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SEC/CORPORATE

Meeting of the SEC Advisory Committee on Small and Emerging Companies

The Securities and Exchange Commission's Advisory Committee on Small and Emerging Companies (Committee) met on June 3 to discuss various topics including (1) SEC rules with respect to intrastate crowdfunding; (2) the effectiveness of the current public company disclosure regime; (3) rules and market structure matters relevant to venture exchanges; and (4) the SEC's treatment of "finders" who facilitate capital raising for small companies. The Committee also provided a written recommendation to the SEC to formalize the so-called "Section 4(a)(1½)" exemption from registration under the Securities Act of 1933 (1933 Act).

Crowdfunding and Rule 147

In her opening remarks at the meeting, SEC Chair Mary Jo White emphasized her priority to complete the crowdfunding rulemaking required under the Jumpstart Our Business Startups Act (JOBS Act) this year. Chair White noted that more than 20 states have enacted some form of intrastate crowdfunding (i.e., crowdfunding solely within one state) legislation or rules. While there currently are safe harbors from 1933 Act registration applicable to intrastate crowdfunding, Chair White acknowledged that rules such as Rule 147 (which provides a safe harbor for offerings conducted solely within one state) and Rule 504 (which provides an exemption for sales of securities up to $1,000,000) could benefit from modernization. Indeed, with respect to Rule 147, Chair White remarked that "how an issuer might conduct an intrastate offering using the internet was not contemplated" at the time of adoption.

Regarding Rule 147 and the need for modernization, the Committee discussed the challenges issuers face in complying with Rule 147, including with respect to its "80 percent rule" (which requires that 80 percent of an issuer's (1) gross revenues be derived from, (2) assets be located in, and (3) net proceeds of the offering be used within, the issuer's state of operation). Michael Pieciak, who serves as the North American Securities Administrators Association observer on the Committee, noted that, with online based businesses and customers, it is increasingly difficult to abide by Rule 147, and even to make the necessary calculations. The Committee adopted a recommendation that the SEC modernize Rule 147.

Public Company Disclosure Effectiveness

The Committee discussed the SEC's "Disclosure Effectiveness" agenda. Karen Garnett, associate director of the SEC's Division of Corporation Finance (Division), noted that the Division is focused on three main areas of improvement: (1) Regulation S-K, (2) Regulation S-X and (3) the manner in which companies provide information, including EDGAR. Ms. Garnett highlighted a speech given by the Division's director, Keith Higgins, that provides background on the SEC's Disclosure Effectiveness agenda, which was previously discussed in the *Corporate and Financial Weekly Digest edition of October 10, 2014*.

The Committee heard from various industry members with respect to the disclosure regime. Common concerns of those present included the cost and volume (and value of certain disclosure requirements) of the current disclosure regime, particularly for smaller companies. Redundancy within the disclosure regime was also

discussed. While Ms. Garnett expressed the SEC's understanding and concern for the cost burdens of the disclosure regime on registrants, she emphasized the need to balance those concerns with the Division's commitment to the continued improvement of information available to investors.

Rules and Market Structure Matters Relevant to Venture Exchanges

The Committee continued the discussion from its March 4, 2015 meeting on secondary market trading, particularly through venture exchanges (see the *Corporate and Financial Weekly Digest edition of March 6, 2015*). David Shillman, the associate director of the SEC's Division of Trading & Markets, noted in his remarks that the real issue with venture exchanges is the difficulty in creating a viable market, largely because of the difficulty in attracting liquidity providers to the market. Shillman indicated the ongoing challenge for the SEC with respect to venture exchanges will be to create rules and trading venues that attract liquidity providers (e.g., by restricting competition among venues in order to promote and aggregate liquidity in small-cap securities) without reducing competition to the point that there is a risk for abuse by liquidity providers with monopoly power within the exchanges.

SEC's Treatment of "Finders"

The Committee also discussed issues with respect to finders—those individuals who connect businesses with capital, for a fee, but do not register as broker-dealers. Gregory C. Yadley, a member of the Committee, noted that the underlying issue is that small and growing companies are in constant need of raising capital (and in need of assistance in being connected with sources of capital), but many fully registered broker-dealers are uninterested in assisting with micro and small offerings. Yadley noted that finders could fill that gap, but under the current disclosure regime, the finders would be operating in violation of federal and state securities laws. Yadley further noted that the SEC has taken meaningful action to address the issue of unregistered intermediaries in private company mergers and acquisitions transactions. Specifically, in a 2014 "No-Action" letter the SEC specified that it would not recommend enforcement action if an "M&A Broker" engages in certain activities in connection with the purchase or sale of privately held companies without registering as a broker-dealer (see the *Corporate and Financial Weekly Digest* edition of February 7, 2014). There appeared to be general agreement of the Committee members that the SEC should also take action to legitimize finders in the capital raising context, through some combination of exemptions and rules, but the Committee decided to table any formal recommendation until they could review the issue further.

Recommendation to Formalize Rule 4(a)(1½)

The Committee recommended that the SEC formalize the 'Section 4(a)(1½)' exemption to mimic existing opinion practice for resales of privately-issued securities by shareholders who are not able to rely on Securities Act Rule 144. In making its recommendation, the Committee noted that there are many situations in which selling shareholders are unable to rely on the Rule 144 safe harbor (which allows selling shareholders to sell privately-issued securities subject to the conditions of the rule). When the conditions of Rule 144 are not met, shareholders often rely on the so-called Section 4(a)(1½) exemption, which is not currently codified in law or formalized under SEC rules (but rather has developed through case law and legal opinion practice). The Section 4(a)(1½) exemption incorporates elements of the exemptions available under Securities Act Section 4(a)(1) for persons other than an issuer, underwriter or dealer, and Section 4(a)(2) for transactions by an issuer not involved in a public offering. The Committee recommended that the SEC formalize the Section 4(a)(1½) exemption under SEC rules.

The video of the meeting in its entirety can be found on the Committee's website.

BROKER-DEALER

FINRA Requests Comment on a Proposed Rule to Require Delivery of an Educational Communication to Customers of a Transferring Representative

The Financial Industry Regulatory Authority recently issued Regulatory Notice 15-19 to solicit comments on a proposed rule that would require member firms that hire or associate with a registered representative (recruiting firm) to provide educational communications to (1) former retail customers of the transferring representative who

the member firm, directly or through the transferring representative, tries to induce to transfer assets to the recruiting firm or (2) former retail customers who choose to transfer assets to the recruiting firm. FINRA is concerned that retail customers are not cognizant of all relevant factors to consider in making informed decisions regarding whether to transfer assets to their registered representative's new firm.

The educational communication would need to highlight the possible implications resulting from the transfer of assets to the recruiting firm and also suggest questions the customer may want to ask in making an informed decision. The suggestions that the educational communication would highlight include whether financial incentives received by the representative may create a conflict of interest and the potential costs related to the transfer of assets.

The comment period expires on July 13.

Click here for Regulatory Notice 15-19.

DERIVATIVES

See "CFTC Issues Relief From IB and CTA Registration to Foreign Persons Dealing in Swaps for International Financial Institutions" in the CFTC section.

CFTC

CFTC Issues Relief From IB and CTA Registration to Foreign Persons Dealing in Swaps for International Financial Institutions

On June 4, the Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) issued no-action relief from introducing broker (IB) and commodity trading advisor (CTA) registration to persons located outside the United States engaged in swaps activities for specified supranational banks and development organizations, such as the International Monetary Fund and the International Bank for Reconstruction and Development (World Bank), that have offices in the United States (international financial institutions or IFIs).

The unidentified parties who sought no-action relief explained that they act as underwriters with respect to non-US offerings of structured notes issued by certain IFIs; that the IFIs generally enter into swaps to hedge the risk of their exposure under the structured notes; and that the underwriters or their non-US affiliates may facilitate (and sometimes advise on) an appropriate swap with the IFI's preferred swap counterparty (or counterparties). Noting that the CFTC and the staff had previously granted certain exemptions to IFIs in connection with foreign futures and options transactions and swap dealing activities, DSIO granted relief from registration as an IB to persons located outside the United States solely with regard to activities involving swaps for a customer that is an IFI and as a CTA in connection with providing advice solely incidental to those activities.

Relief will expire on the date that is the later of (1) the effective date and (2) the compliance date of any final rule or CFTC order providing relief from IB and CTA registration for foreign persons who facilitate swap transactions for IFIs that have offices in the United States.

CFTC Letter No. 15-37 is available here.

LITIGATION

District Court Dismisses Data Breach Class Action Against GameStop, Inc.

The US District Court for the District of Minnesota recently dismissed a data breach class action against GameStop, Inc. and Sunrise Publications, Inc. (d/b/a Game Informer) for lack of constitutional standing because the named plaintiff did not allege injury in fact.

Plaintiff Matthew Carlsen purchased a one-year digital subscription to Game Informer Magazine, a video game magazine published and owned by GameStop. The plaintiff alleged that the defendants shared personally identifiable information (his unique Facebook ID and Game Informer browsing history) with Facebook in violation of Game Informer's privacy policy. That policy states that "Game Informer does not share personal information with anyone."

To establish standing, the plaintiff argued two theories of injury that had been used with varying degrees of success in other privacy policy cases. First, the plaintiff alleged an "overpayment theory"—that he paid for a service with substantial privacy protections but actually received a less valuable service without such protections. Second, the plaintiff alleged a "would not have shopped" theory – that he would not have purchased the subscription had he known his information would be shared with Facebook. The plaintiff did not allege that he suffered any monetary or out-of-pocket loss arising from the alleged breach of the privacy policy, or that Facebook did anything with the information obtained from the defendants.

The District Court dismissed the claim for lack of standing because neither theory of damages alleged an injury in fact capable of surviving a motion to dismiss. The District Court recognized that an "overpayment" theory is potentially viable in certain limited circumstances. The plaintiff's claim, however, failed because (1) he did not allege misuse of highly sensitive financial information such as credit card or social security data, and (2) he did not allege that he paid additional compensation for any privacy features (the same privacy policy applied to both paying and non-paying users).

The court rejected the plaintiff's "would not have shopped" theory of injury because the plaintiff could not plausibly allege that reasonable consumers would expect Game Informer to protect their Facebook ID and Game Informer browsing history while logged into Game Informer's website and Facebook at the same time.

Carlsen v. GameStop, Civil No. 14-3131 (D. Minn. June 4, 2015).

Fourth Circuit Affirms Conviction in Virginia Bank Fraud Case

The US Court of Appeals for the Fourth Circuit recently affirmed convictions for conspiracy to commit bank fraud and other related charges against three former executives of the Bank of the Commonwealth.

In 2008, the Bank of the Commonwealth, a community bank in southeastern Virginia, failed and ultimately caused the Federal Deposit Insurance Corporation to sustain approximately $333 million in losses as the bank's receiver. In December 2012, the bank's former executives were charged with a conspiracy to hide the bank's deteriorating financial condition. Following a 10-week trial involving more than 80 witnesses and 1,000 exhibits, the executives were convicted on multiple charges. Three executives appealed their convictions on various substantive and procedural grounds. Most prominently addressed was one appellant's claim that the District Court improperly limited his time on direct testimony.

The Fourth Circuit held that, although the District Court did eventually restrict the defendant's time on direct examination, the District Court granted multiple extensions after warning defense counsel about straying into irrelevant topics. The Fourth Circuit also emphasized that the appellant testified on direct examination for more than seven hours, which was the longest witness examination of the trial. Similarly, the court noted that the appellant was charged with fewer counts yet testified longer than each of his co-defendants. In light of the extensions, warnings, and greater amount of time available to present his case, the Fourth Circuit found that the District Court did not abuse its discretion in limiting the duration of the appellant's direct testimony.

United States v. Fields, Nos. 13-4711, 13-4818, 13-4863 (4th Cir. June 5, 2015).

BANKING

Six Federal Regulators Issue Final Interagency Policy Statement on Diversity Policies and Practices of Regulated Entities

On June 9, the Federal Reserve Board, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency and Securities and Exchange Commission issued a final joint policy statement on diversity practices with respect to women and

minorities. Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires that each such agency establish an Office of Minority and Women Inclusion (OMWI) to be responsible for all matters relating to diversity in management, employment and business activities. The statute also instructs each OMWI director to develop standards for assessing the diversity policies and practices of the agencies' regulated entities. The final policy statement replicates many features of the 2013 proposed policy statement, and details steps for banks to improve diversity practices, including workforce management, and hiring and procurement, with respect to women and minorities. The statement further calls for institutions to be committed to diversity, and includes reporting standards and other ways for institutions to be transparent about their diversity policies.

To clarify whether the regulation is legally binding, the agencies added the following language to the final policy statement: "This document is a general statement of policy under the Administrative Procedure Act, 5 U.S.C. 553. It does not create new legal obligations. Use of the standards by a regulated entity is voluntary." The agencies also defined the term "minority" as follows: Black Americans, Native Americans, Hispanic Americans and Asian Americans." However, the agencies also stated that the minority (as defined) "does not preclude an entity from using a broader definition with regard to these standards." In this respect, the agencies stated that this language is intended to be sufficiently flexible to encompass other groups if an entity wants to define the term more broadly. For example, a broader definition may include the categories referenced by the Equal Employment Opportunity Commission (EEOC) in its Employer Information Report EEO-1 and EEO-4, as well as individuals with disabilities, veterans and LGBT individuals.

Additionally, the agencies also agree that the concept of inclusion is important to cover in these standards because current leading practices advocate an inclusive culture as essential in the support of diversity and inclusion programs. Therefore, the final policy statement defines "inclusion" to mean a process to create and maintain a positive work environment that values individual similarities and differences, so that all can reach their potential and maximize their contributions to an organization. Finally, the agencies addressed the concerns of some smaller institutions as follows:

> When drafting these standards, the agencies focused primarily on institutions with more than 100 employees. The agencies know that institutions that are small or located in remote areas face different challenges and have different options available to them compared to entities that are larger or located in more urban areas. The agencies encourage each entity to use these standards in a manner appropriate to its unique characteristics.

The specific subject headings addressed in the policy statement, along with the provision of standards to govern such headings, are as follows:

- Organizational Commitment to Diversity and Inclusion
- Workforce Profile and Employment Practices
- Procurement and Business Practices—Supplier Diversity
- Practices to Promote Transparency of Organizational Diversity and Inclusion
- Entities' Self-Assessment

Finally, the policy statement states the following with respect to use by the agencies of information:

> The Agencies may use information submitted to them to monitor progress and trends in the financial services industry with regard to diversity and inclusion in employment and contracting activities and to identify and highlight those policies and practices that have been successful. The primary federal financial regulator will share information with other agencies when appropriate to support coordination of efforts and to avoid duplication. The OMWI directors will also continue to reach out to regulated entities and other interested parties to discuss diversity and inclusion practices and methods of assessment. The Agencies may publish information disclosed to them, such as best practices, in any form that does not identify a particular entity or individual or disclose confidential business information.

Read more.

UK DEVELOPMENTS

British Bankers' Association Response to European Banking Authority Remuneration Consultation

On June 4, the British Bankers' Association (BBA) published its response to a consultation on remuneration guidelines previously published by the European Banking Authority (EBA) on March 4.

The draft guidelines published by the EBA complement the EBA's opinion and report on the application of the Capital Requirements Directive IV (CRD IV) remuneration principles for EU banks and investment firms (i.e., most EU-regulated financial institutions). The draft guidelines provide additional detail from the EBA in support of a cap on the payment of bonuses by such firms. One potentially significant aspect of the draft guidelines relates to the "proportionality principle," which allows EU regulators to follow a purposive interpretation of CRD IV rules and allows smaller firms not to have to comply with bonus deferral requirements and rules relating to the payment of bonuses in securities (pay-out process rules). While the draft guidelines consider implementing specific exemptions for staff that receive only a low amount of variable remuneration (i.e., bonuses), there is a proposal that the proportionality principle could effectively be removed so as to apply the remuneration rules equally to all EU-regulated banks and investment firms, regardless of their size.

The BBA's response notes that the BBA is generally supportive of the EBA's revisions to the guidelines—as this will help to ensure a consistent approach to the implementation of the CRD IV requirements across the European Union. However, the BBA response emphasizes significant concerns over the proposal to remove the proportionality principle—since this will have a significant and disproportionate impact on smaller firms.

The EBA consultation closed on June 4 and the EBA is now considering all the responses received; new remuneration guidelines will be published in the coming months and it is anticipated that EU regulators will implement the guidelines by the end of 2015 so that EU-regulated banks and investment firms will then apply the new remuneration rules to the 2016 performance year and thereafter. (Any EU regulator that elects not to apply the guidelines from the EBA must formally explain to the EBA and other EU authorities why they are not applying the guidelines in their jurisdiction. In the event that the EBA does decide to remove the proportionality requirement and the guidelines ultimately recommend that all firms should comply with the pay-out process rules, it is likely that the Financial Conduct Authority (FCA) will elect not to apply the guidelines in the United Kingdom since, to date, the FCA has taken great care to ensure that CRD IV remuneration rules are proportionate to the scale, nature and complexity of investment firms' business in the United Kingdom).

The EBA consultation is available here.

The BBA response is available online here.

UK Authorities Publish Fair and Effective Markets Review Final Report

In June 2014, the Bank of England, H.M. Treasury and Financial Conduct Authority (UK Authorities) launched their Fair and Effective Markets Review process with the goal of identifying measures to restore confidence in the wholesale fixed income, currency and commodities (FICC) markets. The consultation process focused on addressing four central issues: (1) identifying what "fair" and "effective" mean for the FICC markets; (2) identifying areas in which the FICC markets have failed to meet these "fair" and "effective" standards; (3) determining whether existing reform processes are sufficient to address these shortcomings; and (4) establishing a program for addressing any gaps that remain.

Following an extensive consultation process, which included more than 200 meetings, round table discussions in Washington, DC, Brussels, London, New York and Singapore, and more than 1,000 pages of written commentary, the UK Authorities published their final report (Final Report) on June 10. The Final Report sets out an assessment of the reasons for the recent misconduct and perceived unfairness in the FICC markets, evaluates the progress made in existing regulatory reform efforts to address these issues and sets out a series of recommendations for additional reforms. Specifically, the Final Report recommends that the following steps be taken in the near-term: (1) make individuals active in the FICC markets more accountable for their actions; (2) require greater collective

responsibility among firms active in the FICC markets to develop, and adhere to, certain behavioral standards through the elaboration of a new "FICC Market Standards Board;" (3) impose greater regulatory requirements on FICC market participants, including greater sanctions for misconduct and greater accountability of senior management; and (4) promote cross-border collaboration in developing a set of global standards for the FICC markets. The Final Report also makes two recommendations to guide future oversight of the FICC markets: (1) to promote fairer FICC market structures while enhancing effectiveness; and (2) to ensure a more forward-looking approach to identify and mitigate risks.

In particular, the UK Authorities note the need for greater international collaboration in order to ensure the ongoing effectiveness of the recommendations in the Final Report, and have undertaken an effort to provide a report on the process of implementing their recommendations by June 2016.

A copy of the Final Report can be found here.

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