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SEC/CORPORATE

SEC Advisory Committee on Small and Emerging Companies to Discuss "Accredited Investor" Definition

The Securities and Exchange Commission announced that its Advisory Committee on Small and Emerging Companies (Committee) will hold a public meeting on February 17 to vote on recommendations to the SEC regarding the definition of "accredited investor." At the Committee's prior meeting on December 17, 2014, the Committee discussed potential changes to such definition, including adjusting existing thresholds thereunder.

The Committee serves to provide advice and recommendations to the SEC regarding privately held small businesses and publicly traded companies with a market capitalization of less than $250 million.

Live audio from the upcoming Committee meeting will be available on February 17 on the SEC's website.

The SEC's press release can be read here.

Glass Lewis Enhances its Pay-for-Performance and Equity Plan Models

Glass Lewis, a leading proxy advisory firm, recently announced enhancements to the performance metrics used in both its US and Canadian pay-for-performance (PFP) models and its US equity plan model. The current Glass Lewis PFP models assess the link between executive pay and company performance based on the following five metrics: Change in Operating Cash Flow, Change in Earnings Per Share, Total Shareholder Return, Return on Equity and Return on Assets.

Under the revised PFP models, Glass Lewis modified some of the aforementioned performance metrics for certain industries, with the goal of better reflecting how management, boards and analysts evaluate the operating performance of companies in these industries. The following changes became effective on February 2.

- Change in Operating Cash Flow has been replaced with Tangible Book Value Per Share Growth for companies in the bank, diversified financials and insurance sectors.
- Change in Operating Cash Flow has been replaced with Growth in Funds From Operations for real estate investment trusts (REITs), with the exception of mortgage and specialized REITs.

Glass Lewis will also make the same changes to the performance metrics used in its US equity plan model. Glass Lewis anticipates that these changes will have minimal impact on the grades granted by PFP models and the pass/fail assessments under the equity plan model.

Glass Lewis' announcement is available here.

SEC Issues New Debt Tender Offer Guidance

On January 23, the Securities and Exchange Commission's Division of Corporate Finance issued a no-action letter (New Letter) that (1) substantially revises prior guidance relating to debt tender offers and (2) expands the guidance to cover certain debt exchange offers, effective immediately.

The SEC previously permitted tender offer periods of less than 20 business days, as required by Rule 14e-1(a) under the Securities Exchange Act of 1934, but solely in respect of cash tender offers for non-convertible investment grade debt securities. Subject to the satisfaction of certain conditions outlined herein, the New Letter permits an offeror to conduct a tender offer for non-convertible debt securities (irrespective of investment grade ratings) for five business days, and for cash and/or "Qualified Debt Securities" (i.e., non-convertible debt securities that are identical in all material respects to the targeted debt securities, except for the maturity date, interest payment and record dates, redemption provisions, and interest rate provided that such securities have (1) interest payable only in cash and (2) a weighted average life to maturity that is longer than the targeted debt securities). In order to qualify for the abbreviated five-business-day offer period, a tender offer must satisfy various criteria, including as to the targeted securities, the offeror and the consideration offered, and must comply with specified procedural requirements.

By eliminating the requirement that the targeted securities be investment grade and permitting issuers with an exchange offer alternative, the New Letter should offer issuers flexibility and facilitate the ability of existing debt holders to roll all or part of their investment into new debt securities. However, the opportunities for issuers to refinance current debt pursuant to such an exchange offer may be limited, given that the typical practice of soliciting consents to eliminate restrictive covenants is not permitted pursuant to the New Letter.

Click here for a copy of the New Letter.

BROKER-DEALER

CBOE Proposes to Amend Order Ticket Requirements for Certain Orders

On January 23, the Chicago Board Options Exchange (CBOE) proposed rule changes that would amend order ticket requirements for certain orders under CBOE Rules 6.53 and 24.20. Specifically, the proposed amendment to CBOE Rule 6.53 would require complex orders of 12 legs or less to be entered on a single order ticket at the time of systemization. Complex orders of more than 12 legs may be split across multiple order tickets as long as the Trading Permit Holder (TPH) entering the order includes 12 legs on one of the order tickets and identifies to the CBOE order tickets that are part of the same order. In addition, the proposed amendment to CBOE Rule 24.20 would require a single order ticket at the time of systemization for an SPX combo order of 12 legs or less. An SPX combo order containing more than 12 legs may be represented or executed as a single SPX combo order if it is divided among multiple order tickets and the TPH representing the SPX combo order includes 12 legs on one of the order tickets and identifies to the CBOE the order tickets that are part of the same SPX combo order.

Interested persons may submit comments on these proposed rule changes to the Securities and Exchange Commission until February 19.

The notice of filing is available here.

SEC and FINRA Issue Cybersecurity Publications

On February 3, the Securities and Exchange Commission and Financial Industry Regulatory Authority issued separate publications on cybersecurity risk. The SEC's risk alert provides summary observations from the SEC's Office of Compliance Inspections and Examinations based on prior examinations of broker-dealers and investment advisers. These examinations focused on how firms (1) identify cybersecurity risks; (2) establish cybersecurity policies, procedures and oversight processes; (3) protect their networks and information; (4) identify and address risks associated with remote access to client information, fund transfer requests and third-party vendors; and (5) detect unauthorized activity. The SEC also released an investor bulletin that provides guidance to help investors safeguard their online investment accounts. Among other things, the SEC recommends using a strong password and a two-step verification process.

Separately, FINRA released two publications on cybersecurity. FINRA's cybersecurity report identifies best practices for managing cybersecurity threats based on prior examinations of its member firms. These practices include, among other things, establishing a sound governance framework, utilizing risk assessments and technical controls, developing cyber-incident response plans, and training staff on cybersecurity issues. FINRA also released an investor alert to help investors safeguard their brokerage accounts and financial information.

The publications are available here: SEC Risk Alert, SEC Investor Bulletin, FINRA Report and FINRA Investor Alert.

LITIGATION

SEC Obtains $585 Million Judgment Against MRI International for Ponzi Scheme

A Nevada District Court granted the Securities and Exchange Commission's request for a $585 million judgment against MRI International, Inc. and its former CEO, Edwin Fujinaga, consisting of disgorgement, prejudgment interest and civil monetary penalties. The case involved a Ponzi scheme in which the defendants collected hundreds of millions of dollars for purported investments in medical accounts receivable, but used the investments to finance personal expenses and repay earlier investments. The court found the defendants liable for the scheme in 2014.

The SEC subsequently sought to enter judgment against the defendants, but the defendants contested the SEC's calculations. The defendants first objected to the SEC's $442 million disgorgement request, arguing that it should not have included funds pre-dating 2008 because the complaint only alleged wrongdoing "from approximately 2008." The court disagreed, finding that the complaint alleged pre-2008 wrongdoing, including the collection of investments in 1998 and false representations in MRI's 2006 offering book. The court also found that the prejudgment interest was properly computed from 2008, rejecting the defendants' argument that interest should be calculated from the date of the SEC's 2013 complaint. Lastly, the defendants argued that $20 million in civil penalties was unwarranted because the company no longer existed. The court disagreed and held that the penalty reflects the degree of scienter and ongoing nature of the conduct, in addition to the unlikeliness of future violations.

SEC v. Fujinaga, No. 2:13-cv-01658 (D. Nev. Jan. 27, 2015)

BANKING

Regulators Release Guidance on Private Student Loans With Graduated Repayment Terms at Origination

On January 29, the federal financial regulatory agencies, in partnership with the State Liaison Committee of the Federal Financial Institutions Examination Council, issued guidance for financial institutions on private student loans with graduated repayment terms at origination. This guidance provides principles that financial institutions should consider in their policies and procedures for originating private student loans with graduated repayment terms. The principles, in brief, enunciated in the release issued by the Federal Deposit Insurance Corporation, are as follows:

- Ensure orderly repayment. Private student loans should have defined repayment periods and promote orderly repayment over the life of the loans. Graduated repayment terms should ensure timely loan repayment and be appropriately calibrated according to reasonable industry and market standards based on the amount of debt outstanding. Graduated repayment terms should avoid negative amortization or balloon payments.
- Avoid payment shock. Graduated repayment terms should result in monthly payments that a borrower can meet in a sustained manner over the life of the loan. Graduated increases in a borrower's monthly payment should begin early in the repayment period and phase in the amortization of the principal balance to limit payment shock to the borrower.

- Align payment terms with the borrower's income. Graduated repayment terms should be based on reasonable assumptions about the ability to repay of the borrower and cosigner, if any. Lender underwriting should include an assessment of a borrower's (and, if applicable, a cosigner's) ability to repay the highest amortizing payment over the term of the loan.
- Provide borrowers with clear disclosures. Financial institutions that offer private student loans with graduated repayment terms should provide borrowers with disclosures in compliance with all applicable laws and regulations.
- Comply with all applicable federal and state consumer laws and regulations and reporting standards. Private student loans with graduated repayment terms must comply with all applicable consumer protection laws. These include, but are not limited to, the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, federal and state prohibitions against unfair, deceptive, or abusive acts or practices, and the Truth in Lending Act.
- Contact borrowers before reset dates. Before originating private student loans with graduated repayment terms, financial institutions should develop processes for contacting borrowers before the start of the repayment period and before each payment reset date.

The guidance has been criticized by industry representatives as both overly restrictive and opaque. Some representatives questioned the notion of gauging the ability of an 18-year-old college freshman to repay.

Read the press release here.

Federal Reserve Board Invites Comments on Small Bank Holding Company Policy Statement

On January 29, the Board of Governors of the Federal Reserve System (Board) invited public comment on a proposed rule to expand the applicability of the Board's Small Bank Holding Company Policy Statement (Policy Statement) for small bank holding companies as well as certain savings and loan holding companies. Additionally, the Board announced reduced reporting requirements for certain bank holding companies and savings and loan holding companies.

The Policy Statement "facilitates the transfer of ownership of small community banks by allowing their holding companies to operate with higher levels of debt than would otherwise be permitted." Institutions subject to the Policy Statement are not subject to the Board's regulatory capital requirements. Currently, bank holding companies with less than $500 million in total consolidated assets may be subject to the Policy Statement. Eligible firms must also meet certain qualitative requirements with respect to nonbanking activities, off-balance sheet activities, and publicly-registered debt and equity. The proposed rule allows bank holding companies and savings and loan holding companies with less than $1 billion in total consolidated assets that meet the qualitative requirements to qualify.

The Board also adopted an interim final rule to exclude from the Board's regulatory capital requirements savings and loan holding companies with less than $500 million in total consolidated assets that meet the qualitative requirements in the Policy Statement. Bank holding companies with less than $500 million in total consolidated assets that meet the qualitative requirements in the Policy Statement are already excluded from the Board's regulatory capital requirements.

The proposed rule and interim final rule would implement a law passed by the US Congress in December 2014. Comments on the proposal and interim final rule will be accepted through March 4.

In addition, the Board has taken steps to relieve regulatory reporting burden for bank holding companies and savings and loan holding companies that have less than $1 billion in total consolidated assets and meet the qualitative requirements of the Policy Statement. The Board has proposed to eliminate quarterly consolidated financial reporting requirements (FR Y-9C) for these institutions, and instead require parent-only financial statements (FR Y-9SP). The proposal would also eliminate regulatory capital reporting for savings and loan holding companies with less than $500 million in total consolidated assets from the FR Y-9SP. The Board has filed a request with the Office of Management and Budget to make these changes effective on March 31, while it completes the notice and comment process.

Comments on the regulatory reporting changes will be accepted for 60 days after publication. Access to the proposed rule and the interim final rule may be gained by clicking here.

EU DEVELOPMENTS

ESMA Determines Not to Propose a Clearing Obligation for NDFs

On February 4, the European Securities and Markets Authority (ESMA) published a feedback statement declaring its current intentions not to propose a clearing obligation for non-deliverable forwards (NDFs) under the European Market Infrastructure Regulation for foreign exchange NDFs. The statement is in response to ESMA's October 1, 2014, consultation paper, which proposed draft technical regulatory standards for a mandatory clearing obligation on NDFs.

ESMA determined not to impose a clearing obligation on NDFs at this time in order to take more time to address the concerns raised by the responses to its consultation paper. Industry stakeholders identified two primary areas of concern: 1) the marketplace has minimal experience with the clearing of NDFs; and 2) international consistency of implementation, including timing. The industry also noted that currently only one European central counterparty (CCP) is authorized by ESMA to clear NDFs; the third-country CCPs that can clear NDFs are not yet recognized by ESMA.

ESMA has not ruled out the possibility of later imposing a clearing obligation on NDFs in response to further market developments.

A copy of the ESMA statement can be found here.

Additional Two-Year Clearing Reprieve for European Pension Schemes

The European Commission (EC) has proposed a further two-year extension beyond the three-year exemption from mandatory clearing of over-the-counter derivatives granted to qualifying pension scheme arrangements (PSAs) under Articles 89(1) and (2) of the European Market Infrastructure Directive (EMIR). This exemption was included in EMIR on the basis that PSAs generally do not hold substantial cash assets, which would pose significant challenges for PSAs to meet variation margin (VM) calls from central counterparties (CCPs), which are generally required to be made in cash. CCPs were expected to use this three-year exemption period to identify and bring to market viable solutions to permit PSAs to transfer non-cash collateral as VM.

Article 85(2) of EMIR obliges the EC to consult with the European Markets and Securities Authority and the European Insurance and Occupational Pensions Authority to assess the progress made by CCPs during this period. The report, a draft of which was published on February 3, identifies a series of potential solutions under consideration by CCPs, including the use of repurchase (repo) agreements, agency stock lending, secured lending by corporate entities with large cash reserves, and pass-through of non-cash assets (with or without a security interest) to VM receivers. Despite the variety of potential solutions under consideration, the draft report concludes that, other than in respect of repos, "no sufficient progress appears to have been made by CCPs" to identify a viable solution for PSAs.

Accordingly, the EC has indicated its intention to propose a two-year extension to the exemption from mandatory clearing for PSAs, during which time the EC will engage with CCPs to facilitate bringing one or more viable solutions to market. Article 85(2) of EMIR permits the EC to grant a further one-year extension. However, in the absence of CCPs identifying a solution by August 2018, PSAs will be required to post cash to meet VM calls.

A copy of the EC's draft report can be found here.

The EC's press release accompanying the report can be found 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
Kathleen H. Moriarty	+1.212.940.6304	kathleen.moriarty@kattenlaw.com
Ross Pazzol	+1.312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	+1.312.902.5381	kenneth.rosenzweig@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
LITIGATION		
Bruce M. Sabados	+1.212.940.6369	bruce.sabados@kattenlaw.com
Margaret J. McQuade	+1.212.940.6664	margaret.mcquade@kattenlaw.com
BANKING		
Jeff Werthan	+1.202.625.3569	jeff.werthan@kattenlaw.com
EU DEVELOPMENTS		
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Nathaniel Lalone	+44.20.7776.7629	nathaniel.lalone@kattenlaw.co.uk

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Katten Muchin Rosenman LLP www.kattenlaw.com

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