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SEC/CORPORATE

SEC To Hold Forum on Small Business Capital Formation in November

On October 21, the Securities and Exchange Commission announced that it will hold its annual Government-Business Forum on Small Business Capital Formation on November 19 at its Washington, DC headquarters. The forum will feature panel discussions on exempt and registered offerings occurring after the passage of the Jumpstart Our Business Startups Act (JOBS Act), and breakout sessions regarding the regulation of smaller reporting companies and exempt offerings. Interested individuals can attend in person or via webcast/teleconference. Katten partners Mark Wood and Jonathan Weiner will be participating in the SEC forum and, on November 18, will be panelists at the Growth Capital Summit in Washington, DC, which will include discussions of legislative, regulatory and enforcement developments affecting emerging growth capital markets.

Click here to view the SEC's press release announcing the forum.

DERIVATIVES

Financial Regulators Adopt Final Margin Rules for Non-Cleared Swaps

On October 22, the US prudential regulators (the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve, Comptroller of the Currency, Farm Credit Administration and Federal Housing Finance Agency) jointly adopted final rules that set margin requirements for swap dealers and major participants (collectively, Swap Entities) regulated by those agencies with respect to swaps and security-based swaps that are not cleared with a derivatives clearing organization or clearing agency. The final rules are generally consistent with the international standards for non-cleared swap margin published by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions in September 2013 (International Standards) and will be implemented in phases starting on September 1, 2016. The rules are not intended to have retroactive effect, but will apply to both pre-compliance date swaps and post-compliance date swaps if the two types of transactions are documented in a single master netting agreement.

The substance of the final rules is very similar to that of the margin rules proposed by the prudential regulators last year so the margin requirements for a particular swap or security-based swap are determined by the regulatory categorization of the two counterparties. If the swap is between two Swap Entities or between a Swap Entity and a financial end user with "material swaps exposure", there are mandatory initial margin (IM) and variation margin (VM) requirements. If the swap is between a Swap Entity and a financial end user that does not have a material swaps exposure, only VM applies. There are no mandatory margin requirements for any other pairs of counterparties, but swap dealers remain free to impose traditional contractual margin requirements as they see fit. When IM is mandatory, it must be segregated with a custodian that is not affiliated with the party receiving the IM and cannot be rehypothecated.

Some significant points in the final rules that are different from what was proposed last year are as follow:

- The definition of "affiliate" is now based on financial consolidation.

- The measure of material swaps exposure has been increased from $3 billion to $8 billion, but all other US Dollar amounts in the rules that are derived from the International Standards have been reduced to reflect changes in the Euro-US Dollar exchange rate since the International Standards were published.

- Swaps with affiliates are still subject to the rules, but the rules now specify that: (1) such swaps need only be counted once in calculating aggregate group transaction activity, (2) each affiliate may be granted a separate margin threshold of $20 million, (3) non-cash IM from an affiliate can be held by a Swap Entity or an affiliated custodian; and (4) the exposure on some affiliate swaps can be modeled using a shorter assumed holding period.

- The rules do not apply to any swap that has the benefit of an exemption or exception from clearing enumerated in the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA). (This element of the final rules is being introduced in a separate final rule that also exempts swaps involving banks with $10 billion or less in total assets.)

The effective date of the rules is April 1, 2016, but there are various compliance dates:

- September 1, 2016 for IM and VM for any swap if both counterparties have material swaps exposure (measured for business days in March, April and May of 2016) that exceeds $3 trillion.

- March 1, 2017 for VM for swaps involving any other Swap Entity.

- September 1, 2017 for IM for any swap if both counterparties have material swaps exposure (measured for business days in March, April and May of 2017) that exceeds $2.25 trillion.

- September 1, 2018 for IM for any swap if both counterparties have material swaps exposure (measured for business days in March, April and May of 2018) that exceeds $1.5 trillion.

- September 1, 2019 for IM for any swap if both counterparties have material swaps exposure (measured for business days in March, April and May of 2019) that exceeds $.75 trillion.

- September 1, 2020 for IM for any other Swap Entity.

The text of the two new final rules can be found here.

BANKING

Comptroller of the Currency Discusses Credit Risk

On October 21, in a speech before the Exchequers Club, Comptroller of the Currency Thomas J. Curry gave his current thoughts on credit risk. To read his remarks, click here.

FDIC Board Votes To Increase DIF to 1.35 Percent of Insured Deposits

On October 22, The board of directors of the Federal Deposit Insurance Corporation (FDIC) adopted a proposal to increase the Deposit Insurance Fund (DIF) to the statutorily required minimum level of 1.35 percent. Congress, via the Dodd-Frank Wall Street Reform and Consumer Protection Act, increased the minimum for the DIF reserve ratio (the ratio of the amount in the fund to insured deposits) from 1.15 percent to 1.35 percent and required that the ratio reach 1.35 percent by September 30, 2020. Further, the Dodd-Frank Act also made banks with $10 billion or more in total assets responsible for the increase from 1.15 percent to 1.35 percent. Under a rule adopted by the FDIC in 2011, regular assessment rates for all banks will decline when the reserve ratio reaches 1.15 percent, which the FDIC expects will occur in early 2016. Banks with total assets of less than $10 billion will have substantially lower assessment rates under the 2011 rule. The surcharges would begin the calendar quarter after the reserve ratio of the DIF first reaches or exceeds 1.15 percent—the same time that lower regular deposit insurance assessment (regular assessment) rates take effect—and would continue through the quarter that the reserve ratio first reaches or exceeds 1.35 percent.

The proposed rule would impose on banks with at least $10 billion in assets a surcharge of 4.5 cents per $100 of their assessment base, after making certain adjustments. In its notice, the FDIC states the following:

> The FDIC expects the reserve ratio would likely reach 1.35 percent after approximately two years of payments of the proposed surcharges. "If, contrary to the FDIC's expectations, the reserve ratio does not reach 1.35 percent by December 31, 2018 (provided it is at least 1.15 percent), the FDIC would impose a shortfall assessment on insured depository institutions with total consolidated assets of $10 billion or more on March 31, 2019…. Since the Dodd-Frank Act requires that the FDIC offset the effect of the increase in the reserve ratio from 1.15 percent to 1.35 percent on insured depository institutions with total consolidated assets of less than $10 billion, the FDIC would provide assessment credits to insured depository institutions with total consolidated assets of less than $10 billion for the portion of their regular assessments that contributed to growth in the reserve ratio between 1.15 percent and 1.35 percent.

Read more.

EU DEVELOPMENTS

European Supervisory Authorities Consult on AML-CFT Guidelines

On October 21, the joint committee of the three European Supervisory Authorities (ESAs, comprising the European Banking Authority, the European Securities and Markets Authority, and the European Insurance and Occupational Pensions Authority) opened a public consultation on two sets of anti-money laundering and countering the financing of terrorism (AML-CFT) guidelines. Specifically, the ESAs published a joint consultation paper on risk-based AML-CFT supervision (Supervision CP) and a separate joint consultation paper on the risk factors to be considered when undertaking simplified or enhanced AML-CFT due diligence on customers (Risk Factors CP). Both consultation papers come in the wake of the adoption earlier this year of Directive (EU) 2015/849 of the European Parliament and of the Council of May 20 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (Directive 2015/849), which aligned the European Union's AML-CFT legislative framework with the Financial Action Task Force's (FATF) International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation.

The Supervision CP is directed primarily at the competent authorities (CAs) of EU member states, and is intended to set out a framework for each CA to implement a risk-based approach to AML-CFT supervision, including appropriate risk-based allocations of supervisory resources to AML-CTF issues. The ESAs identify a four-step process in risk-based supervision: (1) identification of AML-CFT risk factors; (2) holistically assessing the risk of a given firm or group of firms; (3) allocation of appropriate supervisory resources; and (4) ongoing monitoring and review. The ESAs then make recommendations in the form of guidelines so that CAs follow a common supervisory approach to AML-CFT issues.

The Risk Factors CP complements the Supervisory CP by focusing on the steps to be taken by credit and financial institutions in assessing the AML-CFT risk associated with a particular business relationship or occasional transaction. Directive 2015/849 permits firms to perform its customer due diligence (CDD) functions on a risk-sensitive basis, and apply either "simplified" CDD when the risks are low, or "enhanced" CDD when risks are higher. The ESAs propose two sets of guidelines—a general set applicable to all firms and a set of sector-specific recommendations to firms in particular sectors—in relation to a firm's determination of the level of CDD to apply to a particular relationship or transaction.

The consultation period for both consultation papers ends on January 22, 2016. The Supervision CP is available here. The Risk Factors CP is available here.

ESMA Publishes Responses to the Consultation on Draft RTS Under the ELTIF Regulation

On October 20, the European Securities and Markets Authority (ESMA) published the responses received to its consultation on Draft Regulatory Technical Standards (draft RTS) under Regulation (EU) 2015/760 (ELTIF Regulation). The ELITF Regulation, which entered into force on June 9, establishes a new investment vehicle, the European long-term investment fund (ELTIF), which will be available to all types of investors across the European Union, including retail investors. To qualify as an ELTIF, a fund must (among other things): (1) be managed by an authorized alternative investment fund manager; (2) have at least 70 percent of its capital invested in eligible investment assets; (3) not engage in short selling; and (4) be subject to strict limits on leverage and derivatives usage. The objective of the ELTIF Regulation is to provide long-term, stable returns by restricting the asset classes in which ELTIFs can invest, with the objective of stimulating employment and economic growth in the European Union. The draft RTS addresses when financial derivative instruments are used solely for hedging purposes, when the life of an ELTIF is considered sufficient in length, the criteria to be used for the orderly disposal of ELTIF assets, disclosure costs and availability to retail investors.

ESMA is expected to finalize the draft RTS in the next few months, which will then be submitted to the European Commission for endorsement.

A copy of ESMA's consultation paper on the ELTIF Regulation, including the draft RTS and responses can be found [here].

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EU DEVELOPMENTS

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