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CORPORATE & FINANCIAL
WEEKLY DIGEST

December 14, 2012

CFTC

CFTC Issues No-Action Letters

The Commodity Futures Trading Commission (CFTC) released a series of staff letters relating to various issues arising under rules implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, including chief compliance officer (CCO) reports, statutory disqualification prohibitions, commodity pool operator (CPO) registration, certain commodity swaps and certain requirements for non-US persons.

- **No-Action Relief for FCM Chief Compliance Officers**. Pursuant to CFTC Letter No. 12-47, the CFTC's Division of Swap Dealer and Intermediary Oversight (SDIO) granted no-action relief that will allow the CCO of a futures commission merchant (FCM) that was registered with the CFTC on June 4, 2012, and currently regulated by a US prudential regulator or registered with the Securities and Exchange Commission, to file an abbreviated annual report for the FCM's fiscal year ending on or before March 31, 2013. The annual report must be filed within ninety days of the FCM's fiscal year-end and must cover the full fiscal year. The abbreviated annual report must include the following information:

  (i) An introduction and an executive summary that contains a description of the FCM's business, identifies the FCM's Chief Executive Officer (CEO) and CCO and the time period of the annual report;

  (ii) A review of policies and procedures reasonably designed to ensure compliance with a list of enumerated customer protection rules, including a description of customer protection policies and procedures, an assessment of the effectiveness of the policies and procedures as of the end of the FCM's fiscal year and a discussion of areas for improvement;

  (iii) A description of material noncompliance issues and corresponding actions taken, including corrective actions related to customer protection rules; and

  (iv) CEO and/or CCO certification(s) stating, "To the best of my knowledge and reasonable belief and under penalty of law, the information contained in the attached annual reporting pertaining to the period from October 1, 2012 through [fiscal year end] is accurate and complete." CFTC Letter No. 12-47 is available here.

- **Further CPO Interpretation and No-Action Relief for Securitization Vehicles and mREITs**. In two separate no-action letters, CFTC staff provided additional guidance and relief for operators of securitization vehicles and mortgage real estate investment trusts (mREITs) seeking to determine their obligations to register as CPOs.

  In CFTC Letter No. 12-44, SDIO staff granted relief from CPO registration to operators of qualifying mREITs, provided that the mREIT limits its exposure to commodity interests to the thresholds specified in the letter, is not marketed as a vehicle for trading commodity interests, and

has or will identify itself as an mREIT in its US income tax returns on Form 1120-REIT. The relief granted in the letter is not self-effectuating—for mREITs in operation as of December 1, a no-action request must be submitted to SDIO prior to December 31, and for mREITs commencing operations after December 1, a no-action request must be submitted within 30 days after commencing operations. CFTC Letter No. 12-44 is available here.

In CFTC Letter No. 12-45, SDIO staff have provided further interpretation of the no-action relief granted to operators of securitization vehicles in CFTC Letter No. 12-14, and have also provided broad no-action relief for securitization vehicles that have not and do not issue new securities after October 12, 2012, as well as time-limited no-action relief to other operators of securitization vehicles. Under the expanded guidance, certain types of securitization vehicles that do not satisfy all of the strict requirements of the original letter may nonetheless be excluded from the definition of "commodity pool" where (among other things) their use of swaps is limited to the extent permitted under Regulation AB and Rule 3a-7 under the Investment Company Act of 1940 and such swaps are not used to create an investment exposure. The letter provides several examples of securitization vehicles that may be excluded under the new guidance, as well as examples of structures that would not be excluded from the commodity pool definition.

CFTC Letter No. 12-45 also includes two broad grants of no-action relief. First, SDIO has granted relief from CPO registration to operators of securitization vehicles that have not and will not issue new securities on or after October 12, provided that the operator will provide certain specified information if requested by the CFTC. Second, SDIO granted time-limited no-action relief to operators of securitization vehicles that are unable to rely upon the relief granted by either CFTC Letter No. 12-14 or 12-45, stating that, in light of ongoing discussions with the securitization industry, SDIO will not recommend enforcement action against such operators for failure to register as a CPO until March 31, 2013. CFTC Letter No. 12-45 is available here.

- **No-Action Relief for Certain SDs and MSPs Relating to Statutory Qualification Prohibitions**. Pursuant to CFTC Letter No. 12-43, 'SDIO issued limited no-action relief for swap dealers (SDs) and major swap participants (MSPs) from compliance with CFTC Regulation 23.22(b), which prohibits persons subject to a statutory disqualification from effecting or being involved in effecting swaps on behalf of the SD or MSP. This relief is only available for non-domestic associated persons of SDs or MSPs who deal solely with non-domestic swap counterparties, and persons employed in a clerical or ministerial capacity by SDs and MSPs. CFTC Letter No. 12-43 is available here.

- **Preservation of Regulatory Status Quo**. In CFTC Letter No. 12-48, the CFTC's Division of Market Oversight (DMO) further extended the temporary exemptive relief originally granted in a CFTC order dated July 14, 2011. Pursuant to the letter, DMO staff will maintain and preserve the regulatory status quo regarding the regulation of certain agricultural swaps and exempt and excluded commodity swaps. Such relief will expire on the earlier of June 30, 2013, or the effective date of the swap execution facility (SEF) final rules. However, an entity may no longer rely on such no-action relief if the entity's application for registration as a designated contract market or SEF has been approved, temporarily approved, withdrawn or denied by the CFTC. CFTC Letter No. 12-48 is available here.

- **No-Action Relief Affecting Non-US Persons**. CFTC staff issued two letters relating to non-US persons. In CFTC Letter No. 12-49, SDIO staff granted no-action relief to any CFTC registrant that does not submit fingerprint cards for its non-US principals. In order to obtain such relief, a registrant must submit, in lieu of a fingerprint card, a signed certification that a reasonable criminal history background check was conducted and no matters were revealed constituting a disqualification under Sections 8a(2) or 8a(3) of the Commodity Exchange Act. CFTC Letter No. 12-49 is available here.

  In CFTC Letter No. 12-46, DMO staff provided temporary no-action relief from certain counterparty reporting obligations under Parts 20, 45 and 46 of the CFTC's regulations for transactions involving non-US counterparties. Because such no-action relief is predicated upon potential non-US privacy law concerns, the relief is extended until the reporting counterparty has obtained consent from either the non-US counterparty or its non-US regulator, or the reporting

party no longer holds a reasonable belief that non-US privacy laws would be violated. In any event, such relief expires no later than June 30, 2013. CFTC Letter No. 12-46 is available here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Division of Investment Management Lifts Actively-Managed ETF Derivatives Use Moratorium and Announces Two Rulemaking Initiatives

In a speech on December 6 before the ALI CLE 2012 Conference on Investment Adviser Regulation: Legal Compliance Forum on Institutional Advisory Services, Norm Champ, the new Director of the Division of Investment Management of the Securities and Exchange Commission, stated, "the Division staff will no longer defer consideration of exemptive requests . . . relating to actively-managed ETFs that make use of derivatives." Such exemptive requests must now contain two specific representations: (1) that the ETF board periodically will review and approve the ETF's use of derivatives and how the ETF's adviser assesses and manages risk regarding the ETF's use of derivatives; and (2) that the ETF's disclosure of its use of derivatives in its offering documents and periodic reports is consistent with relevant SEC guidance.

In March 2010, the Division imposed a moratorium on actively managed ETF exemptive applications where the ETF would use derivatives in its portfolio. The Division later sought public comment on the use of derivatives by all investment companies, including ETFs, under a Concept Release it issued on August 31, 2011, to which it received almost 50 comment letters. Index-based ETFs have been able to seek exemptive relief where their use of derivatives was confined to up to 20% of their portfolio that was not invested directly in their referenced index's components. Mr. Champ also indicated that the moratorium remained in place with respect to new applications for leveraged ETFs and that the Division staff was continuing to review investment company use of derivatives.

Mr. Champ also discussed two rule initiatives that will affect advisers and investment companies. First, the Division is working on rules under the Investment Advisers Act of 19409 for private fund advisers relating to books and records rules and advertising in light of the JOBS Act, which requires the SEC to promulgate rules allowing general solicitation and advertising for certain Regulation D, Rule 506 private placements. Second, the Division will be issuing additional guidance on investment company valuation of securities.

Mr. Champ's speech is available here.

LITIGATION

Antitrust "Tying" Claims Dismissed Against Homebuilders

The US District Court for the Eastern District of California recently ruled on the type of activity that constitutes a claim of impermissible "tying" under federal antitrust law, holding that the alleged misconduct of a group of housing developers did not give rise to an antitrust violation.

A group of homeowners (plaintiffs) brought an antitrust claim against the housing developers (defendants), alleging that defendants had violated antitrust law by "tying" sales of their homes to financing provided by specific lenders. defendants moved to dismiss the antitrust claim.

An antitrust tying arrangement is "a device used by a seller with market power in one product market to extend its market power to a distinct product market." Although the US Supreme Court once remarked that "[t]ying agreements serve hardly any purpose beyond the suppression of competition," *see Standard Oil Co. v. United States*, 337 US 293, 305 (1949), seemingly embracing a per se rule against all tying, it has since rejected that logic and the majority of tying arrangements are analyzed under the rule of reason. *See Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 US 2, 34 (1984) (Brennan, W., concurring).

Here, plaintiffs alleged that defendants, using their market power as home developers and sellers, had "steered" plaintiffs toward particular financing companies, either by "mandating" that plaintiffs use those companies or "wrongfully conditioning" the sale of homes on the use of those companies. Plaintiffs alleged that this "steering" towards certain financing companies allowed defendants to exercise control of the home financing market in violation of antitrust law.

The court ruled that, in order to constitute a tying violation, a defendant's conduct must actually cause a plaintiff to obtain the tied product and the complaint must specify *how* a defendant coerced a plaintiff to obtain the tied product. Because of only conclusory allegations in the complaint and because plaintiffs never actually used the tied financing, the court granted defendants' motion to dismiss the antitrust claim.

Cherrone, et al. v. Florsheim Development, et al., No. Civ. 2:12–02069, 2012 WL 6049021 (E.D. Cal. Dec. 5, 2012) (internal citations omitted).

Delaware Chancery Court Strengthens First-Filed Action Rule

The Delaware Court of Chancery recently stayed a Delaware action in favor of an earlier-filed Texas case because they dealt with substantially similar facts, even where the two lawsuits did not contain identical claims. The ruling emphasizes that filing a complaint in the early stages of a dispute is often necessary to guarantee that a party will be able to litigate the dispute in the preferred forum.

Plaintiff in the Delaware action brought breach of contract and breach of fiduciary duty claims, in connection with a jointly owned company. Plaintiff alleged that defendant, by acquiring a corporation without giving the company an opportunity to acquire it first, had personally usurped a corporate opportunity belonging to the company.

Defendant had preemptively filed an action in Texas two weeks earlier, asking for a declaratory judgment holding that defendant's ownership of the disputed corporation did not constitute a breach of his contract with the company. Accordingly, defendant moved to dismiss or stay the Delaware action under the well-settled "first-filed action" rule, which gives discretion to Delaware courts to stay an action when "(1) there is a prior action pending elsewhere, (2) involving the same parties, (3) the same issues, and (4) the court in the other jurisdiction is capable of rendering prompt and complete justice."

Plaintiff argued that the issues in the Texas action were not identical to those in the Delaware action as the two actions had different legal claims and the Delaware action was more expansive – concerning other alleged misconduct on defendant's part.

The court held that although the issues were not perfectly identical, the first-filed rule only requires a showing that the two actions contain a "substantial or functional identity of issues or claims" based on the same common nucleus of operative facts. The court determined that despite the differences between the claims alleged in the two actions, both actions ultimately arose out of the dispute over defendant's corporate acquisition and how it affected the company, and thus were substantially identical. The court also rejected the notion that the issues of Delaware law could not be competently resolved by the Texas court. Accordingly, the court granted defendant's motion to stay the Delaware action until the Texas action was resolved.

Brookstone Partners Acquisition XVI, LLC, et al. v. Tanus, et al., Civil Action 7533-VCN (Del. Ch. Nov. 20, 2012) (internal citations omitted).

BANKING

CFPB Proposes Consumer Disclosure Experiments

On December 13, the Consumer Financial Protection Bureau (Bureau) issued a proposal that would allow banks to test their own consumer disclosures, with Bureau approval, to see if the disclosure is effective. Known as the "Policy to Encourage Trial Disclosure Programs," the Bureau's goal is to make consumer disclosure more "timely and understandable."

"As part of our efforts to foster innovation in consumer financial markets, the proposed policy will allow companies to conduct real world trials of disclosure alternatives," said Richard Cordray, Director of the Bureau. "That will help the Bureau identify what works and does not work to provide consumers with the clear information they need to make financial decisions in a marketplace of evolving programs and products." The program would involve a waiver, issued by the Bureau, of disclosure requirements that otherwise would be applicable to banks that are approved to participate. "Under the proposed Policy, if the Bureau approves a specific trial, then, for the duration of an agreed testing period, the Bureau will deem the testing company's disclosure, to the extent that it is used

solely by the testing company under the terms and conditions approved by the Bureau, to be in compliance with, or hold it exempt from, applicable federal disclosure requirements."

In addition, the proposal "lays out eligibility criteria for trial programs, which require companies proposing such tests to provide certain information to the Bureau." The proposal states that new disclosures could include modifications to an existing model form, changed delivery mechanisms, wholesale replacement of a model form or existing disclosure requirements with new disclosure requirements or forms, and/or the elimination of select disclosure requirements.

Comments from the public, including other regulatory agencies, will be due 60 days from publication in the Federal Register, expected shortly.

Read more.

UK DEVELOPMENTS

FSA Expresses Concerns About Outsourcing by Asset Managers

On December 11, the UK Financial Services Authority (FSA) published a "Dear CEO" letter which had been sent to the CEO's of regulated asset managers outlining its concerns about asset managers' outsourcing arrangements.

The FSA stated that as a result of discussions with asset managers it had identified that the asset management industry outsources a growing number of activities, and that the small number of outsource providers are usually part of complex international banking groups. Accordingly, the outsource providers generally have balance sheet exposure, at group level, to activities other than the provision of outsourcing activities. The FSA is concerned that if an outsource provider were to face financial distress or severe operational disruption, UK asset managers would not be able to perform critical and important regulated activities and that customers of the asset managers would be disadvantaged.

The FSA sets out concerns about the effectiveness of firms' recovery and resolution plans, and highlights the following issues:

- Reliance on an outsource service provider being a large financial institution that regulators might look to rescue using public funds is inconsistent with the FSA's policy of allowing such organizations to fail. The FSA states that "this approach lacks prudence and is inconsistent with the FSA's policy of allowing such organizations to fail."

- Bringing outsourced activities back in-house would take many months and firms would not immediately have the capacity and expertise required.

- The operational challenges arising from transferring outsourced activities to another provider are substantial. The FSA believes that there are considerable operational challenges involved and it is likely that a transfer could not be implemented swiftly enough to protect customers. It may also not be a realistic option due to concentration risk in the supply of certain activities.

- The FSA believes that "step in" rights in a stressed scenario might prove difficult to enforce, and there could be undue delay and/or operational risks arising which would be to the detriment of customers.

The FSA considers that it is the responsibility of firms' boards of directors to consider the implications of outsourcing to external parties, and to ensure that they have in place an adequate resilience plan enabling the firm to carry out regulated activity if a service provider fails. It requests CEOs to review their firm's' contingency plans, taking into account the FSA's observations in the letter and firms' obligations under chapter 8 of the FSA's SYSC (Systems & Controls) sourcebook.

Read more.

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