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BROKER-DEALER

FINRA Seeks Comment on Fintech Innovation in Broker-Dealer Industry

On July 30, the Financial Industry Regulatory Authority (FINRA) issued a Special Notice requesting comment on how to continue to foster financial technology (fintech) innovation in the financial services industry. In particular, to support its mission of investor protection and market integrity, FINRA is seeking comment from market participants on how FINRA rules or administrative processes could be modified to better facilitate fintech innovation. In addition, FINRA requests comment on three specific areas: the provision of data aggregation services that compile information from different financial accounts for investors, supervisory processes concerning the use of artificial intelligence, and the development of a taxonomy-based machine-readable rulebook.

The deadline for comment is October 12.

The full Notice is available here.

FINRA Seeks Comment on Proposed Amendments to the Membership Application Program Rules

On July 26, the Financial Industry Regulatory Authority (FINRA) issued a Regulatory Notice requesting comment on a proposal to the NASD Rule 1010 Series (collectively, the "Membership Application Program" rules). The Membership Application Program rules govern how FINRA's Department of Member Regulation (the Department) reviews new membership applications and continuing membership applications (CMAs). An applicant must be able to show its ability to comply with the standards set forth in the Membership Allocation Program rules, and, to ensure that such applicant can comply with the rules, the Department considers an applicant's financial, operational and compliance systems.

The proposed rules—the proposed FINRA Rule 1100 Series—are aimed to enhance investor protections and eliminate unnecessary burdens on firms. The proposal would simplify a number of provisions or terms, amends or deletes outdated provisions, and streamlines the rules and its processes by eliminating or consolidating duplicative provisions and codifying existing Department practices. Key changes would include:

- adopting a waive-in application process to allow certain New York Stock Exchange and NYSE American LLC members to automatically become FINRA members and to automatically register their associated persons with FINRA;
- codifying Department practices aimed at reducing the overall review application period from 180 to 150 days;
- requiring a CMA in the event of the direct or indirect change of a member's control person, where a member seeks to engage in settling or clearing transactions for itself or for other broker-dealers for the first time, and where a member seeks to make a business change that would change its exemptive status under Exchange Act Rule 15c3-3(k);
- eliminating the Department's ability to permit interim restrictions pending the review of a CMA;
- setting forth circumstances in which a member may request, and the Department may consider, waiving the CMA filing requirement in connection with a change in capital structure or control person, or in connection with certain acquisitions, divestitures or transfers of the member's assets or business lines; and
- changing the standards for approval of applications.

The comment period expires on October 5.

The full Regulatory Notice is available here.

DERIVATIVES

See "CFTC Extends No-Action Relief to Shanghai Clearing Firm" in the CFTC section and "AFME and ISDA Publish Paper on Brexit Contractual Continuity Issues in OTC Derivatives" in the Brexit/UK Developments section.

CFTC

CFTC Extends No-Action Relief to Shanghai Clearing Firm

On July 31, the Commodity Futures Trading Commission's Division of Clearing and Risk extended no-action relief to the Shanghai Clearing House (SHCH). Originally set to expire on February 28, 2019, the relief is extended until July 31, 2021.

The no-action relief, originally granted in May 2016 and renewed several times, permits SHCH to continue to clear certain swaps subject to mandatory clearing in China for the proprietary trades of SHCH clearing members that are United States persons or their affiliates.

CFTC Letter No. 18-18 is available here.

BREXIT/UK DEVELOPMENTS

AFME and ISDA Publish Paper on Brexit Contractual Continuity Issues in OTC Derivatives

On July 30, the Association of Financial Markets in Europe (AFME) and the International Swaps and Derivatives Association, Inc. (ISDA) released a paper outlining the challenges UK and EU firms will face in relation to legacy over-the-counter (OTC) derivative contracts following the United Kingdom's departure from the European Union (Brexit).

Currently, UK firms use single-market EU passports to engage in regulated activities in other EU member states without the need for a local license; EU firms use similar passporting arrangements to conduct business in the United Kingdom. The paper identifies other problems for legacy OTC derivative contracts entered into using a passport prior to Brexit after the United Kingdom has left the European Union. For example, lifecycle events involved in the contract could give rise to local EU licensing requirements for UK firms and, therefore, UK firms may wish to transfer legacy contracts out of the United Kingdom and into the European Union. The paper addresses the question as to whether it will still be legally permissible to perform contractual obligations arising under such legacy OTC contracts, and if not, whether the contracts are still valid.

To reduce the severity of the risks identified, the paper recommends a transition period under the final withdrawal agreement made between the United Kingdom and the European Union (Withdrawal Agreement). The paper also recommends that the Withdrawal Agreement should contain appropriate provisions to facilitate the transfer or novation of legacy OTC contracts from a UK firm to an appropriately licensed EU firm. However, due to the political uncertainty surrounding the Brexit negotiations, firms should plan for Brexit, assuming that there will be no Withdrawal Agreement.

The paper considers the use of statutory mechanisms to facilitate the transfer of legacy OTC contracts without the need for consent of the counterparty to the contract. The paper provides many examples of such schemes; however, it also identifies that some may not always be suitable or appropriate.

The paper also explores the use of a transfer of legacy OTC contracts by novation. The paper states that this mechanism is not a 'silver bullet' as there are significant execution and timing challenges involved in a large-scale novation of OTC derivative contracts in favor of an entity in a different EU member state. Novation also requires the individual consent of the clients and counter-parties involved, which could be delayed or withheld for a variety of reasons.

AFME and ISDA state that they intend to develop and publish more concrete proposals to help facilitate the transfer or novation of legacy OTC contracts.

The paper is available here.

EU DEVELOPMENTS

ESMA Publishes First Systematic Internalizer Calculations Data for Investment Firms Under MiFID II

On August 1, the European Securities and Markets Authority (ESMA) published the first tranche of data for market participants to determine whether they are systematic internalizers (SIs) in equities, equity-like instruments and bonds under the revised Markets in Financial Instruments Directive (MiFID II).

An SI is an investment firm that, on an organized, frequent, systematic and substantial basis, deals on its own account when executing client orders outside a regulated market, a multilateral trading facility or an organized trading facility without operating a multilateral system.

The data is based on the total number of trades and overall volume in 9,173 equity and equity-like instruments and 73,828 bonds from January through June 2018. The first tranche of data for market participants to determine whether they are SIs in derivatives and other instruments will likely be published on February 1, 2019.

The publication of the first set of data for SI calculations follows ESMA's release of the template for the calculations on July 20 (for more information, see the *Corporate & Financial Weekly Digest* edition of July 27, 2018).

ESMA's data for SI calculations is available here.

ESMA's accompanying press release is available here.

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

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BREXIT/UK/EU DEVELOPMENTS

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