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BROKER-DEALER

Postponement of Margin Rules for Covered Agency Transactions Under FINRA Rule 4210

The Financial Industry Regulatory Authority is filing a rule change (SR-FINRA-2019-005) with the Securities and Exchange Commission that postpones until March 25, 2020 the implementation of mandatory margin for Covered Agency Transactions under FINRA Rule 4210.

It was back in 2015 that FINRA initially proposed to amend FINRA Rule 4210 to establish margin requirements for (1) To Be Announced transactions, inclusive of adjustable rate mortgage transactions; (2) Specified Pool Transactions; and (3) transactions in Collateralized Mortgage Obligations, issued in conformity with a program of an agency or Government-Sponsored Enterprise, with forward settlement dates (collectively, Covered Agency Transactions). The effective date of these rules has already been postponed several times, and the stated purpose of this new postponement is to allow time for discussion of further changes to the rules:

“FINRA is considering, in consultation with industry participants and other regulators, potential amendments to the requirements of SR-FINRA-2015-036. FINRA believes that this is appropriate in the interest of avoiding unnecessary disruption to the Covered Agency Transaction market. Therefore, FINRA is proposing to extend the March 25, 2019 implementation date to March 25, 2020, while FINRA considers potential amendments. FINRA notes that the risk limit determination requirements pursuant to SR-FINRA-2015-036 became effective on December 15, 2016 and, as such, the implementation of such requirements is not affected by the proposed rule change.

“As noted in Item 2 of this filing, FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing. The operative date will be the date of filing of the proposed rule change.”

The text of the rule change is available here.

CFTC

CFTC Issues No-Action Relief From Certain Position Aggregation Requirements

On December 21, 2018, the Division of Market Oversight (DMO) of the Commodity Futures Trading Commission issued Letter 18-33 responding to a request for relief from compliance with certain position aggregation requirements under CFTC Regulation 150.4(b)(2)(i)(D).

CFTC Regulation 150.4(b)(2) provides an owned-entity exemption from aggregation. Any person with an ownership or equity interest in an owned entity of 10 percent or greater generally need not aggregate the accounts or positions of the owned entity with any other account or position such person is required to aggregate, provided that such person and the owned entity meet the conditions (A) through (E) of 150.4(b)(2)(i) (firewall conditions). Subparagraph (D) of the regulation prohibits the sharing of employees that control the trading decisions of either the person or the owned entity.

The request for no-action sought relief where the relevant parties would otherwise be in compliance with the position aggregation requirements in 150.4(b)(2), but for the fact that the parties comply with criterion (D) only in connection with derivatives trading. The parties argued that the term "trading decisions" in criterion (D) should be limited to derivatives trading, instead of covering a variety of activities in different markets for global enterprises (including cash-market trading decisions).

DMO issued this no-action relief letter, which will remain in effect until 12:01 a.m. eastern standard time on August 12. The no-action relief provided by this letter is limited to the firewall condition for the owned entity exemption in 150.4(b)(2)(i)(D) related to the cash-market trading decisions. The relief does not address issues related to aggregation for other purposes under the Commodity Exchange Act and regulations, including manipulation or other abusive practices.

The CFTC Letter 18-33 is available here.

NFA Adopts Interpretive Notice Regarding CPO Internal Controls Systems

On December 10, the National Futures Association (NFA) submitted to the Commodity Futures Trading Commission a proposed Interpretive Notice to NFA Compliance Rule 2-9, which would provide commodity pool operators with guidance on designing and implementing an adequate system of internal controls.

On January 31, the NFA issued Notice I-19-03 announcing the recent adoption of the Interpretive Notice, which will become effective on April 1.

The NFA proposal is available here.

The NFA Notice I-19-03 is available here.

UK/BREXIT DEVELOPMENTS

Bank of England and FCA Provide Updates on Post-Brexit Market Infrastructure Transitional Arrangements and Applications

On January 24, the Bank of England updated its financial market infrastructure supervision websites with interim lists of entities and systems that will enter into the various temporary or transitional arrangements on exit day should the United Kingdom leave the European Union with no implementation period. The lists consist of:

- Third-country central counterparties (CCPs) that will offer clearing services and activities in the UK under the temporary recognition regime of the Central Counterparties (Amendments, etc., and Transitional Provision) (EU Exit) Regulations 2018;

- Third-country central securities depositories (CSDs) that will provide CSD services in the United Kingdom using the transitional provisions of the Central Securities Depositories (Amendment) (EU Exit) Regulations 2018; and

- European Economic Area (EEA) systems whose operators have indicated their intention for such systems to receive settlement finality protection in the United Kingdom pursuant to the draft temporary designation regime of the Draft Financial Markets and Insolvency (Amendment and Transitional Provision) (EU Exit) Regulations 2019.

Each of the lists are non-exhaustive, containing only those entities that have consented to their inclusion and disclosure on such lists which will be updated periodically. The final lists will be published after exit day.

Separately, on January 30, the UK Financial Conduct Authority (FCA) published a list of EEA market operators (as defined in the revised Markets in Financial Instruments Directive (MiFID II)) that have applied or have given notice of their formal intention to apply to become recognized overseas investment exchanges (ROIEs) in the United Kingdom.

The FCA has published the list in response to its September 2018 direction that clarified how market operators from the EEA can apply to become ROIEs (for further details, see the September 14, 2018 edition of *Corporate & Financial Weekly Digest*). ROIE status allows EEA market operators to continue to provide their UK-based members with access to their market, should they no longer be able to rely on MiFID II passport rights once the United Kingdom leaves the European Union.

The FCA warns that just because a market operator is on the list, it should not be taken as evidence that its application to become an ROIE is likely to succeed. The FCA will update the list from time to time.

The list of CCPs is available here.

The list of CSDs is available here.

The list of EEA systems is available here.

The list of ROIE applicants is available here.

EU DEVELOPMENTS

ESMA Updates Q&As Relating to the Benchmarks Regulation

On January 30, the European Securities and Markets Authority (ESMA) published an updated version of its questions and answers on the Benchmarks Regulation (BMR).

ESMA confirms that the scope of application is identical across both sets of legislative provisions, including the transitional provisions under the BMR.

In the new Q&A, ESMA refers to specific requirements for different types of benchmarks which are covered to differing extents by the BMR and the Commission Delegated Regulations (for example, regulated-data benchmarks, interest rate benchmarks, commodity benchmarks, significant benchmarks and non-significant benchmarks).

ESMA's updated Q&As on the BMR are available here.

ESMA Publishes Statement on Clearing and Trading Obligations for Small Financial Counterparties

On January 31, the European Securities and Markets Authority (ESMA) published a statement addressing issues on the forthcoming implementation of the European Market Infrastructure Regulation Regulatory Fitness and Performance program (EMIR REFIT), relating to clearing and trading obligations for small financial counterparties. ESMA's statement also addresses the requirements for reporting of derivatives that were outstanding on or after August 16, 2012, and terminated before the EMIR reporting start date of February 12, 2014, which is a process commonly referred to as "backloading."

In its statement, ESMA notes that it is aware of the challenges faced by certain small financial counterparties when preparing for the deadline of June 21, to start clearing through central counterparties (CCPs) and trading some of their over-the-counter (OTC) derivative contracts on trading venues. As EMIR REFIT negotiations have not yet been finalized, it is not yet known when the resulting text of the EMIR REFIT is expected to apply. This could result in a timing gap during which small financial counterparties, whose derivative positions are below the clearing thresholds, would need to have clearing arrangements in place and start clearing their derivative contracts, before, once again, they are no longer required to do so after EMIR REFIT comes into force.

ESMA is also aware of the challenges that reporting counterparties would face regarding having to comply with the backloading requirement by February 12. The EMIR REFIT proposals remove the backloading requirement from EMIR to help relevant parties meet regulatory needs, and to reduce the substantial and costly adjustments that reporting entities need to make.

The European Commission previously extended the deadline for the completion of backloading from February 12, 2017 to February 12, 2019. The extension of the deadline was in line with ESMA's previous recommendation, and the EMIR REFIT was expected to become effective by the new deadline. However, it is still unclear as to whether these amendments would go into effect before February 12, and ESMA is still addressing the backloading requirement with respect to the reporting obligation.

Consequently, ESMA has indicated that it expects national competent authorities (NCAs) not to prioritize supervisory actions towards counterparties' reporting of backloaded transactions or to counterparties whose positions are expected to be below the clearing thresholds that apply once the EMIR REFIT becomes effective. ESMA also expects NCAs to apply the same proportionate approach to their risk-based supervisory powers in their day-to-day enforcement of EMIR.

ESMA's 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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UK/BREXIT/EU DEVELOPMENTS

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