

BROKER-DEALER

OCIE Issues Risk Alert on Investment Adviser and Broker-Dealer Compliance Issues Related to Regulation S-P

On April 16, the Office of Compliance Inspections and Examinations (OCIE) of the Securities and Exchange Commission issued a Risk Alert providing a list of compliance issues related to Regulation S-P, the primary SEC rule regarding privacy notices and safeguard policies of investment advisers and broker-dealers. The issues proscribed in the Risk Alert were identified by OCIE during recent examinations of SEC-registered investment advisers and brokers-dealers.

For additional analysis, see Katten's advisory "[Not So Secure: OCIE Identifies Regulation S-P Compliance Issues.](#)"

The Risk Alert is available [here](#).

FINRA Publishes Consolidated Criteria to Designate Firms for Mandatory Participation in FINRA's Business Continuity/Disaster Recovery Testing

On April 19, the Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 19-15, addressing the criteria used by FINRA to designate member firms that are required to participate in FINRA's annual business continuity and disaster recovery (BC/DR) testing.

As required by Securities and Exchange Commission Regulation Systems Compliance and Integrity (Regulation SCI), FINRA adopted Rule 4380 in 2015 requiring member firm participation in BC/DR testing. The rule authorizes FINRA to designate firms that are required to participate in FINRA's annual BC/DR test based on established standards, which FINRA first published in Regulatory Notice 15-43 and updated in Regulatory Notice 18-09. Regulatory Notice 19-15 consolidates FINRA's designation criteria, as previously announced in Notices 15-43 and 18-09, without change.

FINRA applies the following criteria to designate member firms for required BC/DR testing:

- For member firms that report on a FINRA Trade Reporting Facility, OTC Reporting Facility, Trade Reporting and Compliance Engine, or Order Audit Trail System, FINRA will designate the participants that account for 5 percent or more of the volume of a specific metric (e.g., number of trades, average dollar volume of certain securities or reportable order events) reported to the applicable reporting facility over the six-month period immediately preceding designation, if the cumulative volume represented by designated firms amounts to at least 50 percent of all volume reported to the applicable reporting facility during the applicable six-month period; and
- For member firms that report on the FINRA OTC Bulletin Board (OTCBB), FINRA will designate the participants that account for at least 20 positions in OTCBB symbols per day on the OTCBB during the applicable six-month period, if the cumulative quoting represented by designated firms amounts to at least 50 percent of all quoting on the OTCBB during the applicable six-month period.

FINRA will notify firms that meet these criteria individually by email in or around April of each year. Market participants that wish to participate on a voluntary basis in FINRA's annual BC/DR testing are encouraged to contact FINRA to consider arrangements to take part in FINRA's testing.

The Notice is available [here](#).

FINRA Forms Office of Financial Innovation

On April 24, the Financial Industry Regulatory Authority (FINRA) announced the formation of the Office of Financial Innovation, which will serve as a central point of coordination for issues related to significant financial innovations by FINRA member firms, particularly new uses of financial technology. The establishment of the Office of Financial Innovation is designed to enhance FINRA's ability to identify, understand and foster financial innovation in the markets to strengthen investor protection and market integrity.

The Office of Financial Innovation will collaborate with teams across FINRA to promote engagement with the industry, regulators, investors and other stakeholders on matters involving significant financial innovation by FINRA member firms, and will incorporate FINRA's existing Office of Emerging Regulatory Issues, which focuses on analyzing new and emerging risks and trends related to the securities market.

FINRA's announcement on the formation of the Office of Financial Innovation is available [here](#).

FINRA Releases Report on 2018 Fine Monies

On April 25, the Financial Industry Regulatory Authority (FINRA) issued a report relating to its use of fine monies collected in 2018. FINRA issued \$61.0 million in fines, and incurred \$81.1 million in fine-eligible expenditures (i.e., capital initiatives, strategic expenditures and other activities eligible to be funded by fine monies based on FINRA's Financial Guiding Principles) in 2018. Since the total of fine-eligible expenditures exceeded the amount of fines issued in 2018, the balance of \$20.1 million was funded from FINRA's reserves.

The fine-eligible expenditures furthered FINRA's goals to implement efficient oversight programs that protect investors and the markets, modernize critical securities industry infrastructure, strengthen FINRA's ability to track trading across markets, enhance FINRA's risk-based analytics, enhance the efficiency of FINRA systems, facilitate compliance by member firms and equip investors with knowledge and resources to help them navigate ever-evolving markets, products and services.

The report is available [here](#).

DERIVATIVES

See "CFTC Approves Final Rule Providing Exception to Annual Privacy Notice Requirements" in the CFTC section.

CFTC

CFTC Approves Final Rule Providing Exception to Annual Privacy Notice Requirements

On April 19, the Commodity Futures Trading Commission approved a final rule revising CFTC Regulation 160.5. The amended rule implements the Fixing America's Surface Transportation Act's (FAST Act) December 2015 statutory amendment to the Gramm-Leach-Bliley Act (GLB Act) by providing an exception to the requirement that certain futures commission merchants, retail foreign exchange dealers, commodity trading advisors, commodity pool operators, introducing brokers, major swap participants and swap dealers (each, a "covered person") to provide annual privacy notices to their respective customers. (The obligation to provide an initial privacy notice is unchanged).

As amended, the rule provides that a covered person is not required to provide an annual privacy notice if the covered person: 1) provides nonpublic personal information to nonaffiliated third parties only in accordance with the provisions of the relevant provisions of Part 160 of the CFTC's rules and any other exceptions adopted by the Commission pursuant to section 504(b) of the GLB Act; and 2) has not changed its policies and practices with regard to disclosing nonpublic personal information from the policies and practices that were disclosed to the customer under in the most recent privacy notice sent to the customer pursuant to Part 160.

CFTC staff worked with the Consumer Financial Protection Bureau, the Securities and Exchange Commission, Federal Trade Commission and National Association of Insurance Commissioners on revising the rule, which goes into effect on May 28.

The final rule is available [here](#).

BANKING

Federal Reserve Proposes Revamped Standards for Determinations of Bank Control

On April 23, the Board of Governors of the Federal Reserve System proposed revisions to the portions of its regulations that relate to determinations of whether a company has the ability to exercise a controlling influence over another company for purposes of the Bank Holding Company Act or the Home Owners' Loan Act. The highlight of the proposal is a tiered framework that would substantially revise and clarify the Board's existing regulatory presumptions of control. The framework—summarized in a single chart—has four tiers, each identified by the threshold percentage level of voting stock held by a potential controlling party. At each level, the framework incorporates the other major factors that the Board has historically viewed as presenting control concerns, such as business relationships and officer/employee interlocks. The proposal also includes a new presumption of noncontrol.

The Federal Reserve will accept comments on the proposal for 60 days after it is published in the *Federal Register*.

The proposal is available [here](#).

The rule includes a chart showing the revamped four tiers of presumptions concerning control, available [here](#).

UK DEVELOPMENTS

FCA Publishes Report on Payment for Order Flow

On April 23, the UK Financial Conduct Authority (FCA) published a report on payment for order flow (PFOF).

The report provides an update on the FCA's supervisory work on conflicts of interest and PFOF, and it follows the FCA's preliminary findings that were published in issue 56 of its *Market Watch* newsletter (as reported in the September 28, 2018 edition of [Corporate & Financial Weekly Digest](#)).

PFOF occurs when an investment firm (usually a broker) that sources liquidity and executes orders for its clients receives a fee or commission from the client originating the order and the counterparty with whom the trade is subsequently executed (typically a market maker or other liquidity provider). PFOF payments create a conflict of interest between the firm and its clients because they incentivize the firm to execute clients' orders with counterparties based on the latter's willingness to pay commissions. PFOF therefore makes it more likely for extra costs to be passed on to the broker's client, through wider bid-ask spreads from market makers and other liquidity providers who agree to pay PFOF to attract order flow from brokers.

Through its supervisory work and assessment of firms' systems and controls monitoring effective compliance, the FCA found a distinction between broking activities that source exclusive liquidity for a specific client and those that provide non-exclusive liquidity to a range of counterparties. In particular, the FCA found that:

1. the majority of firms have stopped charging liquidity providers when sourcing exclusive liquidity for a specific client, regardless of client classification;
2. it has been difficult for firms to be certain if their activity was legitimately providing non-exclusive liquidity to a range of counterparties, which may allow them to manage the conflicts of charging both sides of a trade;
3. firms could do more to improve the systems and controls they use to manage conflicts of interest for specific areas of their business; and
4. firms sometimes routed client orders to overseas affiliates that charged liquidity providers PFOF.

A webpage published alongside the report states that firms should read the report and consider how to improve their practices, policies, systems and controls to meet their obligations. The FCA adds that its supervisory work will continue to prioritize and monitor compliance with conflicts of interest rules and PFOF, and that it will consider using its full range of powers, including enforcement action, to penalize firms breaching its rules.

The FCA's report is available [here](#) and its related webpage is available [here](#).

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UK DEVELOPMENTS

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* Click [here](#) to access the *Corporate & Financial Weekly Digest* archive.

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