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BROKER-DEALER

FINRA Publishes Information Notice Regarding Enhancements to the Disclosure Review Process Relating to Public Financial Records

On May 18, the Financial Industry Regulatory Authority (FINRA) published an Information Notice regarding enhancements to FINRA's disclosure review process (Information Notice). The enhancements will allow member firms to rely on FINRA's verification process to comply with the requirement to conduct public searches related to bankruptcies, judgments and liens. Beginning on July 9, FINRA will conduct a public records search within 15 calendar days of an applicant's submission of a Form U4 and then provide member firms with any information that is different than what was reported on the aforementioned form. Such enhancements are intended to (1) reduce member firm costs related to public record checks; (2) result in the more timely reporting of certain disclosure information; and (3) reduce the late disclosure fees related to judgments and liens.

A copy of the Information Notice is available here.

FINRA Proposes Rule Change to FINRA Regulation, Inc. District Committee Structure and Governance

On May 18, the Financial Industry Regulatory Authority (FINRA) filed a rule change with the Securities and Exchange Commission to amend the by-laws of FINRA Regulation, Inc. (FINRA Regulation)—FINRA's regulatory subsidiary. The rule change would reorganize FINRA Regulation's District Committees (Rule Change), converting FINRA Regulation's District Committees into Regional Committees, which mirror the regions covered by FINRA's districts. This change aligns with FINRA's practice of managing FINRA Regulation's District Committees as region-wide committees. Among other changes, the reorganization also will involve: (1) the revision of FINRA Regulation's candidate and member voting eligibility standards to better reflect the member firms and industries in each of the regions; and (2) conforming amendments to the FINRA Regulation By-Laws and FINRA rules regarding the terminology change. Pursuant to Section 19(b)(3) of the Securities Exchange Act of 1934, as amended, and Rule 19b-4 thereunder, the rule change was effective upon filing.

The text of the Rule Change is available here.

SEC Division of Trading and Markets Director Gives Remarks Regarding Regulation Best Interest

On May 22, Brett Redfearn, the Director of the Securities and Exchange Commission's Division of Trading and Markets spoke at the Financial Industry Regulatory Authority's Annual Conference regarding the newly proposed Regulation Best Interest. (For a more complete discussion of Regulation Best Interest, please refer to Katten's "SEC Proposes Fiduciary Rule for Broker-Dealers" advisory, available here.) Director Redfearn noted that he views Regulation Best Interest as a "significant change from the status quo for broker-dealers that provide advice" that builds upon current regulations. He further noted that Regulation Best Interest tries to achieve two goals: (1) enhancing the quality of broker-dealer recommendations to retail customers; and (2) preserving the "pay as you go" model as a viable choice for investors seeking recommendations about securities.

In addition to noting the goals of Regulation Best Interest, Director Redfearn outlined some of the key aspects of the proposal, including, but not limited to, the contours of the "best interest" standard. He concluded his remarks

by encouraging market participants to submit comments to the numerous questions posed in the proposal. The 90-day comment period for Regulation Best Interest ends on August 7.

The text of Director Redfearn's remarks are available here.

DERIVATIVES

See "CFTC Issues Proposed Rule to Amend Margin Requirements" and "CFTC Issues Virtual Currency Advisory for Exchanges and Clearinghouses" in the CFTC section.

CFTC

CFTC Issues Proposed Rule to Amend Margin Requirements

On May 17, the Commodity Futures Trading Commission released a proposed rule to amend the CFTC's margin requirements for uncleared swaps for swap dealers and major swap participants. The proposed rule amendments are intended to make the same changes to the CFTC margin requirements that federal banking regulators recently proposed for the margin rules for swap dealers that are subject to prudential regulation (for more information, please see the *Corporate & Financial Weekly Digest* edition of February 12, 2018). The proposed rule will ensure that master netting agreements of firms subject to the CFTC margin requirements are not excluded from the definition of "eligible master netting agreement" merely because they comply with recent regulatory changes to the treatment of qualified financial contracts executed with banks ("QFC Rules").

The definition of "eligible master netting agreement" does not currently allow an agreement to contain certain restrictions on the exercise of a covered swap entity's cross-default rights, which are required under the QFC Rules. The proposed rule would amend the definition of "eligible master netting agreement" to allow such restrictions. The proposed rule also makes clear that a swap would not lose its legacy treatment under the CFTC margin requirements (causing it to become a covered swap and causing any netting portfolio in that it is included to be subject to the CFTC margin requirements) by virtue of the swap being amended solely to conform to the QFC Rules.

In the press release accompanying the proposed rule, the CFTC indicated that the proposed rule was designed to reduce regulatory burdens in the derivatives market and eliminate red tape that hinders job creation.

The proposed rule is available here.

CFTC Issues Virtual Currency Advisory for Exchanges and Clearinghouses

On May 21, the Commodity Futures Trading Commission released a staff advisory that provides guidance to designated contract markets (DCMs) and swap execution facilities (SEFs) that plan to list virtual currency derivatives for trading and clearing organizations (DCOs) that plan to clear virtual currency derivatives. The advisory notes that the CFTC's recommendations are informed by the unique characteristics of virtual currencies that make obtaining information about the spot market difficult, including the fact that the commercial uses for virtual currencies are less developed than the commercial uses of other products underlying derivatives, and there is less price verification. The advisory addresses the need for enhanced market surveillance, coordination and communication with CFTC staff, large trading reporting, outreach to relevant stakeholders and risk management of DCOs.

As it relates to market surveillance, the CFTC recommends that DCMs and SEFs seek to (1) establish information sharing arrangements with the underlying spot markets; (2) conduct real time monitoring of trading activity (including data feeds from spot markets); and (3) undertake additional inquiries if unusual patterns are discovered. The CFTC also notes that it believes existing large trader reporting may be helpful in identifying manipulative activity and recommends exchanges set large trader reporting thresholds for any virtual currency derivative contract at 5 bitcoin (or the equivalent for other virtual currencies). As it relates to expected outreach, the CFTC expects that an exchange that plans to list a virtual currency derivative will seek comment from relevant market participants and consider how to address opposing views it receives. Finally, the CFTC will consult with any DCO

that proposes to clear virtual currency derivatives. The CFTC will evaluate proposed margin requirements as well as the DCO's internal governance procedure for approving the virtual currency derivatives and its adherence thereto.

The CFTC's advisory is available here.

CFTC Grants Foreign Board of Trade Application to ASX24

On May 15, the Commodity Futures Trading Commission issued an order granting Australian Securities Exchange Limited (ASX24) registration as a foreign board of trade (FBOT). As a registered FBOT, ASX24 is authorized to permit members and other exchange participants to trade directly on its platform without having to trade through an intermediary. With this order, the CFTC has registered 19 foreign boards of trade from 12 countries. ASX24 previously offered direct access to US participants in accordance with no-action relief issued to its predecessor, the Sydney Futures Exchange Limited.

The CFTC's announcement is available here.

CFTC and NASAA Sign Information Sharing Agreement

On May 21, the Commodity Futures Trading Commission announced that it had signed a mutual cooperation agreement with the North American Securities Administrators Association (NASAA) to promote information sharing between the CFTC and state securities regulators. The agreement is designed to assist in the enforcement of the Commodity Exchange Act, which state securities regulators and state attorneys are statutorily authorized to do alongside the CFTC. Information shared under the MOU also could generate enforcement actions under state securities laws, commodity codes or other areas of law.

The CFTC's announcement is available here.

UK DEVELOPMENTS

FCA Publishes Findings From Its Review of Automated Investment Services

On May 21, the UK Financial Conduct Authority (FCA) published a webpage on its findings from its review of firms offering automated investment services. The aim of the review was to monitor developments in financial innovation to help inform the FCA's regulatory strategy, as set out in its 2017/18 Business Plan.

The FCA reviewed the activities of seven firms offering automated online discretionary management (ODIM), where a firm has the responsibility of investing on behalf of a client, within agreed parameters, on an ongoing basis. The FCA also reviewed three firms providing retail investment advice exclusively through automated channels (auto-advice), where customers do not interact with human financial advisers.

Following its review, the FCA found that:

1. ODIM firms did not sufficiently clarify whether their service was advised, non-advised, discretionary or non-discretionary;
2. some ODIM firms also compared their fee levels against peer services in potentially misleading ways;
3. many ODIM firms did not properly evaluate clients' knowledge and experience, investment objectives and capacity for loss in their suitability assessments;
4. most ODIM firms were unable to show that they had adequate and up-to-date information about clients when providing ongoing portfolio management; and
5. some auto-advice firms lacked adequate fact finding and 'know your client' focus, and instead relied on assumptions about clients.

The FCA emphasized that while it will continue to encourage innovation in automated investment services, its rules on suitability of advice apply regardless of the medium through which the service is offered. The FCA's webpage also reminds firms to consider the FCA's finalized guidance on streamlined advice and related

consolidated guidance (FG17/8) setting out, among other things, the FCA's expectations regarding streamlined advice and fact finding processes.

The FCA intends to review more firms in the auto-advice market later in the 2018/19 financial year. Future reviews will also include assessments of compliance with the revised Markets in Financial Instruments Directive (MiFID II) requirements and the cumulative impact of MiFID II and the Packaged Retail and Insurance-based Investment Products Regulation (PRIIPs).

The FCA's webpage, setting out its expectations of automated investment services, is available here.

The FCA's FG17/8 is available here.

The FCA's 2017/18 Business Plan is available here.

Treasury Committee's Virtual Currencies Inquiry Publishes FCA and Bank of England Evidence

On May 22, the UK's House of Commons Treasury Committee (Treasury Committee) updated its webpage on its inquiry into what it refers to as "digital currencies." The webpage now provides links to written evidence the Treasury Committee has received from the UK Financial Conduct Authority (FCA) and the Bank of England (BoE) in which they outline their work in this area.

The FCA's response considers whether different forms of cryptoassets and products that refer or relate to underlying cryptoassets may fall within its regulatory scope. For example, cryptoassets designed primarily as a means of payment or exchange would not generally sit within the scope of FCA regulation. However, the FCA reiterates that whether a cryptoasset falls within scope of the regulatory perimeter will be fact-specific, depending on the particular cryptoasset instrument in question. Through its work with firms and monitoring market developments, the FCA has identified several potential risks deriving from cryptoassets, including price volatility, market manipulation, cryptoasset derivatives and money laundering. The FCA also is unclear whether the distributed ledger technology underlying many cryptoassets will be adopted broadly across securities markets or remain limited to niche uses.

In the BoE's response, it begins by outlining why it believes that cryptoassets are unlikely to replace commonly used payment systems, due to the current failure to perform three key functions of money: as a store of value; a means of payment; and a unit of account. The BoE also confirms its view that cryptoassets do not currently pose a material threat to financial stability due to the relatively small scale of current cryptoasset use and the negligible exposures and linkages the UK financial system currently has to crytposassets. Nevertheless, due to the rapidly evolving market, industry and technology surrounding cryptoassets, the BoE states that it will continue to closely monitor developments. The UK Prudential Regulation Authority also is assessing how prudential regulations should apply if cryptoassets were held by banks or financial institutions, including whether or not additional requirements are necessary to cover associated risks, such as the extreme levels of volatility that cryptoassets exhibit.

The webpage is available here.

The BoE's written evidence is available here.

The FCA's written evidence is available here.

UK Data Protection Bill Receives Royal Assent

Ahead of the EU's General Data Protection Regulation (GDPR) going into effect on May 25, the UK's Data Protection Bill received Royal Assent on May 23, to become the Data Protection Act 2018 (DPA 2018).

The DPA 2018 is designed to:

- ensure that the standards set out in the GDPR have effect in the UK and to provide for certain derogations permitted by the GDPR;

- repeal and replace the Data Protection Act 1998 as the primary piece of domestic data protection legislation in the UK; and
- ensure that the UK and EU data protection regimes are aligned post-Brexit and that the UK will continue to be able to freely exchange personal data with the EU.

The GDPR is directly applicable in all EU member states, including the UK; however, the DPA 2018 supplements the GDPR and includes provisions relating to, for instance, the Information Commissioner's Office, which is the data protection supervisory authority in the UK. The DPA 2018 also extends domestic data protection laws to areas that are not covered by the GDPR.

The DPA 2018 is available here.

EU DEVELOPMENTS

ESMA Publishes Opinion on Position Limits on ICE Low Sulphur Gasoil 1st Line Contracts

On May 15, the European Securities and Markets Authority (ESMA) published an opinion on position limits proposed by the UK Financial Conduct Authority (FCA) in respect of ICE Low Sulphur Gasoil 1st Line Future and Option contracts. ESMA found that the contracts are consistent with the objectives established in the revised Markets in Financial Instruments Directive (MiFID II) and with the methodology developed for setting those limits. The opinion also concerns certain balance of the month, or "Balmo" contracts, which share contract specifications with the monthly contract and are priced according to the same underlying objectives.

The opinion follows the work plan agreed by ESMA and Member State national competent authorities (NCAs), including the FCA, under which position limits under MiFID II will be published by the NCAs prior to ESMA publishing an opinion on such limits (for further information, please see the September 29, 2017 edition of the *Corporate & Financial Weekly Digest*).

ESMA's opinion is available here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

For more information, contact:

FINANCIAL SERVICES		
Janet M. Angstadt	+1.312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	+1.212.940.6615	henry.bregstein@kattenlaw.com
Kimberly L. Broder	+1.212.940.6342	kimberly.broder@kattenlaw.com
Wendy E. Cohen	+1.212.940.3846	wendy.cohen@kattenlaw.com
Guy C. Dempsey Jr.	+1.212.940.8593	guy.dempsey@kattenlaw.com
Gary DeWaal	+1.212.940.6558	gary.dewaal@kattenlaw.com
Kevin M. Foley	+1.312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	+1.212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	+1.312.902.5241	arthur.hahn@kattenlaw.com
Christian B. Hennion	+1.312.902.5521	christian.hennion@kattenlaw.com
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Fred M. Santo	+1.212.940.8720	fred.santo@kattenlaw.com
Christopher T. Shannon	+1.312.902.5322	chris.shannon@kattenlaw.com
Robert Weiss	+1.212.940.8584	robert.weiss@kattenlaw.com
Lance A. Zinman	+1.312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	+1.312.902.5334	krassimira.zourkova@kattenlaw.com
UK/EU DEVELOPMENTS		
John Ahern	+44.20.7770.5253	john.ahern@kattenlaw.co.uk
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Neil Robson	+44.20.7776.7666	neil.robson@kattenlaw.co.uk
Nathaniel Lalone	+44.20.7776.7629	nathaniel.lalone@kattenlaw.co.uk

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