Katten Financial Markets and Funds *Quick Take*
August 2022

FINRA's New Rule Proposal Eases the Ability for Brokers to Work From Home

By Susan Light

On July 27, 2022, FINRA filed a proposed rule change with the SEC to make it easier for brokers to work from home. The proposed rule will add a category termed a "Residential Supervisory Location" under FINRA Rule 3110 (Supervision) that will treat a private residence where an associated person engages in specified supervisory activities as a non-branch location, subject to certain conditions. A Residential Supervisory Location would become subject to inspections on a regular periodic schedule, generally at least every three years, rather than an annual inspection requirement. *Read about the proposed rule change.*

The Joint Audit Committee in the Post-Archegos Risk Management Landscape

By Stephen Morris

Highlighting the risk management regulatory environment following the 2021 default of Archegos Capital Management, this article discusses the Joint Audit Committee's (JAC) regulatory jurisdiction over futures commission merchants (FCM). In examining the JAC's recent practice in conducting annual financial and operations audits of the industry's largest FCMs, the author discusses initiatives from the Fed and the SEC and suggests ways in which the JAC can align its risk management guidance with those initiatives. *Read the full article.*

Comment Period on Proposed Changes to QPAM Exemption Closes September 26

By Mitchel Pahl and Matthew Rutchik

The US Department of Labor (DOL) has proposed amendments to the "qualified professional asset manager" (QPAM) exemption. The proposed amendments have the potential to substantially impact participants in the financial markets and transactions, which rely on the QPAM exemption. The proposed amendments would:

- significantly broaden the disqualification condition of the QPAM exemption;
- add a one year wind-down period for QPAMs who are disqualified from acting as a QPAM, during which time the QPAM may apply for an individual QPAM exemption and its ability to act on behalf of clients would be restricted;
- require the QPAM and its clients to add contractual assurances and indemnifications in written client agreements, including with an indemnification with respect to "actual costs,"

which “include losses and relates costs arising from unwinding transactions with third parties and transitioning plan assets to an alternative asset manager”;
- require all entities relying on the QPAM Exemption to notify the DOL and the DOL “intends to keep a current list of all [such] entities relying upon the QPAM exemption on its publicly available website”;
- revise a condition relating to the QPAM’s independence and investment authority;
- increase the asset under management and shareholder equity requirements for an entity to be a QPAM; and
- add a recordkeeping requirement for entities that act as a QPAM.

This is the first time the DOL has proposed changes to the QPAM exemption in over 10 years, although many of the proposed changes to the exemption mirror conditions and comments made by the DOL in individual QPAM exemptions issued in the same time frame. The comment period to the proposal is open until September 26, unless it is extended. It is widely expected that the DOL will receive substantial comments on the proposed changes from the ERISA bar as well as from financial markets stakeholders.

Futures Audit Trails Requirements: A Compliance Minefield?

By Stephen Morris

US futures exchange rules require participants with direct access to the exchange’s trading systems to maintain an “electronic audit trail” of all order messages submitted to the exchange. The technical specifications associated with this audit trail requirement are highly prescriptive. Compliance with the requirement — which exchange market regulation divisions monitor with vigilance, typically by way of annual examinations — requires close cooperation among Compliance, Operations and IT personnel within firms that trade through direct access. Audit trails must be complete and accurate and account for every electronic communication a firm’s systems send to or receive from the exchange. (Even what might seem *de minimis* omissions and errors can and do result in fines.) Audit trail records must be maintained for a minimum of five years. *Read about futures audit trails.*

Block Trades, EFRPs and Assorted Other Trade Practice Issues: A Practical Guide of Current Status

By Stephen Morris, Gary DeWaal, Carl Kennedy and Alexander Kim

With some frequency, Katten attorneys field questions from clients about exchange rules on off-exchange execution of futures and options on futures. This advisory provides a high-level overview on this topic in connection with four principal futures exchanges: Chicago Mercantile Exchange Group (CME), ICE Futures U.S. (IFUS), ICE Futures Europe (IFEU) and Cboe Futures Exchange (CFE). In addition, it offers some perspective on other futures trade practice issues that have been recent areas of focus for US regulators. *Read Katten’s advisory.*

Futures Intermediaries: Pre-hedge Block Trades At Your Own Risk

By Stephen Morris

The Commodity Futures Trading Commission recently settled allegations that Powerline Petroleum, a registered introducing broker (IB), failed to disclose its role as a counterparty to block trades, assessing sanctions of $875,000. Separately, Powerline agreed to pay a fine of $225,000 to resolve similar allegations by a disciplinary committee of the New York Mercantile Exchange, as well as claims that it pre-hedged block trades contrary to the exchange’s requirements. Notably, in a strongly worded dissenting statement to the CFTC settlement, Commissioner Summer K. Mersinger objected to certain aspects of the settlement order as “inconsistent with the Commission’s prior treatment of similar cases and fundamentally unfair.”

Separately, ICE Futures US has filed amendments to its Block Trade FAQ clarifying that (i) any party acting principally in a block trade negotiation that plans on engaging in pre-hedging activity will be required, upon request from the exchange, to provide sufficient documentation to support that the persons employed by the party (or its affiliates) involved in the transaction were not acting in an agency capacity during the negotiation and execution of such block trade. and that (ii) communications by a party during block trade negotiations that an order is "being worked" or that the price of the block trade is based on the party's pre-hedging activities plus a mark-up is evidence of "agency duties [being] owed to a counterparty," thus precluding lawful pre-hedging. *Read about block trade challenges.*

Second Circuit Rejects Probabilistic Pleading to Allege Actual Damage in Spoofing Cases

By Christian Kemnitz, Peter Wilson, Elliott Bacon, J Matthew Haws and Loren Lee

On July 20, the US Court of Appeals for the Second Circuit affirmed the dismissal of a putative class action alleging that certain market participants engaged in spoofing in violation of the Commodity Exchange Act, 7 U.S.C. § 1 et seq. (CEA). *Gamma Traders – I LLC v. Merrill Lynch Commodities, Inc.*, No. 21-853, 2022 WL 2821504, at *3 (2d Cir. July 20, 2022) (Op.). Significantly, the court reinforced the CEA's pleading standard in ruling that Plaintiffs failed adequately to allege that they were "actual[ly] damage[d]" by Defendants' alleged spoofing activity. *Id.* at *1 (alteration in original).

The Second Circuit affirmed the district court's holding that Plaintiffs failed to allege exactly how they were damaged by Defendants' spoofing in the futures and options markets for precious metals. Instead of pointing to a specific trade affected by Defendants' alleged conduct, Plaintiffs argued that Defendants' damaged them because (a) Defendants spoofed thousands of times and Plaintiffs made thousands of trades; and (b) Plaintiffs traded on nine days in which Defendants allegedly engaged in spoofing activity. The Court rejected both arguments. *Read Katten's advisory.*

Second Circuit Rejects Supreme Court?

By Richard Zelichov

The Second Circuit's recent decision in *SEC v. Rio Tinto PLC, et al* held that "misstatements and omissions alone do not suffice for scheme liability under Rule 10b-5(a) and (c)." In reaching this conclusion, the Second Circuit rejected the SEC's argument that the Supreme Court's decision in *Lorenzo v. SEC*, 139 S. Ct. 1094 (2019) had overruled an earlier Second Circuit decision that had reached the same conclusion. The Second Circuit so held primarily because a contrary ruling would result in "the scheme subsections [of Rule 10b-5] would swallow the misstatement subsections" and would "likely 'revive in substance the implied cause of action against all aiders and abettors'" thereby eliminating the distinction between primary and secondary liability under Rule 10b-5. Importantly, the defendant and the dissent in *Lorenzo* made the same arguments, but the Supreme Court majority did not find them persuasive. *Read about the Second Circuit's interpretation of Rule 10b-5.*

M&A in the FinTech Space

By Edward Tran

Published by *Only Strategic* on its *Financialnewslink* and *Bankingnewslink* sites, the article examines the mergers and acquisitions trends in the FinTech space. Despite the recent market turbulence, the pace of M&A in this space may very well continue its trend of being robust throughout 2022. The uptick in deal flow suggests an opportunity for start-ups to sell products and services into the global financial ecosystem, highlighting the ever-present shift from a traditional adversarial approach to a new cooperative one. The article also explores the UK regulatory climate, how it can affect FinTech innovation and subsequently M&A interests. *Read the FinTech article.*

UK Real Property Beneficial Ownership Register Progresses in England and Wales

By Oliver Williams, Gavin Vollans, Edward Tran and Omar Malek

On August 1, a new Register of Overseas Entities under the Economic Crime (Transparency and Enforcement) Act 2022 went into effect, requiring overseas entities that currently own land in the United Kingdom to register verified information relating to their beneficial owners or managing officers at Companies House by January 31, 2023. Overseas entities looking to buy, sell, transfer or lease land, or create a charge against land in the UK will need to register with Companies House.

After registering, the name of the overseas entity and its beneficial owners will be publicly available. The amendment provisions to the Land Registration Act 2002 (which, in effect, prevent the Land Registry from registering an overseas entity as a proprietor unless it has an overseas entity ID) goes into effect on September 5. From September 5, 2022, overseas entities will not be able to register their asset with HM Land Registry if they have not undergone the verification process with Companies House. *Read Katten's advisory.*

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