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CORPORATE & FINANCIAL
WEEKLY DIGEST

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CFTC

NFA Notifies Members of Chief Compliance Officer Requirements for Certain FCMs

The National Futures Association (NFA) has reminded its members that new Chief Compliance Officer (CCO) requirements affecting all Futures Commission Merchants (FCMs) currently regulated by a US prudential regulator or in some capacity registered with the Securities and Exchange Commission take effect on October 1. In accordance with Commodity Futures Trading Commission Regulation 3.3, each affected FCM must designate a CCO and list that person as principal of the firm by October 1. An FCM must file a CFTC Form 8-R and a fingerprint card on behalf of the designated CCO unless the CCO is currently a principal. The FCM must also update the CCO Contact Information Section on the FCM's CFTC Form 7-R. All forms must be completed through NFA's Online Registration System.

Each affected FCM's CCO must also file a CCO Annual Report as of the date of the FCM's first fiscal year end after October 1, covering the period from October 1, 2012 through the date of the fiscal year end. The CCO Annual Report must be submitted electronically to the CFTC no later than 90 days following the fiscal year end.

More information is available here.

NFA to Publicly Display FCM Financial Data Online

The National Futures Association (NFA) has announced that beginning November 1, it will made available on NFA's BASIC online system three separate Futures Commission Merchants (FCM) financial reports. The FCM Capital Report will report the most recent month's adjusted net capital, required net capital, and excess net capital. The FCM Customer Segregated Funds Report will report information with respect to funds held in customer segregated accounts. Similarly, the FCM Customer Secured Amount Funds Report will report information relating to customer secured amount funds.

More information is available here.

CME Issues Guidance on Manual/Automated Trading Indicator

Chicago Mercantile Exchange Group (CME Group) issued an advisory notice on an upcoming rule change that will codify the requirement that every CME Globex order identify whether it was entered by manual or automated means. A manual order is an order entered directly by an individual into a front-end system and which is routed in its entirety to Globex at the time of submission. An automated order is an order that is generated and/or routed to Globex without human intervention. The advisory clarifies that an Automated Trading System team may not use its TAG 50 to enter manual orders. All manually entered orders must identify the Tag 50 of the specific person who entered the order.

The rule is effective October 8, 2012, pending all regulatory review periods.

More information is available here.

LITIGATION

District Court Considers Whether Officer May Be Individually Liable for Company's Debt

The US District Court for the Southern District of Indiana recently held that a lender adequately alleged facts sufficient to hold a corporate executive personally liable for the repayment of a corporate loan.

Plaintiff Michael Mathioudakis brought a breach of contract action against defendants Conversational Computing Corporation (CCC) and its founder and Chief Executive Officer Stephen Rondel, alleging that CCC and Mr. Rondel failed to repay a short-term (30-day) $200,000 loan made to the company through an unsecured promissory note. Among other things, plaintiff alleged that in making the loan he relied on false representations by defendant Rondel regarding the existence of a pending new outside investment in CCC that, presumably, would help support CCC's financial condition.

Defendant Rondel moved to dismiss the complaint on the grounds that: (i) he signed the note as an officer for CCC and not in his individual or personal capacity; (ii) plaintiff did not allege fraud with specificity; and (iii) plaintiff failed to allege he "rightfully relied" upon the alleged false representations.

The District Court found that plaintiff adequately alleged two factors sufficient to justify piercing the corporate veil. First, plaintiff alleged that CCC could not meet payroll and thus was undercapitalized at the time defendant Rondel solicited the note. Second, according to the complaint, defendant Rondel induced the loan by falsely representing that CCC needed financing only in the short term because it had recently obtained a $1 million investment from a foreign citizen (and that the investment was delayed due to Patriot Act issues).

The court concluded that these allegations were sufficiently particularized for purposes of Section 9(b) of the Federal Rules of Civil Procedure and, if true, would be sufficient to pierce the corporate veil and hold defendant Rondel personally liable for the loan. Finally, the court held that the issue of whether plaintiff's reliance was reasonable could not be resolved at the pleading stage.

Mathioudakis v. Conversational Computing Corporation and Stephen Rondel, No. 1:12-cv-00558-JMS-DKL (S.D. Ind. Sept. 13, 2012).

District Court Dismisses Shareholder Class Action Suit for Securities Fraud

The US District Court for the Eastern District of Washington recently granted defendants' motion to dismiss plaintiffs' class action complaint for failure to satisfy the heightened pleading requirements of the Private Securities Litigation Reform Act (PSLRA).

Lead plaintiff, the City of Royal Oak Retirement System, brought this federal securities fraud class action pursuant to Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 on behalf of all persons who purchased or otherwise acquired Itron, Inc. (Itron) securities during the class period. Plaintiffs alleged that Itron overstated its net revenue for the three quarters ending September 30, 2010, by improperly (or prematurely) including revenue from an extended warranty contract.

Defendants moved to dismiss the complaint on the basis that plaintiff failed to allege particularized facts establishing a "strong inference" of scienter as required by the PSLRA. Plaintiffs argued, among other things, that: (i) Itron restated its financial statements for the three quarters at issue; (ii) the restatement was material in that it involved more than 5% of net revenue; (iii) the accounting rules at issue were not complex; (iv) that a substantial percentage of management's compensation was tied to net revenue; and (v) senior management signed Sarbanes-Oxley certifications attesting to the accuracy of the company's financial statements.

The court observed that the scienter requirement is satisfied where a complaint pleads facts showing that the defendant made the misstatement at issue intentionally or with deliberate recklessness. To satisfy the deliberate recklessness requirement, the facts alleged must show not simple or excusable negligence, but "an extreme departure from the standards of ordinary care."

The court found that the accounting error at issue was “barely above” the 5% “rule of thumb” for determining materiality, the case did not concern “a myriad” of accounting errors, and the restatement involved “premature” and not “fictitious” revenue. As a result, the court concluded, the more cogent and compelling inference was that the company “made a mistake” and was not acting with intent to deceive investors.

City of Royal Oak Retirement System v. Itron, Inc., No. CV-11-77-RMP (E.D. Wash. Sept. 11, 2012).

BANKING

OCC Issues Rule on Investments in Corporate Debt Securities, Applicable to Federal Savings Associations

On September 12, the Office of the Comptroller of the Currency (OCC) advised federal savings associations to review the Federal Deposit Insurance Corporation’s (FDIC) final rule and guidance issued on July 24 on investments in corporate debt securities. Federal savings associations have until January 1, 2013, to comply with the FDIC’s final rule. In addition, the OCC reminded federal savings associations they must comply by January 1, 2013 with the OCC’s final rules and guidance regarding investments in other securities, published on June 26.

The Dodd-Frank Wall Street Reform and Consumer Protection Act authorized the FDIC to issue a final rule to establish “standards of creditworthiness” to replace previously used “investment grade” standards for corporate debt security investments held or acquired by savings associations. The FDIC published its final rule July 24 in the *Federal Register* (77 FR 43151) and in FDIC Financial Institution Letter FIL-34-2012. The FDIC’s final rule amended 12 CFR 362 and was effective July 21, 2012. The FDIC, however, is allowing savings associations a transition period, ending January 1, 2013, to comply.

The FDIC’s standards of creditworthiness, requirement for consistency with safety and soundness principles, and due diligence guidance “are comparable and largely consistent with the OCC’s previously released final rules and guidance regarding securities investments.” On June 26, the OCC published OCC Bulletin 2012-18, “Alternatives to the Use of External Credit Ratings in the Regulations of the OCC: Final Rules and Guidance.” The bulletin informed federal savings associations that they are required to follow the FDIC’s standards of creditworthiness when purchasing corporate debt, pursuant to 12 USC 1831(e)(d), as amended by the Dodd–Frank Act, section 939(a)(2). The OCC expects federal savings associations to comply with the final rules by January 1, 2013.

Read more.

UK DEVELOPMENTS

HM Treasury Consults on FPC’s Macro-Prudential Tools

On September 18, HM Treasury published a consultation paper on the powers to be made available to the Financial Policy Committee (FPC) to perform its macro-prudential regulatory role within the Bank of England under the regulatory regime being introduced under the Financial Services Bill currently before Parliament. The FPC will monitor the financial system and identify and address systemic risks. The FPC will have macro-prudential powers designed to allow the FPC to mitigate risks to financial stability. It will have powers of recommendation and powers of direction to help achieve its objectives.

In addition to making recommendations to the successor regulators of the Financial Service Authority, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), it is proposed that the FPC will also be empowered to make recommendations:

- To HM Treasury, for example relating to HM Treasury’s powers to extend or modify the perimeter of regulation.
- Within the Bank of England, for example regarding the Bank’s regulation of systemically important financial infrastructure, such as payment and settlement systems.
- To other persons, for example directly to the industry or other regulated bodies.

Recommendations to the regulators can be made on a “comply or explain” basis, so that the regulators would be required to comply with the recommendation or explain to the FPC and the public why they are not doing so.

The comment period runs until December 11.

Read more.

EU DEVELOPMENTS

ESMA Consults on Guidelines on Remuneration Policies and Practices

On September 17, the European Securities and Markets Authority (ESMA) published a consultation paper on proposed guidelines on remuneration policies and practices under the Markets in Financial Instruments Directive (2004/39/EC) (MiFID).

The consultation sets out draft guidelines which aim to strengthen investor protection, in the context of existing MiFID rules on conflicts of interest and conduct of business policies relating to remuneration. They are mainly focused on sales activities and retail clients.

For the purpose of the guidelines, remuneration consists of all forms of payments or benefits, provided directly or indirectly, by firms to all staff involved in the provision of investment and ancillary services. This could include client-facing front-line staff, sales staff, their line managers, and other relevant staff such as claims handlers and financial analysts whose remuneration could potentially create an inappropriate incentive to act against the best interests of clients.

The guidelines require an investment firm’s credit institutions and asset managers to have appropriate remuneration policies in place bearing in mind their duty to act honestly, fairly and professionally in the best interests of their clients when providing investment services. Firms should ensure that remuneration is not paid in a manner that aims at circumventing the MiFID requirements and/or the ESMA guidelines.

The comment period runs until December 7. ESMA expects to publish a final report, and final guidelines, by the second quarter of 2013.

Read more.

ESMA Consults on Guidance on Short Selling Regulation Exemptions

On September 17, the European Securities and Markets Authority (ESMA) published a consultation paper on guidance on the market maker and primary dealer exemptions under Article 17 of the EU Short Selling Regulation (EU236/2012).

The consultation paper contains draft guidelines on market making activities as defined under the Short Selling Regulation, and on a common approach to the application of exemptions which will apply to market makers and primary dealers in relation to net short position transparency requirements and the restrictions on uncovered short sales. The guidelines address the criteria to be met in applying for an exemption, and the conditions to be used in assessing exemption applications. The aim is to achieve consistency of market practices, convergence of supervisory practices and a common approach among national competent authorities to the application of these exemptions.

Comments are requested by October 5. ESMA expects to adopt the final version of the guidelines in November 2012.

Read more.

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