CORPORATE & FINANCIAL WEEKLY DIGEST

May 31, 2013

BROKER DEALER

SEC Approves FINRA Rule Change That Requires Reporting OTC Equity Transactions Within 10 Seconds

The Securities and Exchange Commission has approved a proposed rule change by the Financial Industry Regulatory Authority requiring that transactions and transaction cancellations in over-the-counter (OTC) equity securities be reported no later than 10 seconds following execution or cancellation. With respect to transactions that are reported manually, FINRA will take into consideration various factors in determining whether "reasonable justification" exists to excuse late trade reporting. In addition, new supplementary material clarifies the requirement that firms report transactions and transaction cancellations "as soon as practicable." The rule change becomes effective on Monday, November 4, 2013.

Click here for the FINRA Regulatory Notice.

CFTC

NFA Issues Notice to Members Regarding Section 16 Financial Requirements for Cleared Swaps Customer Collateral

On May 30, the National Futures Association issued a notice to its members regarding Section 16 of the NFA Financial Requirements. Beginning July 1, the requirements of Section 16 and the related interpretive notice will apply to futures commission merchants (FCMs) holding cleared swaps customer collateral. Pursuant to Section 16, an FCM must establish written policies and procedures regarding the maintenance of a target residual interest in its cleared swaps customer collateral accounts and comply with the approval and notice requirements related to withdrawing, transferring or otherwise disbursing more than 25% of the FCM's residual interest in cleared swaps collateral accounts, based upon the most current daily cleared swaps customer collateral calculation made pursuant to CFTC Regulation 22.2(g). In making this calculation, the FCM may exclude disbursements made for the benefit of cleared swaps customers.

Section 16 also requires FCMs to, among other things, provide the NFA with: (i) a cleared swaps customer collateral calculation by noon of each business day; (ii) a monthly notification (beginning with the July 31, 2013 monthly filing) indicating whether any cleared swaps customer collateral was held by an affiliate of the FCM; (iii) the amounts of cleared swaps customer collateral held in cash and each permitted investment under CFTC Regulation 1.25(a) on the 15th and last business day of each month and (iv) the identity of each depository holding cleared swaps customer collateral and the dollar amount held at each such depository on the 15th and last business day of each month.

More information is available here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Order Against ISS

On May 23, the Securities and Exchange Commission charged Institutional Shareholder Services Inc. (ISS), a Maryland-based proxy adviser, with failure to safeguard its advisory clients' confidential proxy voting information. The services provided by ISS include assisting investment advisers in voting proxies of publicly traded companies held in the investment advisers' client accounts. The SEC found that an ISS employee revealed to a proxy solicitor the voting information of more than 100 ISS investment advisory clients in exchange for substantial gifts and entertainment. The SEC order (Order) concludes that ISS failed to establish adequate policies and procedures to prevent the misuse of such material, nonpublic voting information, and requires ISS, among other things, to pay a $300,000 penalty and retain an independent compliance consultant.

The Order does not address the responsibility that the investment advisory clients of ISS may have had in protecting their client proxy voting information. Investment advisers, however, should consider instituting safeguards to protect their material, nonpublic information when they engage proxy advisers or other third party service providers. As a best practice, investment advisers should include confidentiality provisions in their service provider agreements. Such confidentiality provisions should require the service provider to safeguard an investment adviser's material, nonpublic information, such as proxy voting information, and limit access to that information to need-to-know employees of the service provider.

For additional information about the Order, read more.

LITIGATION

Sixth Circuit Lowers Bar for Securities Claims and Creates Circuit Split

The US Court of Appeals for the Sixth Circuit recently held that pleading a claim under Section 11 of the Securities Act of 1933 does not require a showing of defendant's knowledge of false statements in offering documents, thereby significantly relaxing the pleading requirements in that circuit. The Sixth Circuit declined to following the reasoning of the Second and Ninth Circuits on Section 11 pleading requirements and, in doing so, set up a split in the circuits.

The case was brought by investors in securities of Omnicare, Inc., a provider of pharmaceutical care services for residents of long-term care facilities, who alleged that Omnicare and several senior executives deceived them by engaging in a variety of illegal activities, including kickback arrangements with pharmaceutical companies and submissions of false claims to Medicare and Medicaid. Plaintiffs argued that they were misled because Omnicare failed to disclose these illegal activities in a Registration Statement issued in connection with a December 2005 public offering, which attested to Omnicare's claimed "legal compliance." The district court dismissed the case, finding that, among other things, plaintiffs had not sufficiently alleged that Omnicare's top executives knowingly signed the false financial statements at issue.

In overturning the district court's dismissal, a three-judge appellate panel of the Sixth Circuit stated that, for purposes of a claim under Section 11, "No matter the framing, once a false statement has been made, a defendant's knowledge is not relevant to a strict liability claim." The panel declined to impose a *mens rea* state of mind requirement onto Section 11, which by its terms does not include any such requirement. The Sixth Circuit acknowledged that its ruling departed from decisions of the Second and Ninth Circuits, which both rely on the Supreme Court's decision in *Virginia Bankshares Inc. v. Sandberg*, 501 U.S. 1083 (1991). The Sixth Circuit reasoned that the Supreme Court's ruling was inapplicable because it concerned Section 14(a) of the Securities Act and therefore, "The *Virginia Bankshares* court was not faced with and did not address whether a plaintiff must additionally plead knowledge of falsity in order to state a claim." Accordingly, the Sixth Circuit refused to extend *Virginia Bankshares* to impose a knowledge of falsity requirement upon Section 11 claims, reasoning that "it would be unwise for this court to add an element to [Section] 11 claims based on little more than a tea-leaf reading in a [Section] 14(a) case."

Indiana State District Council et al. v. Omnicare Inc. et al., No. 12-5287 (6th Cir. May 23, 2013).

Total Settles FCPA Bribery Claims for $398M

On May 29, French oil and gas company, Total SA, agreed to pay $398 million to settle US civil and criminal allegations that it paid bribes to win oil and gas contracts in Iran in violation of the Foreign Corrupt Practices Act (FCPA). Notably, the criminal penalty is the fourth-largest under the FCPA and the case marks the first coordinated action by French and US law enforcement agencies in a major foreign bribery case.

In a scheme that allegedly began nearly 20 years ago in 1995 and continued until 2004, Total allegedly paid approximately $60 million in bribes to induce an intermediary, designated by an Iranian government official, to help the company win contracts with National Iranian Oil Co. The contracts gave Total the right to develop three oil and gas fields and included a portion of South Parys, the world's largest gas field. Total allegedly characterized the bribes as "business development expenses" in its books and records.

The DOJ filed a three-count criminal investigation charging Total with FCPA conspiracy and internal controls and books-and-records violations. Total agreed to resolve the FCPA charges by paying a $245.2 million criminal penalty, which was at the bottom of the $235.2 to $470.4 million range of fines available under the US Sentencing Guidelines. The company also settled a related civil case with the US Securities and Exchange Commission for $153 million in disgorgement of its profits in the scheme. The criminal case will be dismissed after three years if Total complies with the deferred prosecution agreement, which requires Total to (i) retain a corporate compliance monitor, who will conduct annual reviews; (ii) cooperate with authorities and (iii) implement an enhanced compliance program designed to prevent and detect FCPA violations. The compliance program requires, among other things, that Total's Board of Directors and senior management "provide, strong, explicit and visible support and commitment" to the company's anti-corruption policy and that they appoint a senior executive to oversee the program and report directly to an independent authority, such as internal audit, the Board or a committee thereof. Total's problems, however, are not over. French prosecutors have recommended that the company and its chief executive officer be brought to trial on violations of French law, including France's foreign bribery law.

U.S. v. Total SA, 13-cr-239 (E.D. VA. May 29, 2013).

BANKING

CFPB Amends the Ability-to-Repay Rules Regarding Qualified Mortgages

On May 29, the Consumer Financial Protection Bureau (CFPB) finalized rules to facilitate access to credit by creating specific exemptions and modifications to the CFPB's Ability-to-Repay rule for small creditors, community development lenders, and housing stabilization programs. The amendments also revised rules on how to calculate loan origination compensation for certain purposes.

The CFPB finalized its Ability-to-Repay rule on January 10, 2013. The Ability-to-Repay rule established that most new mortgages must comply with basic requirements that protect consumers from taking on loans they do not have the financial means to pay back. Lenders are presumed to have complied with the Ability-to-Repay rule if they issue "Qualified Mortgages" (QMs).

- *Exempt certain nonprofit creditors*: The final rule exempts from Ability-to-Repay rules certain nonprofit and community-based lenders that work to help low- and moderate-income consumers obtain affordable housing. Among other conditions, the exemptions generally apply to designated categories of community development lenders and to nonprofits that make no more than 200 loans per year and lend only to low- and moderate-income consumers. Similarly, mortgage loans made by or through a housing finance agency or through certain homeownership stabilization and foreclosure prevention programs are exempted from the Ability-to-Repay rules.

- *Facilitate lending by certain small creditors*: This amendment makes several adjustments to the Ability-to-Repay rule in order to facilitate lending by small creditors, including community banks and credit unions that have less than $2 billion in assets and each year make 500 or fewer first-lien mortgages, as defined in the rule. First, the rule generally extends QM status to certain loans that these creditors hold in their own portfolios, even if the consumers' debt-to-income ratio exceeds 43 percent. Second, the final rule provides a two-year transition period during which small lenders can make balloon loans under certain conditions and those loans will meet the definition of QMs. The CFPB expects to continue to study issues concerning access to credit and balloon lending by small creditors. Third, the final rule allows small creditors to charge a higher annual percentage rate for certain first-lien QMs while maintaining a safe harbor for the Ability-to-Repay requirements.

- *Establish how to calculate loan origination compensation:* The Dodd-Frank Wall Street Reform and Consumer Protection Act mandates that QMs have limited points and fees, and that compensation paid to loan originators, such as loan officers and brokers, is included in points and fees. The amendment provides certain exceptions to this Dodd-Frank requirement that loan originator compensation be included in the total permissible points and fees for both QMs and high-cost loans. Under the revised rule, the compensation paid by a mortgage broker to a loan originator employee or paid by a lender to a loan originator employee does not count towards the points and fees threshold. This amendment does not change the January 2013 final rule under which compensation paid by a creditor to a mortgage broker must be included in points and fees, in addition to any origination charges paid by a consumer to a creditor.

The amendments will take effect with the Ability-to-Repay rule on January 10, 2014.

A copy of the amendments to the Ability-to-Repay rule is available here.

EU DEVELOPMENTS

ESMA Approves Co-Operation Agreements With 34 non-EEA Jurisdictions

The European Securities and Markets Authority (ESMA) has approved co-operation arrangements that can now be entered into between European Economic Area (EEA) financial services regulators and 34 non-EEA jurisdictions where alternative investment funds (AIF) and their managers are domiciled.

Under the Alternative Investment Fund Managers Directive (AIFMD), managers from a non-EEA state whose financial services regulator does not have such co-operation arrangements will not be permitted to offer or manage AIFs in the European Union after July 22, 2013.

The AIFMD requires ESMA to negotiate the memoranda of understanding prior to each EEA financial services regulator agreeing to enter into the arrangements with any of the non-EU jurisdictions that it chooses to.

ESMA has stated that some of the key elements of the cooperation arrangements include:

- The exchange of information, cross-border on-site visits and assistance in the enforcement of the respective laws; and

- Sharing of relevant information received from non-EEA authorities between EU regulators, ESMA and the European Systemic Risk Board, provided appropriate safeguards apply.

The 34 jurisdictions that have agreed to the arrangements with ESMA include: Australia, Bermuda, Brazil, BVI, Canada, Cayman Islands, Dubai, Hong Kong, Isle of Man, Israel, Jersey, Singapore, Switzerland and United States.

More information is available here.

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