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SEC/CORPORATE

SEC Releases Registration Fee Estimator

On April 18, the Securities and Exchange Commission announced the release of an online tool that will assist companies in calculating registration fees relating to certain forms to be filed on EDGAR, the SEC's electronic filing database. The registration fee estimator is intended to help issuers more accurately estimate registration filing fees and complete related fee tables. In its press release, however, the SEC cautions issuers that the tool will not serve as an official SEC verification of fees and reminds issuers that they remain responsible for paying all required fees.

The SEC's press release is available here.

The registration fee estimator is available here.

BROKER-DEALER

Pension Income Stream Products

Financial Industry Regulatory Authority recently released Regulatory Notice 16-12 to provide guidance to firms on their responsibilities for sales of pension income stream products. Contracts for pension income stream products involve at least three parties: the pensioner, the investor and a pension purchasing company that facilitates the sale, which may use a member firm and its associated persons to sell these products to investors. In those circumstance, the sales are subject to applicable FINRA rules.

Pension income stream products present a number of investor protection issues, including: (1) significant commissions to purchase the products, (2) illiquidity, and (3) because federal laws prohibit the assignment of particular pension benefits, a pensioner is typically only bound by contract to make the future payments to the investor. As a result, if a pensioner stops making monthly payments, an investor may be left with only a breach of contract claim.

Pension income stream products also may present a number of issues for pensioners, including: (1) pension purchasing companies may not clearly disclose the costs and terms of the product, (2) pension purchasing companies may present confusing offer terms, thereby making it difficult to understand the product, and (3) pensioners may not understand that they may be required to obtain a life insurance policy and that the payments for the policy are subtracted from the lump-sum payment.

Additionally, pension purchasing companies may attempt to circumvent federal and state laws by asserting that pension income stream products are neither a security nor a loan. Whether a particular pension income stream product is a security is dependent on the facts and circumstances specific to that product. FINRA stresses, however, that if a member firm treats a pension income stream product as a non-security when in fact it is a security, it risks violating FINRA rules that impose specific obligations on securities activities. More specifically, if a firm mischaracterizes an income stream product and treats it as an outside business activity under FINRA Rule 3270, rather than a private securities transaction under FINRA Rule 3280, there can be serious ramifications, including: failure (1) to supervise sales of the product, and (2) of the obligation to make sure that all persons engaged in the marketing and sale of such products are appropriately qualified and registered.

As a result of the investor protection issues and regulatory concerns that may arise in the marketing and sale of pension income stream products, member firms that participate in the sale of pension income stream products should adopt procedures and training of associated persons with respect to such products.

The full regulatory notice is available here.

DERIVATIVES

SEC Adopts Business Conduct Rules and Chief Compliance Officer Requirements for Swap Dealers and Major Security-Based Swap Participants

On April 13, the Securities and Exchange Commission voted to adopt final rules (the "Final Rules") implementing business conduct standards and chief compliance officer requirements for security-based swap dealers and major security-based swap participants (collectively, "Swap Entities"). Authority for the SEC to adopt the Final Rules is grounded in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Final Rules are the SEC equivalent for security-based swaps of the business conduct rules for swaps adopted by the Commodity Futures Trading Commission in 2012.

According to the SEC, the Final Rules are designed to improve transparency, facilitate informed decision making and heighten standards of professional conduct by Swap Entities. Like the equivalent CFTC rules, the Final Rules impose obligations on Swap Entities in many areas, including: (1) antifraud; (2) counter party confidential information; (3) know your customer and counter party verification; (4) daily mark, material transaction and clearing disclosure requirements; (5) fair and balanced communications; (6) transactions with and advisory services to Special Entities (as defined in the Final Rules); (7) political contributions to governmental Special Entities; (8) written policies and procedures; and (9) chief compliance officer requirements ("CCO Requirements").

Although the SEC endeavored to harmonize its business conduct and CCO Requirements with those of the CFTC, there are subtle but important differences. Watch for these differences to be outlined in a forthcoming Client Advisory. Additionally, the SEC has provided (1) simpler guidance than the CFTC for determining when the Final Rules will apply to a security-based swap involving at least one non-US person, and (2) a set of rules for the supervision of employees engaged in security-based swap activities that has no equivalent in the CFTC rules.

The Final Rules will go into effect on June 27. The compliance date for most of the New Rules will not occur until entities are required to register as Swap Entities.

The Final Rules are available here.

See "Five Associations Publish Joint Securities Financing Transaction Regulation Information Statement Ahead of July 2016 Compliance Date" and "Financial Regulatory Agencies to Issue New Proposed Compensation Rules" in the EU Developments and Banking sections, respectively.

CFTC

CFTC Enters Into Information Sharing MOU With Three Additional Canadian Provinces

On April 20, the Commodity Futures Trading Commission and three Canadian regulatory authorities signed counterparts to a memorandum of understanding (MOU) designed to promote the cooperation and exchange of information with regard to entities operating on a cross-border basis between the United States and Canada. The Financial and Consumer Services Commission (New Brunswick), the Financial and Consumer Affairs Authority of Saskatchewan, and the Nova Scotia Securities Commission joined the MOU, which was previously executed in 2014 by the CFTC, the Alberta Securities Commission, the British Columbia Securities Commission, the Ontario Securities Commission, and the Québec Autorité des marchés financiers. The MOU allows information sharing with respect to regulated markets, organized trading platforms, central counterparties, trade repositories, intermediaries, dealers and other market participants that are, or have applied to be, authorized or otherwise overseen by one of the signatories to the MOU.

The CFTC's press release is available here.

BANKING

Financial Regulatory Agencies to Issue New Proposed Compensation Rules

On April 21, the National Credit Union Administration issued proposed prototype regulations with other financial institution regulatory agencies (Agencies) to likely follow suit. Required under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act), the rule is intended to (1) prohibit incentive-based payment arrangements that the Agencies determine encourage inappropriate risks by certain financial institutions by providing excessive compensation or that could lead to material financial loss; and (2) require those financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate federal regulator. The Act defines "covered financial institution" to include any of the following types of institutions that have $1 billion or more in assets:

- a depository institution or depository institution holding company, as such terms are defined in section 3 of the Federal Deposit Insurance Act ("FDIA") (12 U.S.C. 1813);
- a broker-dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o);
- a credit union, as described in section 19(b)(1)(A)(iv) of the Federal Reserve Act;
- an investment adviser, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11));
- the Federal National Mortgage Association (Fannie Mae);
- the Federal Home Loan Mortgage Corporation (Freddie Mac); and
- any other financial institution that the appropriate federal regulators, jointly, by rule, determine should be treated as a covered financial institution for these purposes.

Generally, the regulations would control the amount and timing of incentive compensation received by certain employees of the nation's financial institutions, with the largest effect on those institutions with $250 billion or more in assets (Level 1). Employees of a second category of institution, with $50 billion or more of assets (Level 2), would also be subject to similar rules. A third category, covering institutions that have assets equaling or in excess of $1 billion (Level 3), subjects covered institutions to more general provisions of the rule, which prohibit "excessive compensation, fees, or benefits" or any compensation arrangement that "could lead to material financial loss." Other agencies expected to join in the rulemaking include the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission.

The rule covers "senior executive officers" and "significant risk takers" as defined at Level 1 and 2 institutions. Generally, senior executive officers include the president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, chief compliance officer, chief audit executive, chief credit officer, chief accounting officer, or head of a major business line or control function. Significant risk takers are generally employees who receive at least one-third of total compensation in the form of incentive-based compensation and who are (1) highly compensated employees (upper five percent (Level 1) or upper two percent (Level 2) of compensation), or (2) any employee who may commit or expose 0.5 percent or more of the net worth or total capital of the institution.

Generally, those persons covered by the rule would be subject to deferrals periods of up to two years for incentive-based income in amounts ranging from 60 percent to 40 percent, to vesting requirements of up to two years, to non-acceleration requirements, and also to downward adjustment, forfeiture and clawback provisions extending up to seven years. Standards for risk management and effective governance also will be imposed under the proposed rule, as will record-keeping and monitoring requirements.

The proposal, available here, is 279 pages; and comments are due by July 22.

Federal Reserve to Expand Off-Site Examinations

On April 19, the Federal Reserve Board implemented new procedures for examiners to conduct off-site loan reviews for community and small regional banks under the Board's jurisdiction. The Board is offering this option as part of its ongoing efforts "to improve efficiency and provide burden reduction while maintaining quality supervision."

State member banks and US branches and agencies for foreign banking organizations with less than $50 billion in total assets can opt to allow Federal Reserve examiners to review loan files off-site, during both full-scope or target examinations, so long as loan documents can be sent securely and with the required information. "The program is optional so that any bank can still choose an on-site review." Each Reserve Bank retains the ability to deny off-site review requests. Additionally, availability of the program is subject to certain requirements.

More information from the Federal Reserve is available here.

UK DEVELOPMENTS

FCA Paper Regarding High-Frequency Traders

On April 15, the UK Financial Conduct Authority (FCA) published an occasional paper (Paper) in relation to high-frequency traders (HFT). The Paper reports on a study that was conducted by the FCA to test whether or not HFTs were anticipating order flow on a systemic basis, and focused on two key questions:

(1) Whether HFTs capitalize on latency advantages to anticipate orders arriving in quick succession at different trading venues?

(2) Whether HFTs anticipate orders over longer time periods (seconds or tens of seconds)?

The FCA used 2013 order book data from the London Stock Exchange, BATS and Chi-X for its study and took a sample of 120 stocks (60 from the FTSE 100 and 60 from the FTSE 250 index). The Paper, authored by staff in the FCA Chief Economist's Department, found:

(1) There was no evidence of HFTs anticipating orders or trading in front of other participants. The FCA speculates that this is likely to be due to the regulatory set-up in the United Kingdom, as well as to the fact that UK venues are physically close together, and hence the speed advantage is not as important as in other jurisdictions.

(2) There were some patterns of HFT which *may* be consistent with an ability to anticipate orders over longer time periods. However, the FCA noted that there could be alternative explanations for the patterns—namely, that HFTs may simply be reacting more quickly to news and other public information. Additional research will be needed to eliminate the possibility that the driver of such patterns is a faster reaction to public information and the FCA does not draw any conclusions on whether strategies different from those analysed in the Paper are employed by HFTs and other market participants in the UK market and whether or not they are detrimental.

The Paper—and its timing—may be seen as of some significant support to the HFT industry. In the United Kingdom, unlike in the United States where similar allegations originally arose, there is no requirement for an order to be routed according to the best available price on every venue. It remains the case that brokers are free to use routing strategies that cannot easily be predicted—as long as the principle of "best execution" is complied with. The FCA's conclusion that HFTs do not systematically anticipate near-simultaneous marketable orders sent to different trading venues by pure non-HFTs should be of some comfort to HFTs in their businesses as they become drawn more and more into the EU regulatory sphere and as they prepare for the implementation of MiFID II/ MiFIR in January 2018.

A copy of the Paper is available here.

A copy of the FCA's accompanying press release is available here.

EU DEVELOPMENTS

Five Associations Publish Joint Securities Financing Transaction Regulation Information Statement Ahead of July 2016 Compliance Date

On April 13, five industry associations* jointly published an information statement (Information Statement) in relation to the EU Securities Financing Transactions Regulation (SFTR).

As noted in our *Corporate & Financial Weekly Digest edition of August 14, 2015*, the SFTR is designed to enhance transparency of securities financing transactions and reuse (or "shadow banking"). The SFTR went into effect on January 12, and implements various disclosure, consent and reporting requirements to this end. In particular, Article 15 of the SFTR sets out disclosure and consent conditions for reuse, which firms will need to comply with after July 13, 2016.

Article 15 provides that in order for a right of reuse to apply, parties must:

(1) inform the providing counterparty in writing of the risks and consequences of a) granting consent to a right of use of collateral under a security collateral arrangement, or b) concluding a title transfer collateral arrangement; and

(2) obtain the providing counterparty's prior express written consent to the right of use or provision of collateral by way of a title transfer collateral arrangement.

Article 15 further provides that in order to exercise a right for reuse, parties must ensure:

(1) reuse is undertaken in accordance with the terms specified in the collateral arrangement; and

(2) the financial instruments received under a collateral arrangement are transferred from the account of the providing counterparty.

The Information Statement published aims to assist firms to comply with Article 15, ahead of the July 13, 2016 compliance date. The obligation requires compliance not only for new collateral arrangements but also for those existing prior to July 13, 2016. In March 2016, the European Securities and Markets Authority (ESMA) also issued a discussion paper (Discussion Paper) for consultation in relation to the SFTR, which included proposed rules in relation to reporting. The consultation closed on April 22, with ESMA to consider feedback received in Q2 2016.

*The Information Statement was published jointly by International Swaps and Derivatives Association, Inc., the Association for Financial Markets in Europe, the Futures Industry Association, the International Capital Market Association and the International Securities Lending Association.

The SFTR is available here.

A copy of ESMA's Discussion Paper is available here.

A copy of the joint Press Release accompanying the Information Statement 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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* Click here to access the *Corporate & Financial Weekly Digest* archive.