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SEC/CORPORATE

SEC Division of Corporation Finance Issues New C&DI Related to Rule 147 and Website/Social Media Use

On October 2, the Securities and Exchange Commission's Division of Corporation Finance issued a new Compliance and Disclosure Interpretation (C&DI) regarding whether an issuer of securities may use its own website or social media to offer securities in a manner consistent with Rule 147 under the Securities Act of 1933 (Securities Act). Rule 147 provides objective standards for satisfying the exemption from registration provided by Section 3(a)(11) under the Securities Act (which generally exempts from registration securities offered and sold by an issuer if the transaction is wholly intrastate, meaning the issuer and all the offerees/purchasers are residents of the same state).

C&DI 141.05 provides that issuers may use their websites or social media to offer securities in accordance with Rule 147 by taking specified precautions. For example, an issuer could "implement technological measures" such that communications that constitute offers are only made to those persons whose IP addresses originate from the issuer's state of residence (and prevent offers to persons whose IP addresses originate in other states). C&DI 141.05 further clarifies that, in any event, any offer should include a disclaimer and restrictive legend "making it clear that the offering is limited to residents" of the same state as the issuer.

Director of SEC Division of Corporation Finance Gives Speech on Securities Disclosure

On October 3, the Director of the Securities and Exchange Commission's Division of Corporation Finance (Division), Keith F. Higgins, spoke at the George A. Leet Business Law Conference, discussing SEC disclosure requirements and offering thoughts on the future of disclosure.

Mr. Higgins noted the Division's Disclosure Effectiveness agenda and its goal of recommending rule changes to the SEC that would (1) update and modernize disclosure requirements, (2) eliminate redundant disclosures and (3) continue to provide material information to investors.

In general, Mr. Higgins emphasized the importance of striking the right balance between providing investors with "the information they need to make informed investment and voting decisions" and "compliance costs for companies and the potential impact on efficiency, competition and capital formation." In doing so, Mr. Higgins highlighted the following considerations:

- the diverse composition of today's investors, which is increasingly more institutional;
- a diverse and changing body of reporting companies, both in terms of (i) size (noting that some have queried whether $75 million in public float is the appropriate threshold for a smaller reporting company and, as a result, the scaled disclosure system) and (ii) type of industry (in this regard Mr. Higgins noted that, at a minimum, industry guides needed to be modernized);
- in some cases, allowing companies more flexibility to provide disclosures they believe to be material to investors via a principles-based approach, rather than an explicitly required line-item approach; and
- changes in technology that could be utilized to make it easier for investors to access more streamlined disclosures (for example, through a "company file" versus a periodic filing approach, while keeping in mind the benefits associated with the standardized process that has developed around the periodic reporting system).

Mr. Higgins also noted that achievement of the right balance would require, in addition to rule changes by the SEC, the proactive involvement of companies.

Read more.

BROKER-DEALER

FINRA Proposes to Extend Tier Size Pilot for OTC Equity Securities

On October 3, the Financial Industry Regulatory Authority, Inc. proposed to amend FINRA Rule 6433 to extend to February 13, 2015, the operation of the Tier Size Pilot (Pilot) that changed minimum quotation sizes (tier sizes) for over-the-counter equity securities (OTC Equity Securities). In FINRA's assessment of the Pilot, it found that the Pilot had a neutral to positive impact on the majority of OTC Equity Securities and tier structure. FINRA also found a 13 percent increase in the number of customer limit orders that met the Pilot display minimum threshold. FINRA seeks to extend the Pilot to accumulate more data to review the effects of the Pilot.

Click here to read the proposed rule.

FINRA Postpones Rules on MPID Requirements for ATSs

On October 2, the Financial Industry Regulatory Authority, Inc. postponed the implementation date of the Market Participant Identifier (MPID) requirements for Alternative Trading Systems (ATSs) when reporting weekly volume and trade information to FINRA. The proposed rules amended FINRA Rules 6160, 6170, 6480 and 6720 to require an ATS to use a single MPID when reporting information to FINRA. The original implementation date was November 10, 2014, and the postponed implementation date is February 2, 2015. The postponement was issued after FINRA members requested it in order to ensure that their trade reports and FINRA Order Audit Trail System reports comply with guidance FINRA released on September 15, which clarified the appropriate indication of MPIDs in various trade reporting situations.

Click here to read the FINRA guidance for ATS reporting and here to read the proposed rule postponement.

FINRA Proposes to Make Permanent the Limited Fee Waiver Pilot Program for TRACE Data

On October 3, the Financial Industry Regulatory Authority, Inc. proposed a rule change to FINRA Rule 7730(C)(1)(A) to adopt as permanent the pilot program to provide certain market participants with a one-month trial period access to a data product that includes real-time Trade Reporting and Compliance Engine (TRACE) transaction data. The one-month trial period waives the FINRA Professional Real-Time Data Display Fee that normally is assessed pursuant to the FINRA Rule. FINRA adopted the fee waiver program to encourage the use of TRACE transaction data to promote more accurate and timely pricing and valuations of debt securities.

Click here to see the proposed rule.

SEC Issues Risk Alert and FAQs on Customer Sales of Unregistered Securities

On October 9, the Securities and Exchange Commission released a Risk Alert and Frequently Asked Questions (FAQs) regarding customers' sales of unregistered securities. The National Examination Program staff (Staff) of the Office of Compliance Inspections and Examinations performed a sweep of 22 broker-dealers to assess compliance with the Securities Act of 1933 (Securities Act) and various anti-money laundering rules under the Bank Secrecy Act and the Securities Exchange Act of 1934. The Risk Alert and FAQs discussed the requirement for broker-dealers to conduct a "reasonable inquiry" regarding customers' unregistered sales of securities, which is required to use the Section 4(a)(4) exemption from Securities Act registration requirements.

In the Risk Alert, the Staff detailed deficiencies in policies and procedures related to the reasonable inquiry, particularly if the broker-dealers failed to make additional inquiries into whether shares were restricted securities. The Staff noted that the broker-dealers failed to file Suspicious Activity Reports regarding red flags of suspicious activity (such as atypical trading patterns). The Staff also noted that certain types of accounts appeared to be associated frequently with dumping large amounts of illiquid microcap stocks, which should have raised red flags for the broker-dealers.

In the FAQs, the Division of Trading and Markets clarified the following items:

- Section 4(a)(4) provides an exemption for broker-dealers executing customers' orders on any exchange or in the over-the-counter market but not soliciting such orders, unless a broker-dealer knows or has reasonable grounds to believe that the transaction is not exempt under Section 5 of the Securities Act.
- Broker-dealers may claim the Section 4(a)(4) exemption if they conduct a "reasonable inquiry" into the facts surrounding an unregistered sale of securities (including but not limited to multiple factors listed in the FAQs).
- In any situation that raises red flags (including but not limited to those listed in the FAQs), broker-dealers violate Section 5 of the Securities Act if they fail to inquire sufficiently into the circumstances of a transaction to ensure it is not unlawful.
- The mere acceptance by a depository trust company of a security does not eliminate the need for broker-dealers to make a reasonable inquiry.
- The delivery of a security without a restrictive legend does not eliminate the need to make a reasonable inquiry.

Click here to read the Risk Alert and here to read the FAQs.

CFTC

CFTC Issues Relief from Certain Part 45 Requirements to Singapore Exchange Derivatives Clearing Limited

On October 8, the Commodity Futures Trading Commission's Divisions of Market Oversight and Clearing and Risk (Divisions) issued No-Action Letter No. 14-122 providing relief to Singapore Exchange Derivatives Clearing Limited (SGX-DC), a registered derivatives clearing organization, from complying with certain swap data reporting requirements under CFTC Regulations 45.3 (creation data) and 45.4 (continuation data). The Divisions stated that the relief is intended to provide SGX-DC with time to develop automated reporting systems while promoting competition and enhancing choice in clearing services for US customers. The relief to SGX-DC will expire on April 30, 2015, and is conditioned on SGX-DC backloading and reporting all Part 45 data for swaps cleared during the relief period to a CFTC-registered swap data repository by May 30, 2015.

CFTC Letter No. 14-122 is available here.

DIGITAL ASSETS AND VIRTUAL CURRENCIES

CFTC Hears Testimony on Bitcoin

The Global Markets Advisory Committee of the Commodity Futures Trading Commission held a public meeting on October 9, in which one panel addressed Bitcoin. The meeting focused on informing the staff regarding basic applications of Bitcoin technology and issues relating to bitcoin-based derivative instruments. Among the panelists for the CFTC meeting was Leonard Nuara, president of TeraExchange LLC. Mr. Nuara announced the execution of the first regulated bitcoin swap on the TeraExchange platform, which recently received approval from the CFTC as a swap execution facility.

Click here to see the CFTC Global Markets Advisory Committee meeting agenda.

LITIGATION

Fifth Circuit Holds Multiple Disclosures Establish Loss Causation in Securities Action

The US Court of Appeals for the Fifth Circuit recently held that multiple partial "corrective" disclosures collectively may satisfy the requirements of pleading loss causation in a securities fraud class action, even if no single disclosure alone is sufficient.

Investors alleged that Amedisys, Inc., a publicly traded corporation that provides home health services to patients with chronic health problems, violated §10(b) of the Securities Exchange Act of 1934 by concealing a Medicare billing fraud scheme. According to the complaint, Amedisys employees allegedly provided medically unnecessary treatment visits to patients in order to hit the most lucrative Medicare reimbursement thresholds.

Plaintiffs alleged that the fraud was eventually revealed to the market through a series of five partial disclosures between August 2008 and July 2010. The five disclosures were: (i) an analyst report speculating on the possibility of fraud at Amedisys; (ii) the resignation of two senior Amedisys executives; (iii) a *Wall Street Journal* article analyzing Amedisys' patient visit data; (iv) the announcement of government investigations; and (v) disappointing quarterly earnings results. As a result of these disclosures, plaintiffs argued that "the truth gradually leaked into the market" and caused a 60 percent decline in Amedisys' stock price.

Amedisys argued that none of the disclosures standing alone were sufficient to establish loss causation. The Fifth Circuit, however, found that the disclosures should not be analyzed in isolation and that the disclosures "collectively constitute and culminate in a corrective disclosure that adequately pleads loss causation." The court explained that, with respect to loss causation, its "holding can best be understood by observing that the whole is greater than the sum of its parts."

Public Emps. Ret. Sys. of Miss. v. Amedisys, Inc., No. 13-30580 (5th Cir. Oct. 2, 2014).

District Court Dismisses Securities Class Action for Failure to Show Causal Connection

The US District Court for the Southern District of New York recently dismissed a securities class action against a battery manufacturer, finding that the plaintiffs failed to plead a causal connection between the alleged revenue misstatements and a drop in the company's stock price.

New Energy Systems Group manufactures and distributes lithium battery shells and related products through a subsidiary based in China. Plaintiffs alleged that New Energy's financial reports filed with the Securities and Exchange Commission for 2008 and 2009 showed substantially more revenue and net income than New Energy's comparable filings submitted to China's State Administration for Industry and Commerce. In essence, plaintiffs alleged that New Energy kept "two sets of books."

New Energy subsequently amended its Chinese filings to comport with the SEC filings in December 2011 and publicized the amendments on its website in March 2011. New Energy's stock price did not react to the amendments. Nearly eight months later, New Energy issued a press release announcing a 42 percent decline in year-over-year revenues. Following this announcement, New Energy's stock price fell by nearly 50 percent. Plaintiffs then filed a putative class action under Section 10(b) of the Securities Exchange Act of 1934. Defendants moved to dismiss, arguing that the plaintiffs failed to adequately plead loss causation.

The District Court found that the complaint failed to allege that plaintiffs suffered losses either when New Energy amended its Chinese filings or when it publicized information about those amendments. Instead, plaintiffs tied the losses to the press release issued eight months later on a theory that New Energy never had revenue or income previously reported, and it merely "ratcheted down" its revenue in an effort to conceal fraud. The District Court found plaintiffs' theory unavailing, because elements of the alleged fraud would have been exposed to the market through the amendments to the Chinese filings, and the complaint alleged no market reaction whatsoever to the amendments. Consequentially, the District Court dismissed the complaint.

In re. New Energy Sys. Sec. Litig., No. 12-c-01041 (S.D.N.Y. Sept. 30, 2014).

EU DEVELOPMENTS

Jonathan Hill Confirmed as New European Commissioner for Financial Services

On October 8, members of the European Parliament's Committee on Economic and Monetary Affairs voted 45-13 to confirm Jonathan Hill as the new European Commissioner for financial stability, financial services and capital markets union. Lord Hill's confirmation vote was held after Committee members took the unusual step of requiring him to reappear for a second hearing.

As financial services commissioner, Lord Hill's role will be to oversee the development of the European Union's single market in financial services, and it is expected that much of his initial workload will be directed at implementation of the European Markets in Infrastructure Directive and other post-crisis financial market reforms. In this regard, Lord Hill has indicated his willingness to work cooperatively with his US counterparts to resolve ongoing transatlantic differences on regulatory reform efforts, in particular in respect of derivatives clearing. He has also undertaken to launch a new European "capital markets union" during his term.

The full Commission, to be headed by former Luxembourg Prime Minister Jean-Claude Juncker, must now be approved by a vote of the European Parliament, which is expected to occur on October 22. More information on Lord Hill's testimony before the Committee on Economic and Monetary Affairs can be found here.

ESMA Clearing Obligations for FX NDF and IRS

On October 1 the European Securities and Markets Authority (ESMA) published a consultation paper on draft regulatory technical standards (RTS) for the mandatory clearing of certain foreign-exchange non-deliverable forwards (FX NDF) as required under the European Market Infrastructure Regulation (EMIR). FX NDF are defined as cash-settled foreign exchange forward contracts that cannot result in physical delivery of the designated currencies at maturity. The consultation period will close on November 6.

The FX NDF that will be subject to the mandatory clearing obligation are contracts with maturities between three days and two years settled in USD in the following 11 currencies: Brazilian Real, Chilean Peso, Chinese Yuan, Colombian Peso, Indonesian Rupiah, Indian Rupee, Korean Won, Malaysian Ringgit, Philippine Peso, Russian Ruble, and Taiwan Dollar. Currently, only LCH.Clearnet Ltd is authorized to clear the relevant FX NDF, although ESMA anticipates that such contracts will ultimately be cleared by one or several other EU central counterparties (CCPs) once they have obtained the relevant authorization.

The Global Markets Advisory Committee (GMAC) held a public meeting on October 9 to discuss issues related to clearing FX NDF and the impact of such clearing on the underlying contracts.

ESMA also published final RTS on mandatory clearing for certain interest rate swaps (IRS) on October 1. Details of the original draft RTS for IRS were reported in the *Corporate and Financial Weekly Digest* edition of August 29, 2014. The final RTS did not differ from the draft RTS in terms of the IRS that will be subject to the EMIR mandatory clearing obligation, which include the following classes of IRS that must settle in a single settlement currency in either EUR, GBP or USD:

- basis swaps and fixed-to-float IRS, referencing either EURIBOR or LIBOR, with a maturity of 28 days to 50 years (this category includes instruments settling in Japanese yen);
- forward rate agreements (FRAs), referencing either EURIBOR or LIBOR, with a maturity of three days to three years; and
- overnight index swaps (OIS), referencing the Euro OverNight Index Average, FedFunds or the Sterling OverNight Index Average, with a maturity of seven days to three years.

The final RTS for IRS did modify the number of market participant counterparty categories subject to the mandatory EMIR IRS clearing obligation from three to four and altered the definitions slightly. These four categories and the applicable compliance dates are:

- Category 1 – clearing members of a recognized or authorized CCP - six months after the RTS are entered into force, estimated to be August 2015;
- Category 2 – financial counterparties (as defined under EMIR) and alternative investment funds (AIFs) (as defined under the Alternative Investment Fund Managers Directive) that are non-financial counterparties above the clearing threshold (as defined under EMIR) - 12 months after the RTS are entered into force, estimated to be February 2016;
- Category 3 – financial counterparties (as defined under EMIR) and other AIFs with a low level of activity in uncleared derivatives - 18 months after the RTS are entered into force, estimated to be August 2016; and
- Category 4 – non-financial counterparties (as defined in EMIR) - three years after the RTS are entered into force, estimated to be February 2018.

The European Commission (EC) now has up to three months to endorse the final IRS RTS. If the EC has no objection, the RTS will come into force 20 days after its publication in the *Official Journal of the European Union*.

The ESMA consultation paper on draft RTS for FX NDF can be found here. The ESMA final RTS for IRS can be found here. Details of the CFTC's GMAC meeting can be found here.

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