

## **Keys To Equity Financing: The Compliance Requirements for Lenders and Borrowers**

**Structuring Loans Secured by Stock, Hedge Fund Shares,  
40 Act Companies and Other Investment Vehicles**

---

THURSDAY, MAY 23, 2013

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

---

Today's faculty features:

Craig S. Unterberg, Partner, **Haynes & Boone**, New York

R. Todd Ransom, Partner, **Haynes and Boone**, New York

Lin Yu, Director and Counsel, **Credit Suisse Securities**, New York

---

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 10.**

## *Tips for Optimal Quality*

---

### Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory and you are listening via your computer speakers, you may listen via the phone: dial **1-888-450-9970** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail **[sound@straffordpub.com](mailto:sound@straffordpub.com)** immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press \*0 for assistance.

### Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

## *Continuing Education Credits*

FOR LIVE EVENT ONLY

---

For CLE purposes, please let us know how many people are listening at your location by completing each of the following steps:

- In the chat box, type (1) your **company name** and (2) the **number of attendees at your location**
- Click the SEND button beside the box

## *Program Materials*

---

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the + sign next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

# Equity Financing

## Regulatory and Structural Considerations for Lenders and Borrowers

May 2013



*haynesboone*

Setting precedent.

# Agenda

1. Introduction: Market Concerns & Trends
2. Primary Regulatory Issues
3. Security Interest in Securities, LLC/LP Interests and '40 Act Fund Assets
4. Foreclosure Issues
5. Structural Issues & Common Pitfalls
6. Panel Discussion and Audience Questions

# Introduction

- Types of Transactions:
  - Single stock deals
  - Stock buy-backs
  - Portfolio financing
  - Fund-of-fund financing
  - Acquisition financing / Tender offers
  - Going-private transactions

# Regulatory Issues

## Securities Act

- Prohibition on sale of securities unless:
  - Effective registration statement
  - Exemption from Securities Act
- Securities Act issues are impacted by the type of collateral:
  - Restricted Securities
  - Control Securities



# Regulatory Issues

## Securities Act – Exemptions

- Section 4(1) – exemption for sales other than by “an issuer, underwriter or dealer”
  - Issuer – directly/indirectly/common control
  - Underwriter
- Pledgor and Secured Party risk being an underwriter (Section 2(a)(11))

# Regulatory Issues

## Securities Act – Exemptions

- Section 4(1½) – Private Sale - Conditions
  - Block sale
  - Notice that shares will be restricted
  - Restrictive legend
  - Credit bid
  - Advertising limits and requirements
  - Delivery of all material information by secured party

# Regulatory Issues

## Securities Act – Exemptions

- Rule 144 –Public Sales
  - Affiliates v. Non-Affiliates
  - Reporting Company
  - Holding Period & tacking – recourse v. non-recourse
  - Current public information

# Regulatory Issues

## Securities Act – Exemptions

- Rule 144 (continued)
  - Volume Limits
  - Manner of Sale – “broker’s transaction”
  - Form 144 – representation re: material non-public information

# Regulatory Issues

## Securities Act - Planning

- Planning for a foreclosure sale
- Shelf registration (evergreen)
- Covenant to register upon foreclosure
- Cooperation of issuer/issuer letters

# Regulatory Issues

## Exchange Act - Filing

- Generally, secured parties want to avoid beneficial owner status pre-default
- Collateral registered under Section 12 of the Exchange Act?
- “Beneficial owner”
  - Formal steps
  - Vote, dispose or direct disposition of securities

# Regulatory Issues

## Exchange Act - Filing

- Bona fide pledge
- Bank/financial institution
- Time to file - Sections 13(d) and 13(g)
  - 5% (annual)
  - 10% or intent (promptly)

# Regulatory Issues

## Exchange Act - Filing

- Section 16(a) and 16(b)
  - Reporting requirement
  - Short-swing profit rules (exceptions)



# Regulatory Issues

## Exchange Act – Anti-Fraud

- Section 10(b) and Rule 10(b)(5)
  - Apply to both pledge and foreclosure
  - Material fact and reasonable investor
  - Untrue or omission
  - Judicial element – scienter
  - Fraud by pledgor & knowledge of secured party

# Regulatory Issues

## Margin Regulations

- Regulation U – Non-broker-dealer lenders
- Regulation T – Broker-dealers
- Regulation X – U.S. persons/Foreign lenders

# Regulatory Issues

## Margin Regulations – Reg. U

- The general purpose of Regulation U is to regulate extensions of credit by non-broker-dealer lenders that are both:
  - made “for the purpose, whether immediate, incidental or ultimately, of buying or carrying margin stock”, and
  - secured directly or indirectly by margin stock

# Regulatory Issues

## Margin Regulations – Reg. U

- Margin stock
- Purpose credit
- Directly/Indirectly Secured

# Regulatory Issues

## Margin Regulations – Reg. U

- Maximum loan value – 50% of market value
- Single credit rule
- Form FR U-1

# Regulatory Issues

## Margin Regulations – Reg. U

### Example 1

If a customer pledges to a lender Coca-Cola stock with a current market value of \$2,000,000 to buy \$2,000,000 of IBM stock, then the lender can loan up to \$1,000,000 to that customer for the purchase of the IBM stock. This assumes that the customer is not pledging the IBM stock it purchased.

### Example 2

If a customer pledges to a lender Coca-Cola stock with a current market value of \$2,000,000 to buy \$2,000,000 of IBM stock, which the customer will pledge to the lender after the purchase (\$4,000,000 in total collateral) then the lender may loan up to \$2,000,000 to that customer for the purchase of the IBM stock.

### Example 3

The market value of the Coca-Cola stock drops to \$1,000,000 after the extension of credit. Does the lender need to take any action to increase the amount of the collateral? No, the lender does not need to take any action under Regulation U. Regulation U only imposes an initial margin requirement, and does not contain a maintenance margin requirement.

# Regulatory Issues

## Margin Regulations – Reg. U

- Reg. U applies to both:
  - Extending credit
  - Maintaining credit (i.e., purpose credit previously extended).

# Regulatory Issues

## Margin Regulations – Reg. X

- Liability for credit in contravention of Reg. U or T
- U.S. person – 50% and direct/indirect beneficial interest



# Equity Finance

## Due Diligence

- Relationship of issuer and pledgor
- How and when did pledgor acquire the securities
- DTC eligible
- Transfer agent

# Equity Finance

## Due Diligence

- Examine stock certificates
  - Restrictive legends
  - Shareholders agreement
- Jurisdiction
  - PRIMA vs. Look-through
  - PRIMA vs. UCC
- Subject to local bankruptcy rules

# Security Interest

## Uniform Commercial Code

- Articles 8 and 9
- Secured party's goal – valid, perfected and first priority security interest in the pledged securities

# Security Interest

## Uniform Commercial Code

- Collateral
  - Investment property
  - Securities
  - Security entitlement
  - Securities account
  - General intangibles (LP and LLC interests)

# Security Interest

## Uniform Commercial Code

- Collateral – General Intangibles
  - Limited partnership and limited liability company interests
  - Opting-in to be treated as a “security”
  - Amendment to LP/LLC agreement (condition precedent and negative covenant to prevent opt-out)

# Security Interest

## Uniform Commercial Code

- Methods of perfecting security interest - control
  - Entitlement holder – account holder
  - Control agreement – securities intermediary
  - Secured party as securities intermediary
  - Delivery – certificated securities
  - Filing

# Security Interest

## Uniform Commercial Code

- Methods of perfecting security interest - control
  - Control agreement terms
    - Account structure – securities account, deposit account, hybrid account
    - Entitlement orders and instructions
    - Notice of exclusive control – conditions
    - Cash as a financial asset
    - Sub-custodians and foreign collateral
  - Custodians and '40 Act Funds

# Security Interest

## Foreclosure

- Commercially reasonable (Article 9)
  - Proper notice
  - Lack of good faith
  - Public/private sale
  - Improper advertising
  - Inadequate disclosure
- Question of fact



# Security Interest

## Foreclosure

- Foreclosure – Private sale
  - “customarily sold on a recognized market or subject to widely distributed standard price quotations”
    - Rule 144
    - Section 4(1)
- Court order

# Security Interest

## Foreclosure

- Sanctions for breach of Article 9 foreclosure standards
  - Injunction
  - Loss of deficiency
- Liability for breach of securities regulations

# Regulatory Issues

## Other Regulatory Considerations

- Hart-Scott-Rodino Act
- Bankruptcy Code and safe harbors (e.g., “securities contract”)
- Foreign collateral and Take-Over Rules
- Section 20(a) and 21(a) of the Exchange Act

Craig S. Unterberg

Haynes & Boone

[craig.unterberg@haynesboone.com](mailto:craig.unterberg@haynesboone.com)

R. Todd Ransom

Haynes and Boone

[todd.ransom@haynesboone.com](mailto:todd.ransom@haynesboone.com)

Lin Yu

Credit Suisse Securities

[lin.yu@credit-suisse.com](mailto:lin.yu@credit-suisse.com)

# Equity Financing

## Regulatory and Structural Considerations for Lenders and Borrowers

May 2013



*haynesboone*

Setting precedent.