Fourteenth Amendment to the US Constitution or (2) because SB 826 applies to corporations with principal executive offices in California, regardless of their state of incorporation, the "internal affairs doctrine," which is a conflict-of-laws principle that provides that the state of incorporation of a corporation should have the authority to regulate such corporation's internal affairs (including with regard to its board of directors).

The full text of SB 826 is available here.

DERIVATIVES

See "CFTC Chairman Giancarlo Releases White Paper Addressing Cross-Border Swaps Regulation" in the CFTC section.

CFTC

CFTC Releases White Paper Addressing Cross-Border Swaps Regulation

On October 1, Commodity Futures Trading Commission Chairman J. Christopher Giancarlo released a white paper addressing the regulation of cross-border swaps. The white paper, titled "Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation," sets forth various proposed changes to the CFTC's current cross-border approach.

Among other things, the white paper recommends that the CFTC expand the use of its exemptive authority for non-US swaps central counterparties (CCPs) that do not pose substantial risk to the US financial system and that are subject to "comparable, comprehensive supervision and regulation" by appropriate governmental authorities in the home country of the CCPs. More specifically, these non-US CCPs should be permitted to provide clearing services to US customers indirectly through non-US clearing members without registering as derivatives clearing organizations or futures commission merchants, respectively.

The white paper also recommends that the CFTC should generally exempt from swap execution facility (SEF) registration non-US trading venues that are regulated in jurisdictions that are comparable to the United States. Similarly, the white paper proposes a deferential approach that would permit non-US persons to rely on substituted compliance with respect to the swap clearing and trade execution requirements in comparable jurisdictions.

With respect to non-US swap dealers regulated by comparable jurisdictions, the white paper proposes that non-US persons whose swaps are guaranteed by a US person (Guaranteed Entities) generally should be required to count all their swap dealing activity toward the *de minimis* threshold. In contrast, other non-US persons, including foreign consolidated subsidiaries of a US parent entity, should not be required to count toward the *de minimis* threshold swaps with (1) Guaranteed Entities that are registered as swap dealers (or are affiliated with a registered swap dealer), (2) Guaranteed Entities that are guaranteed by a non-financial guarantor, or (3) foreign branches of US banks that are registered as swap dealers. In any event, all non-US dealers should be permitted to exclude from the *de minimis* threshold swaps executed anonymously on a registered SEF, designated contract market, or foreign board of trade and cleared by a registered or exempt clearing organization.

Finally, the white paper sets forth two main proposals with respect to US swaps that are arranged, negotiated or executed within the United States by personnel or agents of non-US persons. As proposed in the white paper, any swap that is executed in the Unites States should be subject to US swap execution rules. Second, any swap that is arranged, negotiated or executed within the United States by personnel or agents of non-US persons should not count towards a potential non-US dealer's *de minimis* threshold if the non-US dealer is in a comparable jurisdiction.

Chairman Giancarlo intends to instruct the CFTC staff to draft for the Commission's consideration rule proposals intended to implement the recommendations set out in the white paper.

The full white paper is available here.

CFTC and Australian Securities Regulator Sign FinTech Cooperation Agreement

The Commodity Futures Trading Commission and the Australian Securities and Investments Commission (ASIC) have entered into a cooperation arrangement on financial technology innovation. The arrangement is intended to facilitate cooperation and the sharing of information between the CFTC and ASIC relating to financial technology and the use of technology for purposes of regulation and oversight of financial markets and participants.

More information is available here.

NFA Issues Notice on Calculating Financial Ratios on NFA Forms PQR and PR

National Futures Association (NFA) has issued a notice to commodity pool operator (CPO) and commodity trading advisor (CTA) members clarifying the method by which CPOs and CTAs should calculate the Current Asset/Current Liability (CA/CL) ratios and the Total Revenue/Total Expenses (TR/TE) ratios for purposes of NFA Forms PQR and PR.

As set forth in the notice, both ratios must be calculated using the accrual method rather than using the cash basis of accounting. In addition, the CA balance should be calculated using only assets owned by the CPO or CTA (rather than including client assets invested in pools or managed accounts) and only include current assets. Non-current assets should not be included in this calculation.

The notice also clarifies that the TR/TE ratio should be calculated using revenue earned and expenses incurred during the prior 12 months.

NFA Notice I-18-20 is available here.

BANKING

LIBOR Replacement Language Published for Comment

The Alternate Reference Rates Committee, operating under the auspices of the Federal Reserve, has published two consultations concerning the replacement of the London Inter-bank Offered Rate (LIBOR) in financial contracts. One consultation deals with floating rate notes and the other deals with syndicated business loans. The consultations contain draft fallback provisions for contracts referencing LIBOR that are intended to minimize disruption when the calculation of LIBOR, in its current form, is discontinued or the rate is no longer usable as a practical matter.

The consultations assume that any replacement rate for LIBOR will be based on the secured overnight funding rate (SOFR) developed by the Committee, with appropriate adjustments for the term and credit factors inherent in LIBOR that are not present in SOFR.

The drafts are not intended for use in practice until after comments resulting from the consultation have been considered and factored into the provisions. Comments are requested by November 8.

The consultations are available here.

Federal Banking Agencies Issue Interagency Statement on Sharing Bank Secrecy Act Resources

On October 3, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Financial Crimes Enforcement Network, the National Credit Union Administration and the Office of the Comptroller of the Currency released a joint statement related to the permissible sharing of Bank Secrecy Act (BSA) resources.

The joint statement supports the use of collaborative arrangements to achieve compliance with BSA requirements, where such arrangements comply with applicable law. The intent of the joint statement is to help banks reduce costs and obtain greater specialized expertise in connection with money laundering-related regulatory requirements. The joint statement identifies internal controls, independent testing and money laundering detection training as three areas in which such collaborative efforts may yield savings or other positive results for banks.

The joint statement reaffirms that banks are required to have a BSA and anti-money laundering compliance program that ensures compliance with BSA requirements and is commensurate with its respective risk profile.

The joint statement is available here.

UK/BREXIT DEVELOPMENTS

HM Treasury Publishes Draft EMIR SI Relating to Non-UK CCPs Post-Brexit

HM Treasury published a draft statutory instrument (SI) under the European Market Infrastructure Regulation (EMIR) relating to non-UK central counterparties (CCPs) after the United Kingdom's withdrawal from the European Union (exit day). It has also published a supporting explanatory memorandum.

The explanatory memorandum explains that the purpose of the SI is to use powers in the European Union (Withdrawal Act) 2018 in order to address failures of retained EU law to operate effectively by addressing four points.

Firstly, the SI addresses the deficiencies in EMIR by transferring functions of the European Securities and Markets Authority (ESMA) relating to the recognition of third-country CCPs to the Bank of England and amends the Financial Services and Markets Act 2000, where necessary, to ensure a coherent UK regulatory framework.

Secondly, the SI provides the Bank of England with powers to receive applications from and make decisions on the recognition of non-UK CCPs before exit day to ensure a seamless continuation of services provided by non-UK CCPs currently providing clearing services in the United Kingdom. From exit day, a non-UK CCP will only be able to provide clearing services in the United Kingdom if it has been recognized by the Bank of England under the provision of Article 25 of EMIR.

Thirdly, the SI puts in place a "Temporary Recognition" regime, to enable third-country CCPs to continue their activities in the United Kingdom for a limited period after exit day, if they are currently able to carry out those activities in the European Union under EMIR, and have notified the Bank of England prior to exit day that they intend to continue doing so in the United Kingdom.

Finally, the SI enables the Bank of England to charge fees from non-UK CCPs that are providing services to the United Kingdom, in order to enable the Bank of England to carry out work in relation to their transitional functions.

The draft SI is available here.

The explanatory memorandum is available here.

EU DEVELOPMENTS

ESMA Updates Q&As Relating to the Benchmarks Regulation

On September 27, the European Securities and Markets Authority (ESMA) published an updated version of its questions and answers (Q&As) on the Benchmarks Regulation (BMR).

ESMA has added the following seven new questions and answers, all dated September 26:

- Q&A 5.8 clarifies when financial instruments traded on a systematic internalizer are within scope of the BMR;

- Q&A 5.9 sets out when banks issuing certificates are users of benchmarks;

- Q&A 5.10 explains why the net asset value of investment funds should be considered input data and not benchmarks;

- Q&A 7.2 confirms that a single application for endorsement can include a family of benchmarks;
- Q&A 7.3 sets out ESMA's view that benchmark statements should be published in a language that is accepted by the national competent authority of the relevant member state; and
- Q&As 8.2 and 8.3 concern written plans for cessation or material changes of a benchmark under Article 28(2) of the BMR and, specifically, when the written plan to be produced by benchmark users should be considered "robust" and how the plan should be reflected in the contractual relationship with clients.

ESMA first published the Q&As in July 2017 and most recently updated them in July 2018 (further details of that update can be found in the July 20 edition of *Corporate & Financial Weekly Digest*).

ESMA's updated Q&As on the BMR are available here.

ESMA Updates Q&As Relating to the Market Abuse Regulation

On October 1, the European Securities and Markets Authority (ESMA) published an updated version of its sets of question and answer documents (Q&As) on the Market Abuse Regulation (MAR). ESMA has added three new questions and answers relating to the delay of the disclosure of inside information by a credit or financial institution to preserve financial stability under Article 17(5) of MAR:

- Q&A 5.3 explains that where a credit or financial institution, as issuer, intends to resort to the delayed disclosure of inside information under Article 17(5) of MAR, it should provide evidence to the national competent authority (NCA) that the Article 17(5) conditions are met. Assessment of the conditions should be as complete as possible to the best of the issuer's knowledge, taking into account (1) the risk of undermining the financial stability of the issuer and the financial system; 2i) public interest; and (3) the confidentiality of the information.
- Q&A 5.4 explains that the credit or financial institution notifying the NCA of its intention to resort to the financial stability delay should provide its assessment on the expected length of the delay and details of expected trigger events. Likewise, if the NCA consents to the delay regarding its own assessment, the issuer should update the NCA when it becomes aware of new elements or events that may affect the duration of the delay.
- Q&A 5.5 explains that where the conditions under Article 17(5) are not met and the NCA does not consent to the delay, the credit or financial institution must disclose the inside information immediately as provided in Article 17(6) of MAR and cannot resort to the delay of disclosure under Article 17(4) of MAR.

ESMA's updated Q&As on MAR are available here.

ESMA Publishes Letter on MiFID II and MiFIR Third-Country Regimes

On October 1, the European Securities and Markets Authority (ESMA) published a letter (dated September 26) from ESMA chair Steven Maijoor to European Commission vice president Valdis Dombrovskis on issues relating to third-country firms concerning certain requirements under the revised Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR).

The letter highlights four issues relating to:

- Concerns regarding the MiFIR regime for third-country firms providing investment services and activities to eligible counterparties and *per se* professional clients;
- Concerns regarding the MiFID II regime for third-country firms providing investment services and activities to retail and professional clients on request;
- Third-country firms providing investment services and activities at the exclusive initiative of EU clients (reverse solicitation); and

- Investment firms outsourcing critical or important functions other than those related to portfolio management to third-country providers.

Although the above issues were initially identified in the context of the discussion on the risks arising from Brexit, Mr. Maijoor explains that the issues seem more general and apply beyond Brexit.

The letter is available here.

ESMA Updates Its Opinion on Ancillary Activity Calculations

On October 2, the European Securities and Markets Authority (ESMA) published an updated opinion on ancillary activity calculations under the revised Markets in Financial Instruments Directive (MiFID II).

Article 2(1)(j) of MiFID II provides an exemption for persons dealing on their own account or providing investment services relating to commodity derivatives, provided that their activity is an ancillary activity to their main business. Market participants are required to measure their own activity against total market sizes in commodity derivatives based on historical data. In the opinion, ESMA provides the estimation of the market size of various commodity derivatives, including metals, oil and coal, as well as emission allowances.

The opinion is an updated version of the opinion on ancillary activity calculations that ESMA first published in June 2017 (for further information see the July 7, 2017, edition of *Corporate & Financial Weekly Digest*). ESMA has expanded the opinion to include estimates for 2017 and the all of 2016. ESMA has prepared those estimations based on data collected from trading venues, as well as data reported to trade repositories under the European Market Infrastructure Regulation.

The opinion 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

Mark J. Reyes	+1.312.902.5612	mark.reyes@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
Kimberly L. Broder	+1.212.940.6342	kimberly.broder@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
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

BANKING

Christina J. Grigorian	+1.202.625.3541	christina.grigorian@kattenlaw.com

UK/EU/BREXIT 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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