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Toronto Seminar Series

Tuesday, April 4, 2017
10:30 AM – 1:30 PM

The Fairmont Royal York
100 Front Street West
Toronto, Ontario M5J 1E3

Presenters:

Bradley Berman, Of Counsel, Morrison & Foerster LLP
Lloyd Harmetz, Partner, Morrison & Foerster LLP
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1. **U.S. Tax Reform, etc.**
   10:30 a.m. to 11:00 a.m.

2. **Regulatory Relief: What to Expect**
   11:00 a.m. to 11:30 a.m.

3. **The FRB's LTD, TLAC and Clean Holding Company Final Rules and Tax Treatment**
   11:30 a.m. to Noon

   Lunch
   Noon to 12:30 p.m.

4. **U.S. Securities Law Developments and Canadian Issuers**
   12:30 p.m. to 1:30 p.m.

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U.S. Tax Reform, etc.

Thomas Humphreys

April 4, 2017

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Overview

- U.S. Tax Reform
- Camp and Wyden Derivative Proposals

U.S. Tax Reform

- Now that Republicans have control of the Presidency, House and Senate, significant tax reform could be on the horizon.
- President Trump's plan was published as "Tax Reform that Will Make America Great Again." His campaign website also featured a later iteration of the plan.
- In June 2016 the House Republicans released a tax reform plan entitled "A Better Way: Our Vision for a Confident America."
- President Trump did not fully endorse the House plan, but later iterations of his plan were revised to look like the House plan.

- Individual U.S. Tax Rates
  - Trump Plan

Married Joint	Ordinary Income Rate	Capital Gains
$0-$75,000	12%	0%
$75,000 - $225,000	25%	15%
$225,000+	33%	20%

  - House GOP Plan

Married Joint	Ordinary Income Rate	Capital Gains
$0-$75,300	12%	6%
$75,300 - $231,450	25%	12.5%
$231,450+	33%	16.5%

- President Trump's tax plan for businesses
  - Corporate Tax Rate: 15%
  - Expensing Capital Investments and Interest Deduction Limits
    - Expensing: Trump's proposal would allow firms engaged in U.S. manufacturing to fully expense capital investments.
    - Interest Deductions: However, firms making such an election would lose the deductibility of corporate interest expense.

U.S. Tax Reform, cont'd.

- House GOP tax plan for businesses
  - Corporate Tax Rate: 20%
  - Expensing Capital Investments
    - The House proposal would repeal current depreciation system and allow the cost of capital (for both tangible and intangible assets) to be fully and immediately deductible
  - Interest Deduction Limits
    - Deductions for net interest expenses on debt would only be allowed as a deduction against interest income
    - Unused deductions could be carried forward

- House GOP Plan: Border Adjusted Cash Flow Tax
  - Cash flow tax
    - A business is taxed on its cash flow, i.e., business receipts less expenditures
    - Assets are immediately expensed
  - Border adjusted
    - A border adjusted tax conforms to the "destination-based" principle – generally, tax is levied where goods end up rather than where the goods were produced
    - Exclude from the tax base sales of goods/services to non-U.S. persons
    - Include sales to U.S. persons, including sales by non-U.S. persons to U.S. persons
  - Financial transactions in a Border Adjusted Cash Flow Tax:
    - Include: income from borrowing, deduction for investments in stocks or bonds
    - Exclude: ignore investments in stocks or bonds
    - Something else

- Repatriation under each plan
  - President Trump's Plan: deemed repatriation of corporate profits held offshore at a one-time rate of 10%
  - House GOP Plan:
    - Accumulated foreign earnings would be subject to tax at 8.75% to the extent held in cash or cash equivalents, or otherwise will be subject to tax at 3.5%
    - Companies would be allowed to pay the resulting tax liability over an eight-year period

Camp and Wyden Derivative Proposals

- In 2014, former Representative Dave Camp [(R-MI)] released a draft tax reform plan, which included a mark to market proposal for derivatives.
- In May 2016, Senator Ron Wyden (D-OR) released a similar mark to market proposal, entitled the Modernization of Derivatives Act.
- Under the Camp proposal, a derivative held at the end of a taxable year would be required to be marked to market, with the resulting gain or loss treated as ordinary and as attributable to a taxpayer's trade or business.
  - The proposal generally defined a derivative as any contract, the value of which, or any payment or other transfer with respect to which, is directly or indirectly determined by reference to seven underliers listed by the discussion draft, such as stock, an index, or a partnership interest. Real property was included as an underlier, with some exceptions.

- The Camp proposal would generally treat the non-derivative portion of a straddle as a derivative for both timing and character purposes, and upon establishing a straddle, any built-in gain position would be treated as sold for its fair market value.

Camp and Wyden Derivative Proposals, cont'd.

- Under the Modernization of Derivatives Act (the "Act") introduced by Senator Wyden, a taxpayer would be required to mark to market an investment in the event of a "taxable event" with respect to a derivative or underlying investment.
  - A "taxable event" with respect to a derivative would be (1) the termination or transfer of such a derivative, or (2) the close of a taxpayer's taxable year if the taxpayer had obligations and rights with respect to the derivative at that time.
  - The Act generally defines "derivative" the same as the Camp proposal (but includes the derivative component of a principal-back note).
  - Similar to the Camp proposal, any gain or loss under the Act would be treated as ordinary and as attributable to a taxpayer's trade or business
- The Act would also replace current anti-abuse straddle rules and constructive sale rules with a new general rule for capital hedging for taxpayers that use derivatives to hedge capital assets, called "investment hedging units."

Camp and Wyden Derivative Proposals, cont'd.

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Regulatory Relief: What to Expect

Oliver Ireland

April 2017

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Where are we?

Dodd-Frank Act

- July 21, 2010
- Circa 370,000 words.
- Major issues addressed:
  - Financial stability
    - Oversight of nonbank SIFIs
    - Enhanced requirements for banking organizations with total assets of greater than $50 billion
      - Liquidity requirements
      - Overall risk management requirements
      - Resolution planning
      - Concentration limits
      - Contingent capital
      - Short-Term debt limits
      - Risk committee requirement

Dodd-Frank Act, cont'd.

- Enhanced requirements for banking organizations with total assets of greater than $50 billion
  - Stress tests
  - Leverage limit
  - Capital on off balance sheet activities
  - Trickle down
- Orderly liquidation
- Elimination of OTS
- Regulation of advisers
- Federal Insurance Office
- Changes to bank and holding company supervision and regulation
  - Volcker Rule
- Regulation of derivatives
- Oversight of payment clearing and settlement systems
- Changes to the supervision and regulation of securities activities

Dodd-Frank Act, cont'd.

- Creation of the Consumer Financial Protection Bureau
  - Jurisdiction over virtually all federal consumer financial protection laws
  - UDAAP rule writing authority
  - Jurisdiction over non bank providers of consumer financial products and service
  - Broad enforcement powers
- Mortgage underwriting standards

Basel III

- New higher capital levels
- Limitations on capital instruments
- New risk weights
- Capital conservation buffer (CCB)
- Countercyclical capital buffer (CCyB)
- Liquidity Coverage Ratio (LCR)
- Net Stable Funding Ratio (NSFR)
- Total loss absorbing capacity (TLAC)
- G-SIB surcharge

What's Left?

- Most, but not all rules have been adopted
- Some are still proposed
  - For example, the rules relating to incentive-based compensation
- Some are still phasing in
  - For example, capital rule phase-in
- Housing finance has not been addressed

Avenues for Change

Three Avenues for Change

- Changes in supervisory discretion
  - Prosecutorial discretion
    - Consent orders
    - MOUs
    - MRIAs
    - MRAs
    - Exam reports
  - No requirements for notice and comment
  - No delayed effective dates
  - New agency appointments may be key
    - Most financial regulatory agencies are independent and not subject to executive orders
      - May comply with the spirit of executive orders
      - CFPB?
    - It may take awhile for the message to get to field examiners
  - Limited by statutes and rules

Three Avenues for Change, cont'd.

- Rule changes
  - Notice and comment generally required
    - Need to justify the change
  - Broad discretion in capital and liquidity numbers
  - Less discretion in some of the consumer rules
  - Interagency rules like the Volcker Rule are likely to take more time
- Statutory Changes
- Congressional Review Act
  - Can invalidate new and recent agency rules

CCAR

- In January 2017 the Federal Reserve adopted a final rule that revises the capital plan and stress test rules under the Dodd-Frank Act
- Establishes new class of BHCs with at least $50 billion in total consolidated assets—"large" and "noncomplex" firms that are subject to less stringent requirements than other BHCs subject to CCAR
- A large and noncomplex firm:
  - maintains total consolidated assets of at least $50 billion but less than $250 billion,
  - maintains nonbank assets of less than $75 billion, and
  - is not classified as a U.S. G-SIB

- These firms are:
  - No longer subject to the qualitative component of CCAR
  - Benefit from the modification of certain regulatory reporting requirements under the Federal Reserve's capital plan rule
  - Will be subject to Fed supervisory review of capital plans in a manner similar to existing supervisory programs
- For BHCs with greater than $50 billion in TCAs, the rule simplifies the initial applicability provisions for the capital plan and stress test rules, and provides additional time before those requirements apply to BHCs that cross the $50 billion threshold near the April 5 capital plan submission and stress test date

CCAR, cont'd.

Executive Orders

Presidential Actions in 2017

- On January 30, 2017, President Trump issued an Executive Order, titled *Reducing Regulation and Controlling Regulatory Costs*.
  - Notes that the policy of the executive branch is to be "prudent and financially responsible in the expenditure of funds, from both public and private sources."
  - Establishes a regulatory cap for fiscal year 2017—unless prohibited by law, whenever an executive department or agency publicly proposes for notice and comment (or otherwise promulgates a new regulation), it must identify at least two existing regulations to be repealed.
- On February 2, 2017, the Office of Information and Regulatory Affairs issued its *Interim Guidance Implementing Section 2 of the Executive Order of January 30, 2017*.
  - Explains that departments and agencies may comply with the requirements of the Executive Order "by issuing two 'deregulatory' actions for each new significant regulatory action that imposes costs."

Executive Orders

- On February 24, 2017, President Trump issued an Executive Order, Enforcing the Regulatory Reform Agenda
  - Requires regulatory reform officers and regulatory reform task forces in each agency
  - Identify regulations that:
    - Eliminate jobs, or inhibit job creation;
    - Are outdated, unnecessary, or ineffective;
    - Impose costs that exceed benefits;
    - Create a serious inconsistency or otherwise interfere with regulatory reform initiatives and policies;
    - Are inconsistent with the requirements of section 515 of the Treasury and General Government Appropriations Act, 2001 (44 U.S.C. 3516 note), or the guidance issued pursuant to that provision, in particular those regulations that rely in whole or in part on data, information, or methods that are not publicly available or that are insufficiently transparent to meet the standard for reproducibility; or

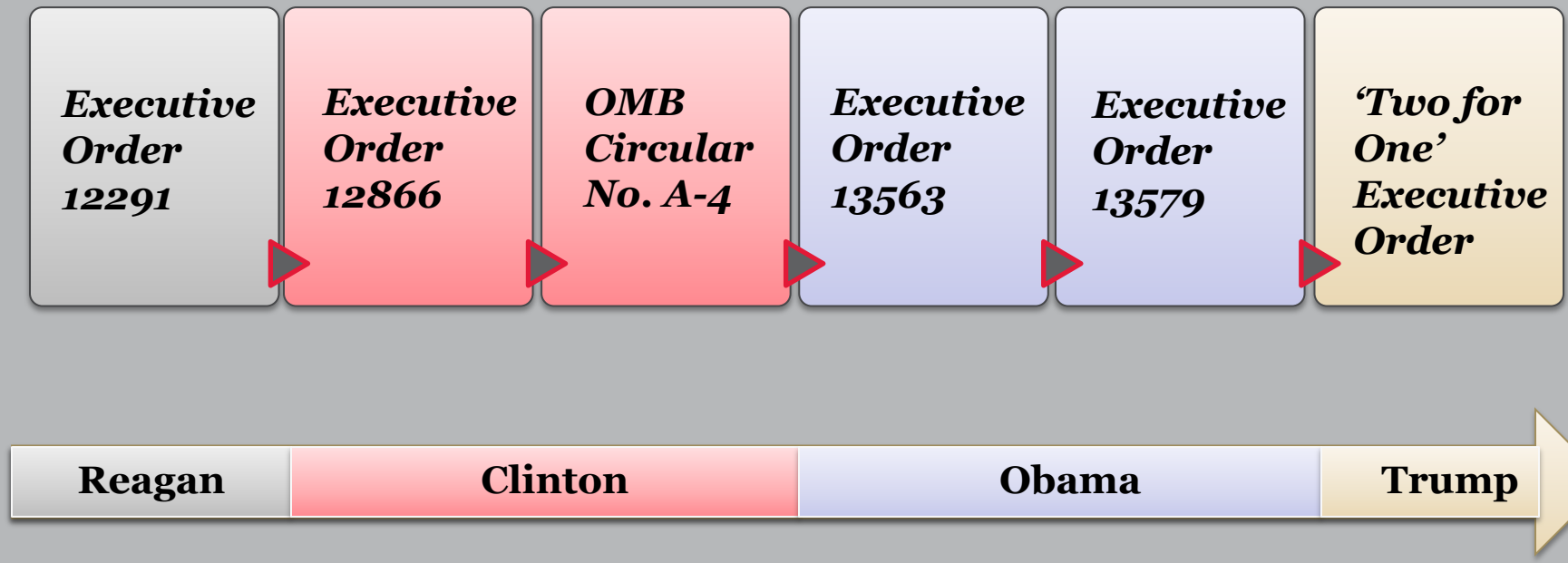
Executive Orders, cont'd.

- derive from or implement Executive Orders or other Presidential directives that have been subsequently rescinded or substantially modified.
- Within 90 days and thereafter report on progress, including identifying regulations for repeal, replacement or modification

Core Principles for Regulating the United States Financial System

- On February 3, 2017, President Donald Trump signed the Executive Order on Core Principles for Regulating the United States Financial System. The order outlined seven principles of regulation, or "Core Principles", which the Trump Administration will follow to regulate the U.S. financial system. The principles were listed as follows:
  - Empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth;
  - Prevent taxpayer-funded bailouts;
  - Foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry;
  - Enable American companies to be competitive with foreign firms in domestic and foreign markets;
  - Advance American interests in international financial regulatory negotiations and meetings;
  - Make regulation efficient, effective, and appropriately tailored; and
  - Restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework.

Cost-Benefit Requirements Within the Rulemaking Process



Cost-Benefit Requirements Within the Rulemaking Process: Pre-Trump

- ***Executive Order 12291 (Feb. 1981)***.
  - Regulatory Impact Analysis must be conducted in connection with every "Major Rule."
  - Must contain a description of the potential: (i) benefits of rule; (ii) costs of rule; and (iii) net benefits of rule.
- ***Executive Order 12866 (Oct. 1993)*** *(revokes Executive Order 12291)*. Agencies should assess all costs/benefits of viable regulatory alternatives, including the alternative of not regulating.
  - "Significant" regulatory actions must be submitted to Office of Information and Regulatory Affairs ("OIRA") for review.
- ***OMB Circular A-4 (Sept. 2003)***. Designed to ". . . standardiz[e] the way benefits and costs of Federal regulatory actions are measured and reported."
  - "Good regulatory analysis" encompasses: (i) a statement of the need for a proposed action; (ii) an examination of alternative approaches; and (iii) an evaluation of benefits and costs, including cost-benefit and cost-effectiveness analyses.
  - To properly evaluate costs and benefits of regulations and alternatives, an agency must:
    - Explain how the actions required by the rule are linked;
    - Identify a baseline; and
    - Identify the expected undesirable side-effects and ancillary benefits.
  - "Opportunity cost" is the appropriate concept for valuing benefits and costs.
    - "Willingness-to-pay" captures the notion of opportunity cost.
    - However, "willingness-to-accept" can also be instructive.

- ***Executive Order 13563 (Jan. 18, 2011)***
  - Regulatory system must "take into account benefits and costs, both quantitative and qualitative" and measure "the actual results of regulatory requirements.
  - Each executive agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.
  - Where feasible, executive agencies should consider values that are "difficult or impossible to quantify" (e.g., equity, human dignity, fairness and distribute impacts).
- ***Executive Order 13579 (July 11, 2011)***
  - Extends Executive Order 13563 to independent regulatory agencies.
  - Independent regulatory agencies should consider how best to promote "retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome . . ."

Pre-Trump, cont'd.

The Choice Act

The Financial Choice Act

- The Financial Choice Act of 2016 (the "Choice Act") is viewed as the first major concerted effort to provide an alternative to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") as a way to end "Too Big to Fail."
- The Choice Act addresses a broad range of issues:
  - Capital election
  - Curtailing systemic provisions of Dodd-Frank Act
  - CFPB reform
  - Durbin repeal
  - Fiduciary rule repeal
  - Regulatory "accountability" measures
  - Volcker Rule repeal
  - Mortgage reform
  - Securities rules changes

The Choice Act

- Capital election provisions

Qualification Criteria:	**BHCs and SHLCs must maintain a ratio of average tier 1 common equity, and additional tier 1 capital instruments issued on or before June 1, 2016,[1] to total leverage exposure, as measured for purposes of the supplementary ratio, of 10% for itself (and each IDI), and each IDI must maintain a CAMELS rating of 1 or 2**
Section	Exemptions
102(a)(1)	Exempts from regulatory capital and liquidity requirements, including: (1) Basel III; (2) supplementary leverage ratio; (3) LCR; and (4) NSFR.
102(a)(2)	Exempts from limitations on capital distributions.
102(a)(3)(A)	Exempts BHCs from any consideration of any risk the BHCs may pose to U.S. financial stability.
102(a)(3)(B)	Exempts from any consideration of limitations on proposed mergers, consolidations, or acquisitions due to concentrations risks to the U.S. financial stability.
102(a)(3)(C) &(D)	Exempts from any consideration of risk to U.S. financial stability in applications by BHCs to engage in nonbanking activities.
102(a)(3)(E)	Exempts from any consideration of whether a merger under the Bank Merger Act would pose a risk to U.S. financial stability.

[1] BHCs with less than $15 billion in consolidated assets can include certain TruPS issued before May 19, 2010, and for traditional banking organizations with no trading assets and limited swaps, the leverage exposure is limited to Call Report assets minus tier 1 capital deductions.

Qualification Criteria:	**BHCs and SHLCs must maintain a ratio of average tier 1 common equity, and additional tier 1 capital instruments issued on or before June 1, 2016, to total leverage exposure, as measured for purposes of the supplementary ratio, of 10% for itself (and each IDI), and each IDI must maintain a CAMELS rating of 1 or 2**
Section	Exemptions
102(a)(3)(F)	Exempts SLHCs from consideration of any risk the SLHC may pose to U.S. financial stability.
102(a)(4)	Exempts BHCs from the 10% deposit cap on interstate acquisitions, removes the $10b cap on FHCs acquiring companies without prior approval, and exempts the BHC from the 10% cap on consolidated liabilities.
102(a)(5)	Exempts the IDIs from the 10% deposit cap on mergers.
102(a)(6)	Exempts BHCs with total consolidated assets >$50b from the approval requirements for acquisitions >$10b.
102(a)(7)	Exempts SHLCs from the 10% deposit cap.
102(a)(8)	Exempts BHCs with >$50b from Dodd-Frank Section 165, and similar requirements relating to prudential standards, including: (1) risk based or leverage capital; (2) liquidity; (3) overall risk management, including a risk committee; (4) concentration limits; (5) contingent capital requirements; (6) enhanced disclosures; (7) short-term debit limits; and (8) resolution planning and credit exposure reports.
102(a)(9)	Exempts from any federal limitations on mergers, consolidations, or acquisitions of assets or control, to the extent such limitations relate to capital or liquidity standards or concentrations of deposits or assets.
102(b)	Exempts certain banking organizations with consolidated assets of between $10b and $50b from annual stress tests.
102(c)	IDIs are deemed well capitalized for purposes of prompt corrective action.

The Choice Act, cont'd.

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The FRB's LTD, TLAC and Clean Holding Company Final Rules and Tax Treatment

April 2017

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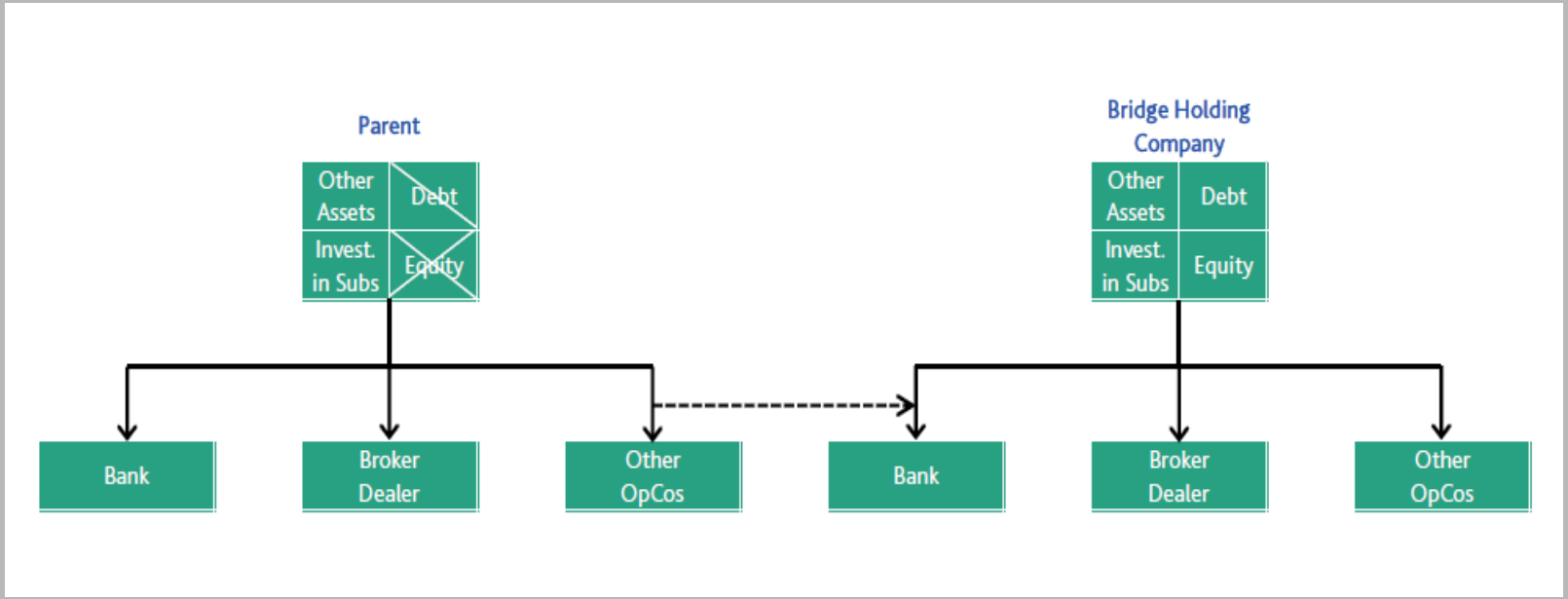
FRB Final Rule

Single point of entry resolution



FRB proposal

- The FRB released its proposal on October 30, 2015, which set forth for covered BHCs and covered IHCs an external TLAC requirement in the case of covered BHCs (and an internal TLAC requirement in the case of covered IHCs), a related TLAC buffer, a minimum long-term debt (LTD) requirement for covered BHCs (and a minimum internal long-term debt requirement for covered IHCs), and a "clean holding company" requirement
- The FRB proposal was premised on the view that TLAC alone would not be sufficient to facilitate SPOE resolution
- In addition, to avoid contagion risk, the FRB proposal also would have penalized banks generally for holding unsecured debt of a covered BHC

Final FRB Rules

- On December 15, 2016, the FRB voted unanimously to adopt final rules that impose an external TLAC requirement in the case of covered BHCs (and a TLAC requirement in the case of covered IHCs, which has been modified from the proposal), related TLAC buffers, a minimum LTD requirement for covered BHCs (and a minimum LTD requirement for covered IHCs, which has been modified from the proposal), and a "clean holding company" requirement
- The final rules differ from the proposed rules only in certain modest respects

Principal Differences

- Effective date of January 1, 2019 (in other words, no "phase in" period from 2019 to 2022)
- Grandfathering of outstanding LTD of covered BHCs issued prior to December 31, 2016 (including otherwise eligible LTD governed by non-U.S. laws and otherwise eligible LTD subject to acceleration clauses)
- FRB is allowed to order a G-SIB to exclude from its outstanding eligible LTD any debt securities with features that would significantly impair such debt securities to take losses (subject to notice and opportunity to respond)
- The final rule permits a MPOE approach for a resolution-covered IHC
- A resolution-covered IHC has the option to issue LTD externally to third parties (like a covered BHC) subject to certain conditions

Principal differences, cont'd.

- The final rule contains some modifications to the clean holding company requirement
  - Under the final rule, covered BHCs and covered IHCs are permitted to guarantee certain QFCs of their subsidiaries to the extent guarantees are permitted by regulations governing stays
  - The final rule imposes a 5% cap on external liabilities (other than those related to TLAC) unless the covered BHCs and covered IHCs issue eligible LTD as contractually subordinated debt
- The capital deduction for investments in the unsecured debt of covered BHCs and covered IHCs that was in the proposed rule is not included in the final rule; however, this issue is expected to be addressed jointly with the OCC and the FDIC

External long-term debt

- The final rule includes both a minimum LTD requirement and a minimum TLAC requirement
- **Why a long-term debt requirement?**
  - In principle, the objective of the external LTD requirement is to ensure that each covered BHC has a minimum amount of eligible external LTD such that, if the covered BHC's going-concern capital is depleted and the covered BHC fails and enters resolution, the eligible external LTD will be sufficient to absorb losses and recapitalize the covered BHC by replenishing its going-concern capital (referred to in the preamble as a "capital refill" approach)
- **What is eligible external long-term debt?**
- Debt securities issued directly by the covered BHC that:
  - Are unsecured
  - Are "plain vanilla"

- Are governed by U.S. law ***(commenters had requested that the FRB consider debt securities governed by the laws of at least certain foreign jurisdictions)***
- Only 50% of the amount of eligible external LTD that is due to be paid between one and two years can be used for purposes of the eligible external LTD requirement (although all of it would count in full for purposes of the external TLAC requirement)

- ***The amount of eligible external LTD due to be paid in less than one year will not count toward the external TLAC or the external LTD requirement***
- **What is "plain vanilla" debt?**
  - The debt cannot contain an embedded derivative, have a credit sensitive feature (such as an interest rate that resets periodically based in whole or in part on the G-SIB's credit quality), contain any contractual conversion or exchange features, or include acceleration rights, other than a right that is exercisable in the event of the covered BHC's insolvency or a payment failure that continues for 30 days or more; no structured notes

External long-term debt, cont'd.

- **What is the external LTD requirement under the final rule?**
  - A covered BHC must maintain outstanding eligible external LTD in amount not less than the greater of: 6% of total RWA plus the G-SIB surcharge, and 4.5% of total leverage exposure
- **Can a covered BHC redeem or repurchase outstanding external LTD?**
  - A covered BHC must seek FRB approval to repurchase or redeem where the repurchase or redemption would result in noncompliance with the requirement
- **Other relevant provisions**
  - The final rule includes a new provision that the FRB may, after notice and an opportunity to respond, order a G-SIB to exclude from its outstanding eligible LTD amount any debt securities with features that would hinder a resolution
  - No grace period during which a covered BHC that breaches the external LTD requirement can take voluntary actions to come into compliance without being subject to other regulatory consequences

- **Grandfather provision**
  - Certain outstanding LTD of covered BHCs issued prior to December 31, 2016 counts toward the external LTD and external TLAC requirements
- **Acceleration provisions and incentives to redeem**
  - Eligible external LTD cannot have a contractual right to acceleration of payment of principal or interest, other than on the occurrence of either an insolvency event or a payment default event that continues for 30 days or more, except that eligible external LTD instruments are permitted to give a holder a put right as of a future date certain, subject to certain conditions

External TLAC

- **What is eligible external TLAC?**
  - The sum of (1) common equity Tier 1 capital and AT1 capital issued directly by the covered BHC (excluding minority interests), plus (2) the covered BHC's eligible external LTD that is due to be paid after one year or more
    - **The proposal had been based on the "remaining maturity" of the debt, rather than the unpaid principal amount "due to be paid"**
- **What is the required amount of eligible external TLAC?**
  - An amount not less than the greater of 18% of the covered BHC's total RWAs and 7.5% of the covered BHC's total leverage exposure
  - In addition, there are two separate external TLAC buffers
    - **Same as the proposal, except the leverage component of the external TLAC requirement is reduced from 9.5% to 7.5%, and the FRB has adopted a 2% buffer on top of the leverage component**

- **TLAC Buffers for covered BHCs**
  - ***TLAC Leverage Buffer***: the final rule reduced the minimum amount of the leverage component of the external TLAC requirement (from 9.5% to 7.5%) and a 2% buffer has been added over the leverage component of the external TLAC requirement. This buffer must be filled solely with T1 capital and breach of this buffer subjects the BHC to limits on capital distributions and discretionary bonus payments
  - ***TLAC RWA Buffer***: the TLAC buffer for the RWA component of the external TLAC requirement is equal to 2.5% plus the GSIB surcharge applicable to the covered BHC under method 1 of the GSIB surcharge rule plus any applicable countercyclical capital buffer. This buffer must be filled solely with CET1. Breach of this buffer subjects the BHC to limits on capital distributions and discretionary bonus payments
- Limitations on distribution and discretionary bonus payments will be based on the more restrictive of these two buffers

Eligibility of Specific Securities

- Eligible LTD cannot include contractual provisions for conversion into or exchange for equity
  - A convertible debt instrument is viewed as a debt instrument with an embedded stock call option
- Debt with a "survivor put": the date on which debt is due to be paid is the date that the holder first has a contractual right to request or require payment of principal—as a result, debt with a survivor put would be treated as having matured on the first day it became subject to a put right, or the date of issuance, and it would not qualify as eligible LTD

Structured notes

- A “structured note” is a debt instrument that:
  - Has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature;
  - Has an embedded derivative or similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities;
  - Does not specify a minimum principal amount that becomes due and payable upon acceleration or early termination; or
  - Is not classified as debt under U.S. generally accepted accounting principles.
- Definition clearly applies to both principal-protected and non-principal protected structured notes.

- The final rule makes clear that a structured note does not include a non-dollar-denominated instrument or an instrument whose interest payments are based on an interest rate index (for example, a floating-rate note linked to the federal funds rate or to LIBOR) that satisfy the proposed requirements in all other respects
- These requirements are applicable only at the BHC level, so, they would not be applicable to: structured bank notes or to market-linked CDs

Structured notes, cont'd.

IHCs

IHCs of Foreign G-SIBs

- A covered IHC is any US IHC (FBOs with consolidated global assets of $50 billion or more and consolidated U.S. assets of $10 billion or more must establish an IHC) that is controlled by a FBO that is a G-SIB
- A covered IHC's eligible TLAC equals the sum of the Tier 1 regulatory capital issued from the covered IHC to the foreign parent that controls the covered IHC, and the covered IHC's eligible LTD
- Significant changes were made from the NPR to the final rules in relation to covered IHCs—for example, the final rules include a number of provisions that facilitate the resolution of a FBO under a MPOE approach

SPOE or MPOE

- **Is the covered IHC expected to enter resolution?**
  - If so, it is referred to as a resolution covered IHC in a MPOE resolution strategy, or operate outside of resolution proceedings (a non-resolution covered IHC) while its foreign parent entity is resolved under a SPOE approach
  - A resolution covered IHC (adopting a MPOE approach) has the option either to: issue capital and LTD to third parties, as will covered BHCs, or to issue LTD internally
  - A non-resolution covered IHC will be required to issue LTD either to a foreign parent or to a directly or indirectly wholly owned foreign subsidiary of the top-tier foreign parent (internal TLAC and LTD)

- The IHC must certify to the FRB on the later of June 30, 2017, or one year prior to the date on which the covered IHC is required to comply with the covered IHC TLAC and LTD requirements as to its planned approach
  - The FRB will review the IHC's certification and the FRB has the discretion to determine that an entity that is certified to be a non-resolution covered IHC is a resolution-covered IHC (or vice versa), in which case, the IHC will have an additional one-year (or longer) period in which to comply

Calibration of IHC Requirements

- **What is the TLAC requirement?**
  - For SPOE, a non-resolution covered IHC would be required to keep outstanding eligible internal TLAC at least equal to the greater of: (i) 16% of the IHC's total RWAs, (ii) 6% of total leverage exposure (for those IHCs subject to the supplementary leverage ratio (SLR)), and (iii) 8% of average total consolidated assets as computed for purposes of the US Tier 1 leverage ratio
  - For MPOE, resolution covered IHC would be required to keep outstanding eligible TLAC at least equal to the greater of: (i) 18% of the covered IHC's total RWAs, (ii) for covered IHCs subject to the SLR, 6.75% of total leverage exposure, and (iii) 9% of average total consolidated assets as computed for purposes of the US Tier 1 leverage ratio
    - A buffer applies only in respect of the RWA component of the TLAC requirement

- **What is the minimum eligible LTD requirement?**
  - Eligible LTD will at least equal the greater of (i) 6% of total RWAs, (ii) for covered IHCs subject to the SLR, 2.5% of total leverage exposure, and (iii) 3.5% of average total consolidated assets
    - **The RWA component has been reduced from the proposal (7%) to 6%; the SLR component has been reduced from 3% to 2.5%, and the TCAs component from 4% to 3.5%**

Eligible LTD for IHCs

- **What are the requirements for eligible LTD for IHCs?**
  - Same general requirements as those applicable to eligible external LTD for covered BHCs
  - Same grandfather provision as available to covered BHCs
  - Covered IHCs may adopt either contractual subordination or structural subordination for their eligible LTD
  - Eligible internal LTD must include a contractual trigger pursuant to which the FRB could require the covered IHC to convert or exchange the LTD into CET1 without the covered IHC's entry into a resolution proceeding if:
    - FRB determines that the covered IHC is in default or in danger of default, and
    - Any of the following apply: the top tier FBO or any subsidiary outside the United States is put into resolution, the home country supervisory authority consents to the conversion or does not object following 24 hours' notice, or the FRB provides a written recommendation to the UST that the FDIC should be appointed as receiver

Eligible LTD for IHCs, cont'd.

- There are a number of differences from the proposal:
  - The final rule removes FRB's ability to require cancellation of debt and requires only ability of the FRB to require conversion or exchange;
  - The final rule permits eligible internal debt securities to have the same acceleration clauses as eligible external LTD;
  - Eligible external debt securities are not required to be contractually subordinated; and
  - Final rule allows for possibility of partial conversion or exchange of less than all of the eligible internal debt securities of the IHC.

The Clean Holding Company

Clean Holding Company

- **What is the clean holding company requirement?**
  - The proposal sets out a "clean holding company" requirement, which has two parts:
  - First, a covered BHC is prohibited from
    - Engaging in short-term borrowings (any debt instrument with an original maturity of less than 365 days, including short-term deposits and demand deposits, issued to any person, unless the person is a subsidiary of the covered BHC),
    - Entering into QFCs (the final rule contains some changes that address credit support issues),
    - Issuing guarantees of subsidiary liabilities that could create cross-default, set-off or netting rights for creditors of the subsidiary, but exempts guarantees subject to a FRB stay rule restricting default rights or any similar rule of another U.S. banking agency

- Second, a covered BHC's third-party non-contingent liabilities (other than those related to eligible external TLAC) that are pari passu with or junior to its eligible external LTD to a cap of 5% of the value of its eligible external TLAC
- The final rule modifies the treatment of the 5% cap
  - Covered BHCs and covered IHCs have the option to contractually subordinate their eligible LTD to other third party liabilities without the need for the 5% cap
  - A BHC can satisfy the external LTD requirement with either senior or subordinated debt instruments
  - A covered BHC that chooses to issue all of its external LTD with a contractual subordination provision would not be subject to the 5% cap
- The preamble also makes it clear that the cap does not limit a covered BHC's ability to issue structured notes out of subsidiaries

Disclosures

Disclosures

- A covered BHC and a resolution-covered IHC must publicly disclose a description of the financial consequences to unsecured debtholders of the covered BHC or the resolution-covered IHC, as the case may be, of the entity's entry into a resolution proceeding in which the covered BHC (or resolution-covered IHC) is the only entity that would enter resolution
- The required disclosure may be made:
  - On the entity's website, or
  - In a public report or regulatory filing
- Also, such disclosures must be included in the offering documents for all eligible LTD

Changes to Indentures

Changes to Indentures

- Under the FRB final rule, in order to be eligible LTD, BHC debt cannot give holders a right of acceleration for principal or interest, except upon an insolvency or a payment default after a 30-day grace period.
- Result:
  - Acceptable events of default are bankruptcy, and non-payment of principal or interest after a 30-day grace period
  - Formerly, a non-payment of principal was an event of default without a grace period
  - Covenant default, cross-default, sinking fund non-payments and other events are no longer acceptable

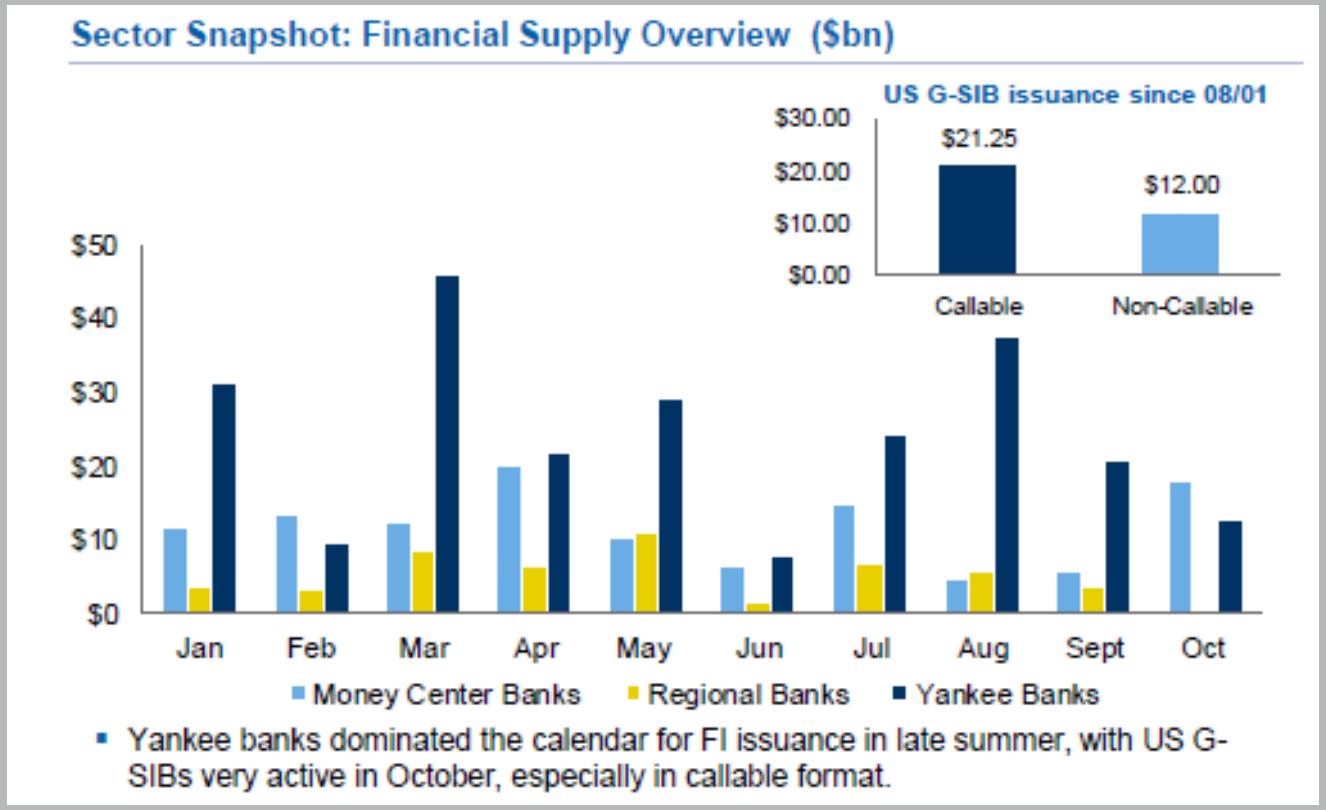
Changes to Indentures, cont'd.

- Recent supplemental indentures filed by, among others, JPMorgan, Citigroup, Morgan Stanley and Goldman amended their indentures generally in the following manner:
  - Sinking fund deposit and covenant defaults were removed
  - "Covenant Breach" was added
    - Breach of any covenant in the indenture (including the deposit of any sinking fund payment)
    - Not an event of default
    - But holders can sue on the contract
    - Damages uncertain – as opposed to acceleration upon an event of default
  - Merger clause clarified that all events of defaults and covenant breaches must be resolved prior to a merger, plus any "default" – defined to include any event that, after notice and lapse of time, would become an event of default or covenant breach – must be resolved
  - Generally, disallowed events of default put into a covenant breach
  - But: trustee can cause an acceleration of an event of default without any action by the holders
  - Holders seeking to enforce a covenant breach must satisfy the notice and indemnity provisions of the limitations on suits requirements

Market Reaction

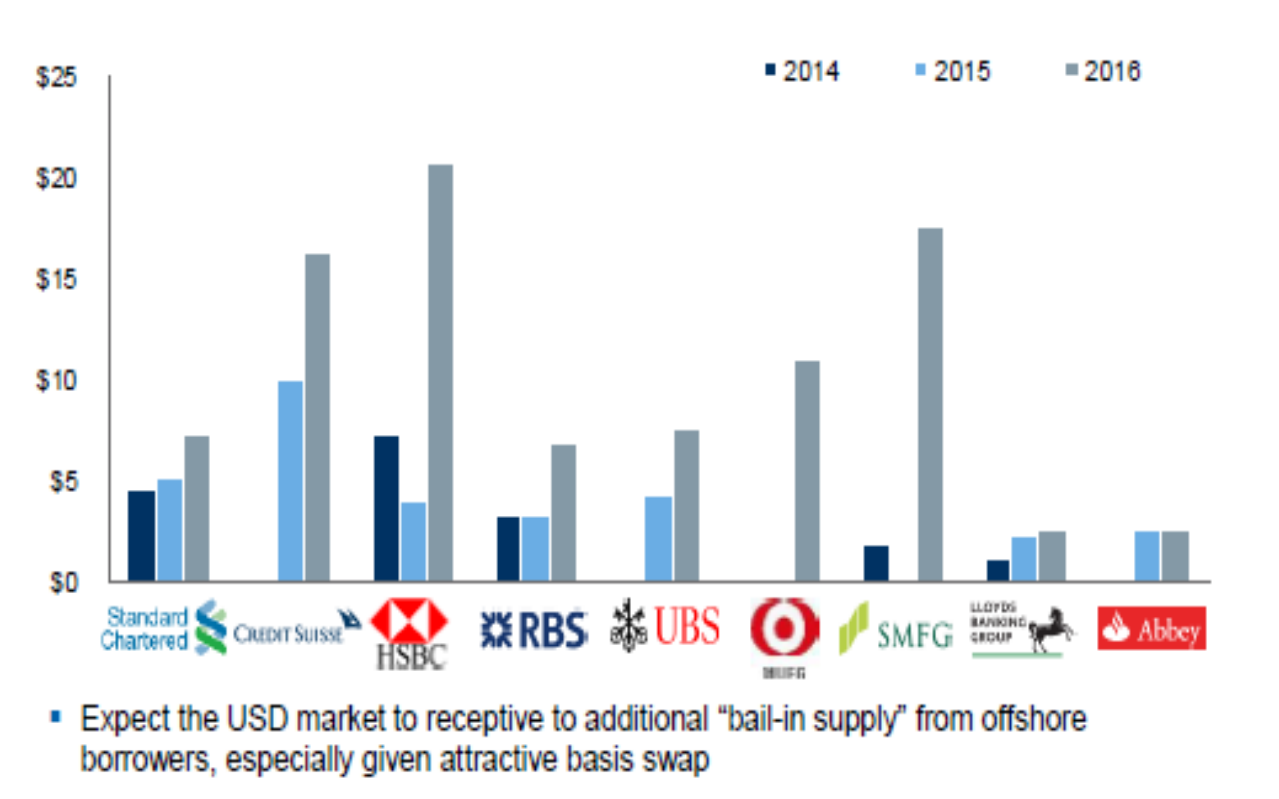
Market Reaction

- Thus far, there has been active issuance by financial institutions of TLAC qualifying securities
- There has been no notable pricing differentiation for TLAC versus non-TLAC issuance or as between domestic and foreign bank supply



Attributed to RBC Capital Markets

Market reaction, cont'd.



Attributed to RBC Capital Markets

Market reaction, cont'd.

Tax Implications

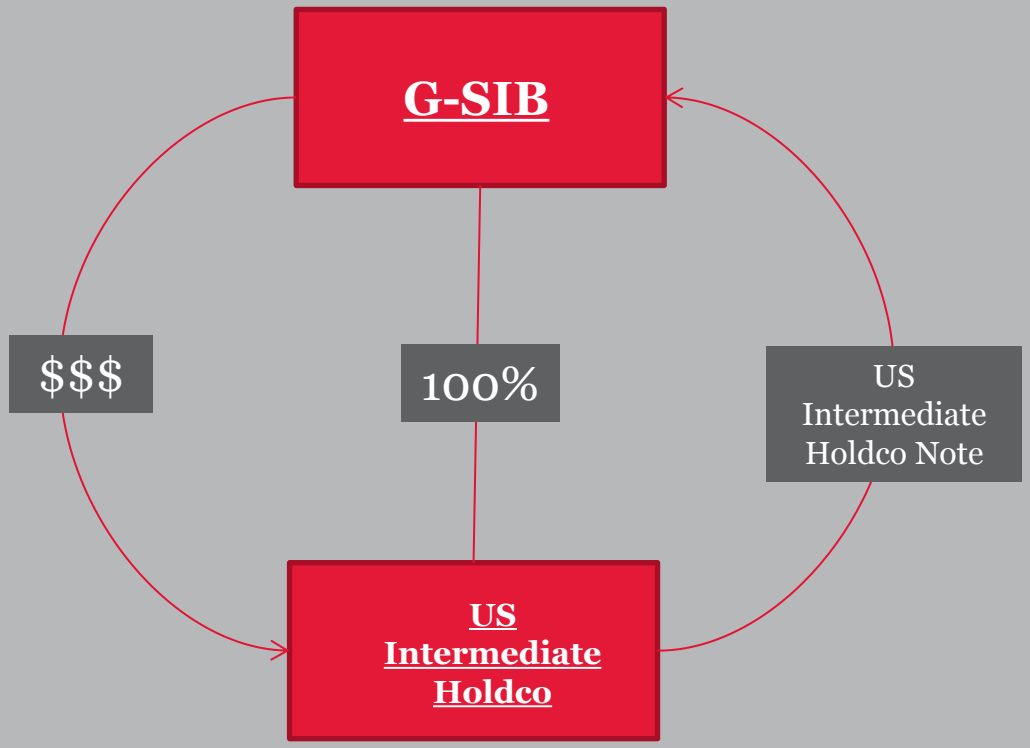
TLAC Tax Treatment

- Revenue Procedure 2017-12

- Issue: whether "internal TLAC," i.e., debt issued by a domestic international holding company to foreign GSIB is debt for federal income tax purposes.

- Features:
  - Debt in form
  - Subordinated
  - Subject to federally mandated contractual trigger that causes conversion to equity in distress situations

- Structure



TLAC, cont'd.

TLAC, cont'd.

- Revenue Procedure 2017-12 provides the following:
  - "Despite being debt in form, internal TLAC issued under the Board regulations lacks several of the elements that generally are required for an instrument to be treated as indebtedness for federal tax purposes."
  - "The Treasury Department and the IRS believe that it is in the interest of sound tax administration to apply federal tax principles in a manner that will support the rules promulgated by the Board for recapitalizing the issuer of internal TLAC on a going-concern basis."
  - "The IRS will treat internal [TLAC that is issued by an IHC of a foreign GSIB] as indebtedness for federal tax purposes to the extent that the internal TLAC has not been subject to a debt conversion order."

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U.S. Securities Law Developments and Canadian Issuers

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Today's Agenda

- "Two for One," and Regulatory Reform
- T+2 Settlement
- Guidance relating to Rule 144A
- Guidance for Foreign Private Issuers
- Regulation S guidance
- XBRL and Canadian Issuers
- Exhibit Filings

"Two for One"?

- The January 30, 2017 "two for one" order contemplates that, for each new rule issued by an executive department or agency, two regulations would need to be identified for elimination.
- Subsequent guidance issued on February 2, 2017: independent agencies, such as the SEC, are not covered by the order.
  - In addition, the original order does not cover "self-regulatory organizations," such as FINRA.
- That being said, "regulatory reform" is in the air.
  - SEC and FINRA of their relevant rules, with a view to making the capital-formation process more efficient, while maintaining protections particularly for retail investors.

T+2 Settlement

Final Rules Adopted in March 2017

- Amends Rule 15c6-1(a)
  - SEC release: https://www.sec.gov/rules/final/2017/34-80295.pdf
- Unless otherwise agreed by the parties, secondary transactions of most securities must settle in two business days.
- These rule changes, together with related stock exchange and FINRA regulations, have been percolating in the U.S. for some time.
- Impact of shorter settlement cycle:
  - Working group needs to focus on settlement items at an earlier date.

T+2, cont'd.

- For initial issuances, the rules technically don't apply.
- However, must be prepared for what initial holders will do, particularly if they trade immediately.
- If settlement cycle is greater than T+2, warnings in offering documents to explain that additional settlement arrangements must be made if buyer resells immediately.
- Impact on structured product and other sales:
  - Many market participants continue to offer securities under a "longer" settlement cycle, such as T+5.
  - These market participants may wish to continue their existing practices.
  - Other market participants may be content to continue with T+3.
- What's next? Roll-out into the Canadian market?

Guidance Relating to Rule 144A

What Is a QIB?

- Issuer's perspective:
  - Question is key to determining the availability of the Rule 144A exemption, and receiving required legal opinions.
- Investor's perspective:
  - Question frequently arises in giving representations and warranties as to its status under Rule 144A.

- What types of securities may be counted in determining whether an investor satisfies the $100 million requirement?
  - Securities purchased and held on margin may be counted as "owned," *provided that they* are not subject to a repurchase agreement (C&DI *138.05*)
  - An entity may count securities that have been loaned to borrowers (C&DI *138.06, Dec 2016*)
  - Cannot count securities that it has borrowed, since these securities are not "owned" (C&DI *138.07*)
  - Cannot count short positions in securities for the same reason—these do not represent an ownership interest (C&DI *138.08*)

What Is a QIB? – Aggregating Fund Families

- For a family funds: funds that are not registered investment companies cannot be aggregated with the investments held by registered investment companies in the fund family (C&DI 138.09)

What is a QIB? – Limited Partnerships

- Rule 144A(a)(v): [a]ny entity, all of the equity owners of which are qualified institutional buyers, acting for its own account or the accounts of other qualified institutional buyers
- How should the general partner of a limited partnership be determined?
  - Analysis: limited partners are the equity owners of a limited partnership
  - Result: the general partner, unless that person is also a limited partner, need not be considered in determining whether a limited partnership is a QIB (C&DI *138.10*)

Foreign Private Issuers, December 2016 C&DIs

Definition of Foreign Private Issuer

- An FPI is any issuer (other than a foreign government) incorporated or organized under the laws of a jurisdiction outside of the U.S., unless more than 50% of the issuer's outstanding voting securities are held directly or indirectly by residents of the U.S., and any of the following applies:
  - The majority of the issuer's executive officers or directors are U.S. citizens or residents;
  - The majority of the issuer's assets are located in the U.S.; or
  - The issuer's business is principally administered in the U.S.
- New guidance is designed to assist in the application of this definition.

Treatment of Multiple Voting Classes

- An issuer with multiple voting classes may now utilize one of two methods to determine whether its voting stock is owned by more than 50% of U.S. residents by assessing:
  - Whether 50 percent of the voting power of those classes on a combined basis is directly or indirectly owned of record by residents of the United States; or
  - The number of its voting securities.
- The SEC noted that an issuer "must apply a determination methodology on a consistent basis."

Evaluating U.S. Residency

- What factors that should be employed to determine whether an individual qualifies as a "U.S. resident" for purposes of evaluating whether an issuer's outstanding voting securities are held of record by U.S. residents?
  - Permanent resident status (i.e., a green card holder) is presumed to be a U.S. resident.
  - Individuals without permanent-resident status may also, but without the benefit of a presumption, be deemed U.S. residents based on several criteria, including:
    - Tax residency;
    - Nationality;
    - Mailing address;
    - Physical presence;
    - The location of a significant portion of the individual's financial and legal relationships; or
    - Immigration status.
  - An issuer must nevertheless "decide what criteria it will use to determine residency and apply them consistently without changing them to achieve a desired result."

Are Executive Officers or Directors U.S. Citizens or Residents?

- To determine whether a majority of an issuer's executive officers or directors are U.S. residents or citizens, the assessment must be made *separately for both directors and executive officers*.
- As a result, four determinations must be made:
  - The citizenship status of its executive officers;
  - The residency status of its executive officers;
  - The citizenship status of its directors; and
  - The residency status of its directors.
- Issuers with two boards of directors: issuer must make the "majority" analysis with respect to the board of directors that performs functions that closely resemble those undertaken by a U.S.-style board of directors.
- If these functions are allocated to both boards, then the issuer may "aggregate the members of both boards for purposes of calculating the majority."

Is the Majority of the Issuer's Assets Located in the U.S.?

- To determine whether more than 50% of an issuer's assets are located in the United States, the Staff has clarified that an issuer may either:
  - Use the geographic segment information determined in the preparation of its financial statements; or
  - Apply on a consistent basis any other reasonable methodology in assessing the location and amount of its assets.

Is the Issuer's Business Administered Principally in the U.S.?

- There is no particular factor that is determinative for evaluating whether an issuer's business is administered principally in the United States.
- An issuer must assess on a consolidated basis the location from which its officers, partners or managers primarily direct, control and coordinate its activities.

Offerings by Foreign Private Issuers and Form 20-F

Offerings with a Non-FPI Subsidiary as Issuer or Guarantor

- The C&DIs clarify that, provided that the relevant provisions of Regulation S-X are satisfied:
  - An FPI can use the F-Forms (and Form 20-F for reporting requirements) where it issues securities that are guaranteed by a subsidiary that is not an FPI.
  - This is also the case where the FPI is the guarantor, and the non-FPI is the issuer.
- The C&DI is of particular use in the case of high-yield securities that have subsidiary guarantees, or in the case of issuances by a finance subsidiary.

Wholly Owned Subsidiary's Omission of Information in Its Form 20-F

- An FPI's wholly owned subsidiary may omit certain information under General Instruction I(2) (to Form 10-K) from its Form 20-F filing.
- The registrant must include a prominent statement on the Form 20-F's cover page:
  - That it satisfies the conditions set forth under General Instruction I(1)(a) and (b) to Form 10-K; and
  - Is filing the Form 20-F with a reduced disclosure format.

Form 20-F Filing Deadline

- General Instruction A(b)(2) to Form 20-F -- Form 20-F must be filed within four months after the end of an issuer's fiscal year.
- If the last day of an issuer's fiscal year is the last day of the month, the Form 20-F will be due four "complete" months after that day.
  - E.g.: Jan 31st fiscal year end – Form 20-F due on May 30th
- If the last day of the issuer's fiscal year falls on any day other than the end of a month, the Form 20-F must be filed on the same day four months ahead.
  - E.g.: Jan 30th fiscal year end – Form 20-F due on May 30th

Incorporation of Information by Reference into Form 20-F

- Under Rule 12b-23 under the Exchange Act, information previously filed with the SEC may be incorporated by reference into any item of Form 20-F, subject to Rule 12b-23's limitation.
- An FPI that incorporates this type of information by reference must "identify with specificity the information that is being incorporated by reference."

XBRL and Canadian Issuers

What Is XBRL?

- eXtensible Business Reporting Language (XBRL): an interactive data format for financial information.
- Initial rules date back to 2009: SEC reporting companies must file with the SEC and post to their websites their financial statements in XBRL format.
- Using this format, financial information can be downloaded directly into spreadsheets, analyzed using commercial software packages, and used by investors and analysts in a variety of ways.
- XBRL supplements the traditional presentation of financial statements.
- Initially, the SEC delayed compliance for foreign private issuers report using International Financial Reporting Standards, as issued by the International Accounting Standards Board (IFRS), pending the SEC's specification of an XBRL "taxonomy" for IFRS.
  - Taxonomy: a standard list of tags for specific items IFRS financial data.)

XBRL and Canada

- Not new to the Canadian market.
- The Canadian Securities Administrators established an XBRL voluntary filing program: May 2007.
- Initially designed to help the CSA assess the usefulness of XBRL.
- Initially, the voluntary XBRL filings were considered supplementary filings -- issuers need to file their financial statements in PDF format, as required by Canadian securities legislation.

Impact on Canadian Registrants

- Canadian issuers filing will be required to include financial statements in XBRL format (even if they prepare financial statements in accordance with IFRS)
- When Requirements Begin to Apply: annual reports filed beginning in 2018 relating to their fiscal years ending on or after December 15, 2017.
  - Earlier compliance is voluntary.

- Financial data to be filed as an exhibit to a Form 40-F in XBRL format (and posted on the relevant corporate website):
  - balance sheet;
  - income statement;
  - statement of cash flows;
  - statement of stockholders' equity;
  - statement of comprehensive income, if presented separately;
  - notes to the financial statements; and
  - any applicable schedules to the financial statements.

Impact on Canadian Registrants, Cont'd.

- Registration Statements:
  - Financial statements in XBRL format will be required for registration statements under the 1933 Act.
    - Exception: IPOs.
  - XBRL format: not required as an exhibit to a 1933 Act registration statement that does not contain financial statements, such as a Form F-10 registration statement filed by a Canadian issuer under the MJDS or a registration statement form that incorporates by reference the financial statements from an issuer's 1934 reports.
- Additional Representations and Warranties Requested by Some Underwriters
  - Sample: "The interactive data in the eXtensible Business Reporting Language ("XBRL") incorporated by reference in the Registration Statement, the [Prospectus Supplement] and the Disclosure Package fairly presents in all material respects the information called for and has been prepared in accordance with the SEC's rules and guidelines applicable thereto."

Hyperlinks to Exhibits

New Exhibit Requirements

- Adopted March 2017.
- Applies to filings made on or after September 1, 2017.
- Applies to registrations under the 1933 Act and periodic filings under the 1934 Act that are subject to the exhibit requirements of Item 601 of Regulation S-K.
- Canadian issuers:
  - Does not apply to MJDS forms, such as Form 40-K, or to Form 6-K.
    - The SEC believes that hyperlinks in these forms may have less utility, because exhibits, and an exhibit index, are not required for these forms.
  - *Does* apply to registration statements on Form F-3.
  - Optional compliance for investor convenience.