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## SEC/CORPORATE

### SEC Amends the Definition of "Smaller Reporting Company"

On June 28, the Securities and Exchange Commission announced that it adopted amendments to the definition of "smaller reporting company," which will allow more companies to take advantage of accommodations such as scaled disclosure. The amendments were adopted generally as proposed on June 27, 2016, with a few significant changes. The proposed amendments were previously covered in the July 8, 2016 edition of the *Corporate & Financial Weekly Digest*.

The amended smaller reporting company definition:

- increases the public float threshold from $75 million to $250 million;
- increases the annual revenues threshold from $50 million to $100 million for companies with no public float; and
- provides that the annual revenues threshold will now apply to companies with less than a $700 million public float (rather than only to companies with no public float, as provided prior to the amendments).

The determination of whether a company qualifies as a smaller reporting company occurs in connection with the filing of its initial registration statement and annually, based upon the company's public float as of the last business day of the company's most recently completed second fiscal quarter. Consistent with the definition of a smaller reporting company before the amendments, a company that does not qualify as a smaller reporting company (either at the time of its initial registration or its annual determination) under the initial qualification thresholds will remain unqualified until it meets one of the lower qualification thresholds. Pursuant to the amendments, however, the lower qualification thresholds were amended and set at 80% of the amended initial public float and revenues thresholds. For example, a company that does not initially qualify because its public float exceeds the $250 million threshold would subsequently qualify if it has a public float of less than $200 million as of the subsequent measurement date. Once qualified, that company would then remain a smaller reporting company until its public float exceeds $250 million as of a subsequent measurement date.

In order to preserve the existing thresholds for "accelerated filers" and "large accelerated filers," the definitions of these terms were amended so that qualifying as a smaller reporting company no longer automatically results in the company being regarded as a non-accelerated filer. Thus, as a consequence of the increased smaller reporting company definition thresholds, some smaller reporting companies also may qualify as accelerated filers or, under very limited circumstances, large accelerated filers.

As highlighted in the SEC's announcement, the final rules do not change the accelerated filer or large accelerated filer thresholds. Accordingly, a smaller reporting company with a public float of $75 million or greater will continue to be subject to the accelerated filer requirements, such as providing an auditor's attestation report on internal control over financial reporting and applicable deadlines for filing of periodic reports. The SEC noted, however, that at the direction of SEC Chairman Jay Clayton, the Commission staff has begun formulating recommendations for amendments to the accelerated filer definition to reduce the number of companies that would qualify as accelerated filers in order to promote capital formation and reduce compliance costs for those companies while maintaining investor protections.

In addition to the amendments to the smaller reporting company definition, the SEC also amended Rule 3-05 of Regulation S-X in order to maintain the alignment between Rule 3-05 and the definition of smaller reporting company. Under Rule 3-05, where a business that is acquired or to be acquired is significant at the 50% level (i.e., any of the significant subsidiary tests for the acquired business exceed 50%), the registrant is generally required to file three years of historical financial statements of such business that is acquired or to be acquired. However, financial statements for the earliest of the three fiscal years may be omitted if the net revenues of the business acquired or to be acquired are less than $100 million (as compared to $50 million prior to the amendments).

The final rules will go into effect on September 10.

The SEC's final rule is available here.

The SEC's press release is available here.

### SEC Approves Amendment to Rule 701 and Issues a Concept Release Regarding Form S-8 and Rule 701

As previously reported in the *Corporate & Financial Weekly Digest* edition of June 1, 2018, on May 24, President Trump signed into law the Economic Growth, Regulatory Relief and Consumer Protection Act (the Act), Section 507 of which directs the Securities and Exchange Commission to adopt an amendment to Rule 701 under the Securities Act of 1933. Rule 701 generally provides an exemption from the registration requirement imposed by the Securities Act for issuances of securities by a company that is not subject to the reporting requirements of the Securities Exchange Act of 1934 to its employees, directors and consultants under compensatory benefit plans. Pursuant to Section (e) of Rule 701, if the aggregate sales price or amount of securities sold by an issuer to investors in reliance on Rule 701 during any 12-month period exceeds $5 million, the issuer is required to deliver to investors an additional disclosure, including specified financial statements and risk factors. On July 18, consistent with the mandate under the Act, the SEC issued a final rule amending Section (e) of Rule 701 to increase the threshold for providing enhanced disclosure from $5 million to $10 million (subject to inflation adjustment every five years).

Also on July 18, the SEC issued a concept release, seeking public comment on ways to modernize Rule 701 and Form S-8 (which is the registration statement for compensatory offerings by reporting companies). In issuing the release, the SEC staff noted the significant evolution in both types of compensatory offerings and the composition of the workforce since the SEC last substantively amended its rules related to compensatory arrangements in 1999.

The full text of the release is available here.

The full text of a press release issued by the SEC regarding the Release and the amendment to Rule 701(e) is available here.

## BROKER-DEALER

### SEC Adopts New Form ATS-N and Amendments to Regulation ATS and Exchange Act Rule 3a1-1 to Enhance Transparency and Oversight of Alternative Trading Systems

On July 18, the Securities and Exchange Commission adopted new Form ATS-N and amendments to Regulation ATS and Exchange Act Rule 3a1-1. The new requirements are designed to enhance transparency of alternative trading systems (ATSs) that trade stocks listed on a national securities exchange (NMS Stock ATSs) by requiring them to publicly disclose detailed information about their operations, including order types and market data used on the ATS, fees, the ATS's execution and priority procedures, and any procedures to segment orders on the ATS.

Form ATS-N will require an NMS Stock ATS to disclose information regarding: (1) its broker-dealer operator (including identifying information and ownership); (2) ATS-related activities of its broker-dealer operator (including trading activities of the broker-dealer operator and its affiliates on the ATS, whether subscribers to the ATS can opt out of interacting with orders and trading interest of the broker-dealer operator and its affiliates, arrangements between the broker dealer operator and trading centers to access the ATS services, activities of service providers to the broker dealer operator, and safeguards and procedures established to protect the confidential trading

information of subscribers); and (3) the manner of operations of the NMS Stock ATS (including the means of entry for orders and trading interests, trading services, facilities, and rules of the ATS, display of orders and other trading interests, procedures for stopping or suspending trading, fees, counter-party selection, procedures regarding trade reporting, clearance and settlement, and sources, and uses of market data).

The SEC will make public an NMS Stock ATS's Form ATS-N, and any amendments thereto, when it becomes effective through the SEC's Electronic Data Gathering, Analysis and Retrieval (EDGAR) system. Additionally, each NMS Stock ATS will be required to include a direct URL hyperlink on its website linking to where such NMS Stock ATS's documents are located on the SEC's website. An NMS Stock ATS will be required to file material amendments to its Form ATS-N 30 calendar days prior to the implementation of the change.

Finally, the amendments will require all ATSs to have, maintain and adhere to written safeguards and procedures to protect the confidential trading information of their subscribers.

The amendments will become effective 60 days from the date they are published in the *Federal Register* and an entity seeking to operate as an NMS Stock ATS will be required to file a Form ATS-N effective as of January 7, 2019.

More information is available here.

## DERIVATIVES

*See "CFTC Permits DCOs to Invest Customer Funds in European Sovereign Debt" in the CFTC section.*

## CFTC

### CFTC Permits DCOs to Invest Customer Funds in European Sovereign Debt

The Commodity Futures Trading Commission has issued an order granting limited relief from the provisions of CFTC Rule 1.25 that will allow derivatives clearing organizations (DCOs) to invest euro-denominated futures and cleared swap customer funds in euro-denominated sovereign debt issued by France and Germany. Among other requirements, the order provides that the dollar-weighted average of the time-to-maturity of a DCO's portfolio of investments in each sovereign's debt must not exceed 60 days. In addition, any direct investment in foreign sovereign debt must have a remaining maturity of 180 days or less.

The order further permits DCOs to use customer funds to enter into repurchase agreements with foreign banks and foreign securities broker-dealers for euro-denominated sovereign debt issued by France and Germany. DCOs also may hold the sovereign debt purchased under a repurchase agreement in a safekeeping account at a foreign bank.

The CFTC issued the order in response to a petition from ICE Clear Credit, ICE Clear US and ICE Clear Europe.

The CFTC's order is available here.

### Regulators Publish Changes to the Volcker Rule

On July 17, the *Federal Register* published proposed changes to the Volcker Rule that were jointly approved by the Federal Reserve Board, the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Securities and Exchange Commission. As described in greater detail in the June 1, 2018 edition of the *Corporate & Financial Weekly Digest*, the proposed changes are intended to eliminate or modify requirements that the regulatory agencies believe are not necessary to effectively implement the statute without diminishing the safety and soundness of the entities subject to the Volcker Rule.

Comments on the proposed changes must be made by September 17.

The *Federal Register* publication is available here.

### CFTC Issues Customer Advisory on Digital Coins and Tokens

The Commodity Futures Trading Commission has issued an advisory warning customers of the dangers of purchasing digital coins or tokens. Among other things, the advisory warns customers that buying digital coins or tokens for speculative purposes carries significant risk and identifies various factors that could affect the current or longer-term value of a digital coin or token, including:

- forks in the public ledger or other related application;
- changes in mining or validation costs;
- acceptance of other methods of payment in place of the digital coin or token;
- changes to the relationship between the value of a digital coin or token and the offered product or service;
- broad acceptance of the digital coin or token as a medium of exchange or store of value;
- competitors or technological changes;
- changes in demand for the underlying network or platform associated with the digital coin or token;
- market liquidity; and
- hacking theft.

The advisory also notes that fraud is another significant risk to consider. Potential customers should better protect themselves by conducting extensive due diligence on the digital coins or tokens, including asking whether the digital coins or tokens are securities and whether the offering is registered with the Securities and Exchange Commission.

The CFTC advisory is available here.

## DIGITAL ASSETS AND VIRTUAL CURRENCIES

*See "CFTC Issues Customer Advisory on Digital Coins and Tokens" in the CFTC section.*

### FSB Publishes Report on Cryptoassets

On July 16, the Financial Stability Board (FSB) published a report on the work of the FSB and standard setting bodies on cryptoassets. The report was delivered to the G20 Finance Ministers and Central Bank Governors ahead of their meeting on July 21 – 22.

The standard setting bodies, whose work is summarized in the FSB's report, are: (1) the FSB itself; (2) the Committee on Payments and Market Infrastructures (CPMI); (3) the International Organization of Securities Commissions (IOSCO); and (4) the Basel Committee on Banking Supervision (BCBS). In relation to each body, the report includes the following:

- FSB—While agreeing that cryptoassets "do not pose a "material risk to global financial stability at this time," the FSB, in collaboration with the CPMI, has developed a framework to monitor the speed of changes in this area and data gaps. The FSB will continue to seek to improve this framework.
- CPMI—The CPMI has published reports on digital currencies and distributed ledgers in previous years, and is continuing to monitor and analyze developments in those areas. Its work has focused on assessing the opportunities for increased efficiency and the possible loss of safety which are associated with these innovative technologies.
- IOSCO—In January 2018, IOSCO issued a communication (available here) raising its concern with initial coin offerings (ICOs). In May 2018, its board agreed to develop a support framework, which is still in progress, to enable its members to identify regulatory risks relating to ICOs and the offering of ICOs in various jurisdictions. It is considering various examinations with respect to cryptoasset platforms (more commonly, "crypto-exchanges"), and also established an ICO consultation network.

- BCBS—The BCBS's work falls into three categories: (1) quantifying the materiality of banks' direct and indirect cryptoasset exposures; (2) clarifying the prudential treatment of banks' cryptoassets exposures; and (3) monitoring developments related to cryptoassets/technology-enabled innovation in financial services and assessing the implications for banks and supervisors.

The report confirms that the Financial Action Task Force (FATF) will report separately to the G20 on FATF's work regarding cryptoasset money laundering and terrorist financing risks.

The FSB's report is available here, with the accompanying press release available here.

## INVESTMENT COMPANIES AND INVESTMENT ADVISERS

### OCIE Issues Risk Alert on Compliance Issues Related to Best Execution by Investment Advisers

On July 11, the Office of Compliance Inspections and Examinations (OCIE) of the Securities and Exchange Commission issued a Risk Alert to provide investment advisers and other market participants with information concerning many of the most common deficiencies that OCIE staff has found in recent examinations of investment advisers' compliance with their best execution obligations under the Investment Advisers Act of 1940 (the Advisers Act). The Advisers Act best execution obligation requires an investment adviser to execute securities transactions for clients in such a manner that the client's total costs, or proceeds in each transaction, are the most favorable under the circumstances taking into consideration the full range and quality of a broker-dealer's services including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to the investment adviser. Furthermore, an investment adviser should periodically evaluate the execution quality of broker-dealers executing their clients' transactions.

In evaluating best execution, an investment adviser who is in receipt of brokerage and research services ("soft dollar arrangements") covered by Section 28(e) of the Securities Exchange Act of 1934 ("Section 28(e) Safe Harbor") may pay more than the lowest commission rate to receive such brokerage and research without breaching its best execution obligation. However, if an investment adviser receives products or services that are used for both eligible Section 28(e) brokerage and research and other functions ("mixed use") the adviser must make a reasonable allocation of the costs of the products or services according to their use. Specifically, to be able to rely on the 28(e) Safe Harbor with respect to mixed-use items, the investment adviser may pay for the portions of the product or service used for Section 28(e) eligible brokerage and research with commission dollars while the portions of the product or service used for other purposes must be paid for by the investment adviser from its own assets. Furthermore, the investment adviser must maintain adequate books and records regarding such allocations.

The Risk Alert provided the following examples of the most common deficiencies observed by the OCIE staff associated with investment advisers' best execution obligations:

- **Not performing best execution reviews.** Certain investment advisers could not demonstrate that they periodically and systematically evaluated the execution performance of broker-dealers used to execute client transactions.
- **Not considering materially relevant factors during best execution reviews.** Certain investment advisers did not consider the full range and quality of a broker-dealer's services in directing brokerage, including evaluating qualitative factors relating to a broker-dealer or not soliciting and reviewing input from the investment adviser's traders and portfolio managers during the review.
- **Not seeking comparisons from other broker-dealers.** Certain investment advisers utilized certain broker-dealers without seeking out or considering the quality and costs of services available from other broker-dealers.
- **Not fully disclosing best execution practices.** Certain investment advisers did not provide full disclosure of best execution practices. For example, certain investment advisers did not disclose that certain types of client accounts may trade the same securities after other client accounts or the potential impact of this practice on execution prices.

- **Not disclosing soft dollar arrangements.** Certain investment advisers did not appear to provide full and fair disclosure in Form ADV of their soft dollar arrangements. Examples of inadequate disclosures included: improperly disclosing the use of soft dollar arrangements, not disclosing that certain clients may bear more of the cost of soft dollar arrangements, and not disclosing that certain products and services acquired by soft dollars were not eligible under Section 28(e) of the Securities Exchange Act of 1934.
- **Not properly administering mixed use allocations.** Certain investment advisers did not appear to make a reasonable allocation of the cost of a mixed use product or service or did not produce support of the rationale for mixed use allocations.
- **Inadequate policies and procedures relating to best execution. / Not following best execution policies and procedures.** Certain investment advisers did not appear to have adequate compliance policies and procedures or internal controls regarding best execution. Alternatively, certain investment advisers did not follow their policies and procedures regarding best execution. Examples of policies not followed included best execution review policies and soft dollar expense allocations policies, and ongoing monitoring policies.

The Risk Alert is available here.

## BREXIT/UK DEVELOPMENTS

*See "FSB Publishes Report on Cryptoassets" in the Digital Assets and Virtual Currencies section.*

### Draft Financial Regulators' Powers Regulations 2018 Published

On July 16, a draft of the Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 was published. The publication of the draft regulations follows the making of the first delegated legislation under the European Union (Withdrawal) Act 2018 earlier this month (discussed in the *Corporate & Financial Weekly Digest* edition of July 13, 2018) and provides one of the first indications of the UK approach to "onshoring" EU legislation as part of the United Kingdom's withdrawal from the European Union (Brexit).

The draft regulations grant certain UK authorities (the Financial Conduct Authority, the Prudential Regulation Authority, the Bank of England and the Payment Systems Regulator) powers to make and amend binding technical standards (BTS) in relation to EU laws which will be retained in UK law after Brexit. At present, the European supervisory authorities (e.g., the European Securities and Markets Authority) are responsible for drafting BTS. However, the European supervisory authorities' functions will no longer cover the United Kingdom after Brexit, when existing BTS will become part of UK law. The draft regulations also provide the UK financial regulators with the ability to correct deficiencies which may arise.

The schedules to the draft regulations set out specific EU legislation in relation to which each regulator is considered the "appropriate regulator." In certain circumstances, where under the draft regulations two regulators are deemed the "appropriate regulator," each regulator must consult with, or obtain consent from, the other such regulator before amending the relevant retained EU regulation.

The draft regulations are available here, with accompanying explanatory memorandum here.

## BREXIT/EU DEVELOPMENTS

### ESMA Updates Benchmarks Regulation Q&As

On July 17, the European Securities and Markets Authority (ESMA) updated its Q&As on the EU Benchmarks Regulation (BMR). The Q&As aim to promote common supervisory approaches and practices in the day-to-day application of the BMR.

The update to the Q&As on the BMR clarifies:

1. when a calculation agent is considered a user of benchmarks if it is appointed by an issuer of securities; and

2. whether a benchmark can qualify as a "regulated-data benchmark" if a third party is involved in the process of obtaining the data.

ESMA's prior update to the Q&As on the BMR was released in March 2018 and further details of that update can be found in the *Corporate & Financial Weekly Digest* edition of March 30, 2018.

The updated Q&As on the BMR are available here.

### EU Prospectus Regulation: ESMA Consults on Minimum Information Content for Exemption and Guidelines on Risk Factors and Publishes Final Report on RTS

On July 13, the European Securities and Markets Authority (ESMA) published a press release announcing two consultations with respect to the new EU Prospectus Regulation.

The first consultation paper contains draft technical advice on the minimum content for the information that must be made available to investors when applying for a certain exemption from the requirement to produce a prospectus. The second consultation paper includes draft guidelines on the risk factors featured in a prospectus. While the guidelines are addressed to national competent authorities, the guidelines indicate that financial market participants should take them into account when preparing prospectuses.

ESMA previously published technical advice regarding, among other items, the format and content requirements for a prospectus and the EU growth prospectus under the Prospectus Regulation in April 2018 (for more information, see the *Corporate & Financial Weekly Digest* edition of April 6, 2018).

The consultations close on October 5 and, according to ESMA's press release, it will publish final reports following the consultations by March 31, 2019.

On July 17, ESMA issued a final report with draft regulatory technical standards (RTS) with respect to the Prospectus Regulation. Key areas that the RTS cover are:

1. key financial information to be disclosed for the prospectus summary;
2. advertisements to retail investors;
3. the requirement to publish one or more supplements to a prospectus; and
4. arrangements for the notification portal used for passporting prospectuses.

The RTS are now with the European Commission for endorsement.

ESMA's press release announcing the launch of the two consultations is available here.

The consultation paper on the draft technical advice is available here, and the consultation paper on the draft guidelines on risk factors is available here.

The final report with draft RTS can be read here, with the accompanying press release here.

### Eight EU Member States Publish Joint Statement on the Capital Markets Union Post Brexit

On July 18, eight of the EU member states (Denmark, Estonia, Finland, Ireland, Latvia, Lithuania, Sweden, and The Netherlands) published a joint statement on the Capital Markets Union (CMU) after Brexit. The joint statement sets out the shared views of the member states' finance ministers and urges the European Union to use Brexit as a catalyst in the further development and integration of EU capital markets.

According to the joint statement, the following are priorities in the development of the CMU:

1. setting an ambitious target and prioritizing resources to attain the greatest impact, including carrying out a review of investments firms to implement "more proportionate regulatory regime for investment firms," a proposed framework for covered bonds and proposals surrounding sustainable investments;

2. fostering technology-enabled innovation in financial services;
3. an effective supervisory framework—the joint statement emphasizes that the review of the European supervisory authorities (ESA) should be ultimately focused on supervisory convergence across the European Union, but that progress towards the CMU should be independent of the ESA review; and
4. national reforms which develop local capital markets (e.g., by diversifying financing options).

The joint statement is available here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.


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SEC/CORPORATE

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BREXIT/UK/EU DEVELOPMENTS

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