Katten
Katten Muchin Rosenman LLP

CORPORATE & FINANCIAL
WEEKLY DIGEST

October 30, 2015 Volume X, Issue 42

SEC/CORPORATE

ISS Releases 2016 Draft Voting Policy Changes for Comment

On October 26, Institutional Shareholder Services (ISS), a leading proxy advisory firm, released for comment draft voting policy changes for 2016. The three proposals are as follows:

- **Director Overboarding**: Under the current policy, ISS issues negative vote recommendations for individual directors who (1) sit on more than six public company boards; or (2) are CEOs of public companies and sit on the boards of more than two public companies other than their own (in such case, the negative recommendations being only for the outside board positions). Under the new proposed policy, ISS would issue negative vote recommendations for CEOs of public companies who sit on the board of more than one public company (rather than two) other than their own (which would continue to apply only to the outside board position). For directors who are not CEOs, ISS is proposing to lower the acceptable number of public company board positions from the current six to a total of either four or five (and is seeking comment as to whether four or five is preferable, or if the acceptable number should remain at six). There would be a one-year grace period (until 2017) before the above policy recommendations would take effect.
- **Unilateral Board Actions**: Under the new proposed policy, if a board unilaterally amends the company's bylaws or charter to either (1) classify the board or (2) establish supermajority vote requirements in any period after the company completes its IPO, then ISS would generally issue negative vote recommendations for all director nominees until such unilateral action is reversed or is subsequently approved by the shareholders. ISS is also considering adopting a policy of making negative vote recommendations for director nominees at annual meetings following the completion of an IPO if the board implements (a) a classified board and (b) supermajority vote requirements prior to or in connection with the company's IPO.
- **Compensation-Related Votes For Externally-Managed Issuers**: The third policy proposal would affect issuers (such as REITs) that are externally managed. ISS is proposing to generally recommend an "Against" vote for an issuer's "say-on-pay" proposal in cases where a comprehensive assessment of executive pay is "impossible" because the externally managed issuer provides insufficient disclosure about compensation practices and payments made to executives on the part of the external manager.

The comment period for these proposed policy changes is open until 6:00 p.m. (ET) on November 9. ISS expects to release its final 2016 policies on November 18, and if adopted, the final policies will take effect for shareholder meetings held on or after February 1, 2016.

SEC Issues Guidance on Rule 14a-8(i)(9) and Rule 14a-8(i)(7)

On October 22, the Securities and Exchange Commission's Division of Corporation Finance (Division) issued Staff Legal Bulletin No. 14H (SLB 14H), which (1) sets forth a new standard for determining when a shareholder proposal conflicts with a company proposal and therefore may be excluded from the company's proxy statement under Rule 14a-8(i)(9), and (2) reaffirms the Division's views on the application of the "ordinary business" standard in Rule 14a-8(i)(7).

Rule 14a-(8)(i)(9)

In SLB 14H, the Division stated that, for purposes of Rule 14a-8(i)(9) (which permits a company to exclude a shareholder proposal if the proposal "directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting"), a "direct conflict would exist if a reasonable shareholder could not logically vote in favor of both proposals, i.e., a vote for one proposal is tantamount to a vote against the other proposal." The Division went on to note that, when considering future no-action requests the staff of the Division will focus on whether "a reasonable shareholder could logically vote for both proposals." Under SLB 14H, the Division further noted that a direct conflict would not exist if a shareholder proposal and a company proposal contain different terms but "generally seek a similar objective" (e.g., proposals for proxy access at different ownership thresholds). The Division acknowledged that the new standard under SLB 14H "may be a higher burden for some companies" to adhere to, resulting in the reduced availability of Rule 14a-(8)(i)(9) as a basis for excluding shareholder proposals.

Rule 14a-(8)(i)(7)

The Division reaffirmed its position as to the exclusion of shareholder proposals under Rule 14a-8(i)(7), which allows a company to exclude from its proxy materials shareholder proposals that relate to the company's ordinary business operations. As discussed in the Corporate & Financial Weekly Digest edition of July 17, 2015, the US Court of Appeals for the Third Circuit in *Trinity Wall Street v. Wal-Mart Stores, Inc.* (792 F.3d 323 (3d Cir. 2015)), issued an opinion overturning the November 2014 ruling of the US District Court for the District of Delaware that Wal-Mart Stores, Inc. had improperly excluded a shareholder's request to include a proposal in Wal-Mart's 2014 proxy statement that would have required Wal-Mart's Compensation, Nominating and Governance Committee to evaluate, among other things, whether Wal-Mart should sell products that endanger public safety (even though Wal-Mart had previously been granted no-action relief with respect to such exclusion by the Office of Chief Counsel of the Division). The appellate court concluded that "a potential change in the way Wal-Mart decides which products to sell" related to Wal-Mart's ordinary business operations. Such position was consistent with the views the SEC had previously articulated on the method to analyze proposals under the ordinary business exclusion when the SEC responded to Wal-Mart's request for a no-action letter.

However, the majority opinion employed a new two-part test, "concluding that 'a shareholder must do more than focus its proposal on a significant policy issue; the subject matter of its proposal must 'transcend' the company's ordinary business.'" The majority opinion further noted "that to transcend a company's ordinary business, the significant policy issue must be 'divorced from how a company approaches the nitty-gritty of its core business.'" In SLB 14H, the Division expressed concern that this analytical approach used by the Third Circuit goes beyond the SEC's prior statements. The Division stated that it "intends to continue to apply Rule 14a-8(i)(7) as articulated by the SEC and consistent with the Division's prior application of the exclusion, as endorsed by the concurring judge, when considering no-action requests that raise Rule 14a-8(i)(7) as a basis for exclusion," rather than the two-part test applied in the majority opinion.

See the complete text of SLB 14H here.

DERIVATIVES

See "CFTC Exempts a Japanese Clearing Organization and Korean Exchange From Derivatives Clearing Organization Registration" in the CFTC section.

CFTC

CFTC Exempts a Japanese Clearing Organization and Korean Exchange From Derivatives Clearing Organization Registration

The Commodity Futures Trading Commission has issued separate orders of exemption allowing the Japan Securities Clearing Corporation (JSCC) and Korea Exchange, Inc. (KRX) to clear interest rate swaps without registering as derivatives clearing organizations (DCO). The CFTC granted these exemptions after determining that both entities are subject to a comprehensive supervisory and regulatory framework in their home countries.

The exemptions issued to JSCC and KRX are subject to the following conditions. Among other requirements, each clearing organization must: (1) maintain rules that permit clearing members to clear only for US persons who would be a “proprietary account” of the clearing member as defined in CFTC Rule 1.3(y); (2) allow open access to swaps where one or more of the counterparties is a US person; (3) confirm that it is in good regulatory standing in its home country; (4) submit certain reports to the CFTC; (5) certify annually that it complies with CPMI-IOSCO Principles for Financial Market Infrastructures; and (6) consent to US jurisdiction and agree to make available all books and records for inspection upon request.

The order of exemption from registration for the JSCC is available here.

The order of exemption from registration for the KRX is available here.

CFTC Announces Agenda for Upcoming Market Risk Advisory Committee Meeting

The Commodity Futures Trading Commission’s Market Risk Advisory Committee has announced the agenda for its November 2 meeting. The proposed meeting will discuss the Central Counterparty Clearing House Risk Management Subcommittee’s recommendations for helping central counterparty clearing default plans more accurately reflect market conditions in the event of the default of a significant clearing member.

The meeting agenda is available here.

The press release with instructions for attending, viewing and listening to the meeting is available here.

NFA Adopts Interpretative Notice Regarding Cybersecurity and Information Systems Security Programs

The Commodity Futures Trading Commission has approved the National Futures Association (NFA)’s interpretive notice related to Information System Security Programs (which was discussed in detail in the September 4, 2015 edition of *Corporate and Financial Weekly Digest*).

The interpretive notice will become effective on March 1, 2016 and apply to all NFA member categories.

Interpretive Notice I-15-23 is available here.

BANKING

Federal Reserve Issues Guidance on Waiving of Examinations Prior to Membership or Merger Into a State Member Bank

On October 13, the Board of Governors of the Federal Reserve System (Board) issued guidance that applies to insured depository institutions that are seeking to become state chartered member banks of the Federal Reserve System (state member banks), as well as to insured depository institutions merging with another institution where a state member bank would be the surviving entity, including those with $10 billion or less in total consolidated assets.

The Federal Reserve explained that it is issuing the guidance to provide further explanation on its criteria for waiving or conducting pre-membership safety-and-soundness and consumer compliance examinations of insured depository institutions that are either (1) seeking to become state member banks; or (2) merging with another institution where a state member bank would be the surviving entity. Further, the guidance provides clarification to previously issued guidance as to the eligibility criteria for when the Federal Reserve may waive a pre-membership or pre-merger examination.

A safety-and-soundness or consumer compliance examination of a state nonmember bank, national bank or savings association seeking to convert its status to a state member will not generally be required prior to the conversion if the institution seeking membership meets the criteria for "eligible bank," as set forth in the Board's Regulation H, plus the additional safety-and-soundness and consumer compliance criteria listed below (together referred to as "eligibility criteria"). To meet the Regulation H "eligible bank" criteria, an insured depository institution must:

- be well capitalized under Regulation H, subpart D, Prompt Corrective Action;
- have a composite capital, asset quality, management, earnings and liquidity (CAMELS) rating of 1 or 2 (or equivalent composite rating for a savings association);
- have a Community Reinvestment Act (CRA) rating of "outstanding" or "satisfactory;"
- have a consumer compliance rating of 1 or 2; and
- have no major unresolved supervisory issues outstanding (as determined by the Board or appropriate Federal Reserve Bank in its discretion), including adverse supervisory findings or ratings by the current primary regulator or Consumer Financial Protection Bureau (CFPB).

In addition, the insured depository institution seeking membership must meet the following additional safety-and-soundness criteria:

- the management component of CAMELS is rated 1 or 2;
- the on-site "close date" of the most recent full-scope safety-and-soundness examination is less than nine months from the date of the application for membership;
- there have been no material changes to the bank's business model since the most recent report of examination and no material changes are planned for the next four quarters; and
- the annual growth in total assets, measured as of the most recent quarter end on the institution's Consolidated Reports of Condition and Income, is under 25 percent and planned growth over the next year is less than 25 percent.

In cases where a state nonmember bank, national bank or savings association is merging with a state member bank and the surviving institution is a state member bank, a safety-and-soundness or consumer compliance examination of the state nonmember bank, national bank or savings association will not be required so long as the state member bank meets all of the eligibility criteria on an existing and pro-forma basis. For example, the state member bank would not meet all of the eligibility criteria if its total assets were to increase by 25 percent or more on a pro-forma basis considering both organic growth and assets from the merging institution. Other examples of situations that may cause the merging state member bank to not meet the eligibility criteria include, but would not be limited to, a change in senior leadership, a change in strategy, and a situation where the institution with which it is merging is rated less than satisfactory, has major unresolved supervisory issues or brings new business lines or products to the state member bank.

In all cases, the Federal Reserve Bank must consult with Board supervisory staff when determining whether to waive a safety-and-soundness examination under this policy. Under certain circumstances, a pre-merger or pre-membership examination may be waived even when an institution fails to meet one or more of the safety-and-soundness related eligibility criteria. This can occur if the Federal Reserve Bank, in consultation with Board supervisory staff, determines that conducting a safety-and-soundness examination would be unlikely to provide information that would assist in evaluating the statutory and regulatory factors that the Board is required to consider in acting on the membership or merger application.

The full guidance may be found here.

UK DEVELOPMENTS

UK Senior Managers and Certification Regime To Replace FCA Approved Persons Rules for All UK Authorized Firms

HM Treasury has announced as part of a new bill introduced in the UK parliament, that the current proposals for rules requiring senior banking individuals to have more responsibility in designated areas within banks operating in the United Kingdom should be extended to all UK firms regulated by the Financial Conduct Authority (FCA) and/or the UK Prudential Regulation Authority (PRA) (i.e., the whole of the UK financial services industry).

The Senior Managers and Certification Regime (SM&CR) comes into effect in March 2016 for all British and overseas banks operating in the United Kindom. It requires that senior managers must have identified areas of responsibility and introduces a “duty of responsibility” for such individuals so that key individuals can be identified and penalized if they fail to meet such duty. The SM&CR for banks was introduced by the UK government as a reaction to the financial crisis and the associated public frustration that few individuals were prosecuted for failures at the banks despite the fact that key banks had to be bailed out using vast sums of public money. With the new

SM&CR, the FCA or the PRA will be able to point to key individuals if management failures are identified in banks operating in the United Kingdom and, consequently, those individuals will need to ensure that their areas of responsibility are properly managed to avoid incurring liability.

HM Treasury announced that "it is now appropriate to extend the SM&CR more widely, creating a more rigorous, comprehensive and consistent approach across the financial services industry" and it will replace the current approved persons regime, which, scathingly, the UK's Parliamentary Commission on Banking Standards commented was a "complex and confused mess" with a restricted scope and a lack of clarity as to which specific persons in regulated firms had responsibility for particular areas of the business. Instead, it is intended that the SM&CR will require the creation of "responsibilities maps," causing senior individuals within all regulated firms to be more visible and thereby allow regulators to take direct action against them, if necessary.

HM Treasury's paper announced that:

- The Senior Managers Regime will directly replace the approved persons regime in relation to persons performing the senior roles in a firm. These roles, known as Senior Management Functions (SMFs), will be specified in rules made by the PRA and FCA. Firms need to provide for individuals already approved (e.g. as CF1 directors, CF2 non-executive directors, CF3 chief executives and CF4 partners) to be "grandfathered" into relevant roles in the new SM&CR. Those regulated firms planning a new senior manager appointment, or a material change in role for currently approved individuals, will have to apply to the FCA or the PRA to get such persons approved. As with the current approved persons rules, individuals will not be permitted to take up an SMF role until the FCA or the PRA have given their written consent.
- The parallel Certification Regime will apply to individuals who are not carrying out SMFs but whose roles are deemed capable of causing significant harm to the firm or its customers. Such roles will almost certainly include all persons currently registered with the FCA and the PRA under the approved persons CF30 controlled function, which includes all customer-facing individuals such as advisors, as well as portfolio managers. The certification regime will require regulated firms themselves to assess the fitness and propriety of persons performing such key roles, and to formally certify this at least annually. Persons in these significant harm functions will likely also be notified by firms to the FCA and the PRA, although it will not be necessary to obtain the relevant regulator's prior consent.

HM Treasury has stated that it anticipates that most current approved persons below senior management level are expected to be certified. It is not yet clear whether there will be any certification requirements for a firm's general counsel, chief compliance officer (CF10 in the approved persons rules) or the money laundering reporting officer (CF11), or if such persons will be considered as senior managers requiring regulatory approval. However, what is clear is that the burden of proof will be on regulated firms to certify at least annually that applicable staff are (to use UK regulatory terminology) "fit and proper" to be able to perform their role. That will likely include comprehensive due diligence in obtaining references for new candidates, as well as ensuring that updated training is undertaken by relevant current employees. Any failings within a firm could lead to the relevant senior manager having personal liability and being penalized by the PRA or the FCA.

The SM&CR will come into operation for banks, building societies, credit unions and PRA-regulated investment firms on March 7, 2016, and such firms will have one year from this date to complete the certification of existing staff. It is intended that the SM&CR will apply to all other regulated UK firms beginning in 2018.

The HM Treasury paper on the extension of the SM&CR is available here.

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
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
Ross Pazzol	+1.312.902.5554	ross.pazzol@kattenlaw.com
Fred M. Santo	+1.212.940.8720	fred.santo@kattenlaw.com
Christopher T. Shannon	+1.312.902.5322	chris.shannon@kattenlaw.com
Peter J. Shea	+1.212.940.6447	peter.shea@kattenlaw.com
James Van De Graaff	+1.312.902.5227	james.vandegraaff@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

Jeff Werthan	+1.202.625.3569	jeff.werthan@kattenlaw.com

UK DEVELOPMENTS

Neil Robson	+44.20.7776.7666	neil.robson@kattenlaw.co.uk

* Click here to access the *Corporate & Financial Weekly Digest* archive.

Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.
©2015 Katten Muchin Rosenman LLP. All rights reserved.

Katten
Katten Muchin Rosenman LLP www.kattenlaw.com

AUSTIN | CENTURY CITY | CHARLOTTE | CHICAGO | HOUSTON | IRVING | LONDON | LOS ANGELES | NEW YORK | ORANGE COUNTY | SAN FRANCISCO BAY AREA | SHANGHAI | WASHINGTON, DC

Katten refers to Katten Muchin Rosenman LLP and the affiliated partnership as explained at kattenlaw.com/disclaimer.