Katten

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BROKER-DEALER

SEC Amends Exchange Act Rule 15c2-11 to Enhance Retail Investor Protections and Modernize Governing Quotations for Over-the-Counter Securities

On September 16, the Securities and Exchange Commission adopted amendments to the Securities Exchange Act of 1934 (Exchange Act) Rule 15c2-11 to modernize the rule, including by recognizing advances in communications technology. The rule requires broker-dealers to review key, basic issuer information before initiating or resuming quotations for the issuer's security in the over-the-counter (OTC) market.

Currently, certain of the rule's exceptions permit broker-dealers to maintain a quoted market for an issuer's security in perpetuity in the absence of current and publicly available information about the issuer. Recognizing the faster flow of information today, the amendments generally prohibit broker-dealers from publishing quotations for an issuer's security when issuer information is not current and publicly available, subject to certain exceptions. The amendments also add new exceptions for certain OTC securities that may be less susceptible to fraud or manipulation, such as actively traded securities of well-capitalized issuers, and expand the scope of market participants that may comply with the rule's required review of issuer information.

The amendments to Exchange Act Rule 15c2-11, which was last substantively amended nearly 30 years ago, will become effective 60 days following publication in the Federal Register.

The SEC press release is available here.

SEC Modernizes Disclosures for Banking Registrants

On September 11, the Securities and Exchange Commission announced that it had adopted rules that update and expand the statistical disclosures that bank and savings and loan registrants provide to investors while eliminating duplicative disclosures. The new SEC rules require disclosure about the following:

- distribution of assets, liabilities and stockholders' equity, the related interest income and expense and interest rates and interest differential;
- weighted average yield of investments in debt securities by maturity;
- maturity analysis of the loan portfolio including the amounts that have predetermined interest rates and floating or adjustable interest rates;
- certain credit ratios and the factors that explain material changes in the ratios, or the related components during the periods presented;
- the allowance for credit losses by loan category; and
- bank deposits including average amounts and rate paid and amounts that are uninsured.

The adopted rules will be effective 30 days after publication in the Federal Register and will apply to fiscal years ending on or after December 15, 2021. Voluntary compliance with the new rules will be accepted prior to such compliance date.

The SEC press release is available here.

SEC Releases Report and Recommendations in Connection With The 39th Annual Small Business Forum

On September 14, the Securities and Exchange Commission released its report and recommendations in connection with the Annual Small Business Forum. The report provides a summary of the forum proceedings, including the recommendations developed by participants for changes needed to the capital raising framework, and the SEC's responses to the recommendations. The report is available here.

The SEC press release is available here.

FINRA Issues Guidance on Public Offerings

On September 15, the Financial Industry Regulatory Authority (FINRA) issued guidance on public offerings, outlining the obligations of FINRA member firms under FINRA Rules 5110, 5121 and 2310. Among other things, FINRA members (1) must file documents and other information on a timely basis in connection with public offerings, (2) cannot participate if the underwriting terms and arrangements are unfair or unreasonable, (3) must prominently disclose the nature of any conflicts of interest and (4) if participating in the distribution of shares in a Direct Participation Program or an Unlisted Real Estate Investment Trust, must comply with additional compensation and disclosure requirements as described in FINRA Rule 2310.

The guidance is available here.

CFTC

CFTC Staff Issue Supplemental Advisory and Time-Limited No-Action Relief on Treatment of Separate Accounts by FCMs

On September 15, the staff of the Commodity Futures Trading Commission's (CFTC) Division of Clearing and Risk (DCR) and Division of Swap Dealer and Intermediary Oversight (DSIO) issued CFTC Letter No. 20-28, providing supplemental guidance and further no-action relief with respect to the treatment of separate accounts by futures commission merchants (FCMs). Initial guidance and relief was set out in CFTC Letter No. 19-17, which was issued in July 2019.

As reported in the July 12, 2019 issue of the *Corporate and Financial Weekly Digest* (available here), Letter No. 19-17 was issued in response to two Regulatory Alerts that had been published by the Joint Audit Committee (JAC) with regard to the treatment of separate accounts maintained on behalf of the same underlying customers. The JAC Regulatory Alerts and Letter No. 19-17 dealt with two issues: (1) interpretation of CFTC Regulation 1.56; and (2) compliance with CFTC Regulation 39.13(g)(8)(iii).

CFTC Regulation 1.56

CFTC Regulation 1.56(b) provides that no FCM may: (1) directly or indirectly guarantee a client against loss; (2) limit the loss of a customer; or (3) agree not to call for margin as established by the rules of an exchange. Further, Regulation 1.56(c) provides no person may in any way represent that FCM will engage in any of the acts or practices described in Regulation 1.56(b). In Letter No. 19-17, the staff confirmed that Regulation 1.56(b) prohibits an FCM from agreeing to include in a customer agreement so-called limited recourse provisions, which may restrict the ability of an FCM to look to other accounts of a customer, even if those accounts are controlled by another asset manager. As the staff made clear, an FCM "must retain the ability to ultimately look to funds in other accounts of the beneficial owner, including accounts that may be under different control, as well as the right to call the beneficial owner for additional funds."

In Letter No. 20-28, the CFTC staff again confirmed that contractual provisions that violate, or may be construed to violate, Regulation 1.56(b) are prohibited. However, in response to a request filed by the Futures Industry Association, which noted that, as a result of the COVID-19 Pandemic, many FCMs have encountered difficulties in (1) identifying those customer agreements that may contain provisions that are inconsistent with the terms and conditions of the Letter No. 19-17, and (2) working with their customers to amend such agreements, the staff provided time-limited no-action relief. Under the no-action relief, FCMs will have until March 31, 2021 to remove or otherwise negate the limited recourse provisions contained in customer agreements. After March 31, 2021, no new customer agreement, including a master agreement that adds a new beneficial owner, may contain

provisions, or may be construed to contain provisions, that are prohibited by Regulation 1.56.

The staff also took the opportunity to provide further guidance with respect to the interpretation of Regulation 1.56. First, the staff clarified that Regulation 1.56 does not require a customer agreement to contain any specific or express language in order for an FCM to meet the requirements of the regulation. A customer agreement would comply with the requirements of Regulation 1.56, as long as the agreement does not contain (or incorporate by reference) language that can be construed as a representation that the FCM agrees to any of the terms prohibited by the regulation. The agreement is not required to include additional provisions regarding the FCM's rights against the beneficial owner under such an agreement.

Second, the staff confirmed that an FCM and its customer may agree to a protocol, identifying a specific series of defined steps that an FCM could follow "before resorting to liquidation or accessing the funds in the other accounts of the beneficial owner held at the FCM". However, the staff emphasized that the FCM must retain "at all times, the discretion to determine that the facts and circumstances of a particular shortfall are extraordinary and therefore necessitate accelerating the timeline and relying on the FCM's protocol for liquidation or for accessing funds in the other accounts of the beneficial owner held at the FCM."

Lastly, the staff noted that certain FCMs might choose to rely on the applicable law and severability provisions found in most FCM customer agreements to negate the limited recourse provision in a particular agreement. The staff stated that such reliance would be permissible only if the FCM obtained, by March 31, 2021, "legal Opinion(s) or well-reasoned memorandum(a) from outside counsel confirming that its customer agreements do not contain provisions that violate Regulation 1.56. Further, to the extent that the language used in an agreement could be construed to be in violation of Regulation 1.56, any such violation would be cured if the FCM promptly, but in any event no later than March 31, 2021, sends a written disclosure to the beneficial owner (1) describing the requirements of Regulation 1.56, and (2) explaining that the FCM is relying on the operation of the applicable law and severability provisions in the agreement to comply with the regulation.

CFTC Regulation 39.13(g)(8)(iii)

CFTC Regulation 39.13(g)(8)(iii) provides that each derivatives clearing organization (DCO) must require its clearing members to assure that their customers do not withdraw funds from their accounts with such clearing members, unless the net liquidating value, plus the margin deposits remaining in the customer's accounts after the withdrawal, would be sufficient to meet the customer initial margin requirements with respect to the products or portfolios in the customer's account cleared by the DCO. In its Regulatory Alert, the JAC advised that, although separate accounts of the same beneficial owner may continue to be margined separately, the FCM must combine all accounts of the same regulatory classification — even those under different control — to assess whether it may release excess funds from one account of a beneficial owner.

In Letter No. 19-17, the CFTC staff provided no-action relief with respect to Regulation 39.13(g)(8)(iii), subject to compliance with the terms and conditions set out in the letter. The no-action relief would extend to June 30, 2021, "in order to provide Staff with time to recommend, and the Commission with time to determine whether to conduct, and if so, to in fact conduct, a rulemaking to implement appropriate relief on a permanent basis."

In Letter No. 20-28, in response to the COVID-19 Pandemic, granted FCMs until March 31, 2021 to come into compliance with all of the terms and conditions set out in Letter No. 19-17. Further, the staff extended the term of the no-action relief to December 31, 2021.

A copy of the CFTC's release with a link to CFTC Letter No. 20-28 is available here.

CFTC Further Extends Certain No-Action Relief to Market Participants in Response to COVID-19

On September 11, the Commodity Futures Trading Commission (CFTC) announced that the Division of Swap Dealer and Intermediary Oversight (DSIO) and the Division of Market Oversight (DMO) had issued CFTC Letter No. 20-26, further extending certain elements of the temporary no-action relief issued in response to the COVID-19 pandemic that are set to expire on September 30. The extended relief expires on January 15, 2021.

DSIO and DMO initially granted temporary relief on March 17 to a broad spectrum of market participants to support orderly trading and liquidity as they implemented social distancing measures during the pandemic. Subject to the conditions stated in the no-action letter, the relief provided is as follows:

- DSIO is extending targeted no-action relief for affected firms from CFTC regulations requiring registrants to record oral communications related to voice trading and other telephonic communications, as well as time-stamping requirements when located in remote, socially-distanced locations.
- DMO is extending targeted no-action relief for swap execution facilities and designated contract markets from certain CFTC regulations regarding audit trails, recording of oral communications and related requirements as a result of the displacement of trading personnel from their normal business sites.

In a press release announcing the issuance of the no-action letter, the directors of DSIO and DMO stated that they understood that the current extension would provide registrants with "time to complete the final steps necessary to come into full compliance with CFTC regulations, such as those related to voice recordings and time-stamps" and emphasized that that the "bar for DSIO and DMO granting a third extension will be quite high."

A copy of the CFTC's release with a link to the CFTC Letter No. 20-26 is available here.

CFTC Staff Provides No-Action Relief to Registrant from SEF Reinstatement Requirements

On September 15, the Commodity Futures Trading Commission's (CFTC) Division of Market Oversight (DMO) granted no-action relief to Tassat Derivatives LLC, a CFTC-registered swap execution facility (SEF), from SEF reinstatement requirements under CFTC Regulation 37.3(d). The no-action relief set out in CFTC Letter No. 20-27 is subject to certain conditions.

On November 6, 2019, the CFTC issued a transfer order approving the transfer of trueEX LLC's SEF registration to Tassat. In addition to the SEF registration, Tassat acquired all work product related to the development of a physically-deliverable Bitcoin swap contract. Since the transfer, Tassat has been operational and in compliance with all relevant provisions of the Commodity Exchange Act (CEA) and CFTC regulations pertaining to SEFs. However, since the issuance of the transfer order, Tassat encountered internal and external delays impacting the listing of its Bitcoin swap contract. On August 1, pursuant to CFTC Regulation 40.1 (f), Tassat was deemed dormant because it had no trading for a period of 12 consecutive months and was required to seek reinstatement of its SEF registration in order to continue to operate.

Tassat requested relief from the reinstatement requirements to enable it to list its contract for trading prior to a CFTC decision on reinstatement of its registration. The temporary no-action relief will end when the CFTC determines Tassat's application for reinstatement. Tassat agreed to file its reinstatement application with the CFTC no later than one month from the date of issuance of the relief and also agreed to continue to comply with all applicable provisions of the CEA and CFTC regulatory requirements.

Under the no-action relief, DMO will not recommend the CFTC commence an enforcement action against Tassat for failing to reinstate its SEF registration prior to listing its certified Bitcoin swap contract, or against any Tassat participant who trades the contract upon such listing.

A copy of the CFTC's release with a link to the CFTC Letter No. 20-27 is available here.

BANKING

CFPB Publishes Proposals to Implement Small Business Lending Data Collection Rulemaking

In connection with the requirements set forth in Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Section 1071), the Consumer Financial Protection Bureau (CFPB) released on September 15, both a high-level summary (Summary) and a more detailed outline of the proposals it is considering (Outline) to implement Section 1071's mandate that the CFPB require financial institutions to "compile, maintain, and submit to the [CFPB] certain data on applications for credit for women-owned, minority-owned, and small businesses."

The Outline is a comprehensive document that discusses (1) the relevant law, (2) the regulatory process, (3) the rule proposals the CFPB is considering to implement Section 1071, and (4) an economic analysis of the potential impacts of the proposals on directly affected small entities. Among other provisions, the CFPB notes that it is

considering limiting the scope of the rule's requirement to all small businesses, rather than including both small businesses and women- and minority-owned businesses, given the CFPB's position that this definitional construct would "cover nearly all women-owned and minority-owned businesses." The CFPB is also considering creating an exemption from the definition of "financial institution" to which the proposed rule would apply through the establishment of "either or both a size-based and/or activity-based threshold."

In terms of the scope of products to be covered by the rule, the CFPB states that it is proposing that the term "covered products" include term loans, lines of credit and business credit cards but exclude consumer-designated credit, leases, factoring, trade credit and merchant cash advances.

The CFPB is also considering the right of an applicant to refuse to provide certain information as well as an effective date of two years after the issuance of a final rule.

Public comment on the Outline will be accepted by the CFPB until December 14.

The Summary is available here.

The Outline is available here.

EU DEVELOPMENTS

ECON Announces Implementation of Draft Report on Digital Finance and FinTech

On September 11, the European Parliament's Economic and Monetary Affairs Committee (ECON) published a press release announcing the adoption of its draft report on Digital Finance.

The draft report (PE650.539v01-00), which was prepared in June, is non-binding in effect and sets out recommendations made in response to the European Commission's Digital Finance strategy consultation. The press release welcomes the Commission's commitment to finalizing a FinTech action plan by Q3 2020, with ECON also emphasizing European Union (EU) measures are to ensure all market participants have space to innovate, be proportional and technologically neutral and risk-based, whilst allowing for high levels of consumer and investor protection. The report further calls for the development of a common EU model to be utilised to set standards by the European Supervisory Authorities (ESAs) and international co-operation.

ECON highlights issues and recommendations within the report, including:

- Cryptoassets: Targeted legislation changes to fill regulatory gaps, comprehensive pan-EU open-ended taxonomy for new products, common monitoring and supervisory framework.
- Cyber resilience: Legislative changes focusing on modernization, compliance with international standards and operational resilience testing, to information and communications technology ICT and cybersecurity requirements for the EU financial sector.
- Data: Enactment of EU legislation on privacy and data protection to monitor cross-border data flows, including to and from third countries. (However, the press release notes that the free flow of data within the EU is a necessity in the scaling-up of innovative finance).

The procedure file for the report indicates it will be under consideration of the European Parliament in its plenary session commencing between October 5 and October 8.

The ECON's press release is available here.

The ECON's Draft Report is available here.

AML: FATF 'Red Flags' associated with Cryptoassets

On September 14, the Financial Action Task Force (FATF) published a report on cryptoassets (which the FATF refers to as virtual assets (VAs)) with its 'red flag' indicators of money laundering and terrorist financing (the Report).

Indicators of suspicious VA activities, or potential attempts to avoid law enforcement detection within the Report, are based on more than 100 studies contributed by FATF's global network members, as well as data disclosed within FATF reports and publicly available information on the misuse of VAs.

In the Report, the FATF notes that the existence of a single indicator does not necessarily indicate criminal activity but that, most usually, it is the presence of multiple indicators in a transaction with no logical business explanation that raises suspicion of potential criminal activity. The Report further states that the presence of such indicators should encourage further monitoring, examination and reporting, where appropriate.

The key indicators identified in the Report include:

- Technological features: The increase of anonymity, mixing or 'tumbling' services or anonymity-enhanced cryptocurrencies.
- Geographical risks: Countries with weak, or absent, national measures for VAs are at a higher risk of exploitation.
- Transaction patterns: In instances where transactions are irregular, unusual or uncommon.
- Transaction sizeL In instances where the amount and frequency have no logical business explanation.
- Sender or recipient profiles: unusual behavior can suggest criminal activity.
- Source of funds or wealth that can relate to criminal activity.

The Report is intended to help VA service providers (VASPs), financial institutions, designated non-financial businesses and professions, and other reporting entities detect and report suspicious transactions and facilitate a risk-based approach to customer due diligence (CDD) requirements.

Alongside the Report, the FATF has published handouts summarizing VA red flag indicators relating to the financial and non-financial sectors, VASPs and the public sector. (The Report is in addition to the FATF's guidance for a risk-based approach to VAs and VASPs, which it incorporated into its AML and CTF standards in June 2019. The FATF published a report in June setting out the findings from the 12-month review of its standards in this area.)

The FATF report on Virtual Assets Red Flag Indicators is available here.

The FATF handout on Financial and Non-Financial Sectors is available here.

The FATF handout on Virtual Asset Service Providers is available here.

The FATF handout on the Public Sector is available here.

ESMA Renews 0.1 percent Reporting Requirement of Net Short Positions in EU Issuers

On September 17, the European Securities and Markets Authority (ESMA) renewed its decision (ESMA70-155-11072) to temporarily require holders of net short positions in shares traded on a European Union- (EU) regulated market to report to the relevant EU financial regulator at a reduced threshold of 0.1 percent net short (instead of the pre-existing threshold of 0.2 percent net short). The measure will take effect starting September 18 for a period of three months.

In ESMA's decision notice, it comments that EU Financial Markets have partially recovered since the early days of the COVID-19 outbreak; however, ESMA continues to monitor the situation (which remains unpredictable, particularly in the context of a possible second wave of COVID-19 infections). The renewal of the 0.1 percent reporting threshold is intended to sustain the capacity of EU regulators to manage threats to market integrity and the orderly functioning of markets and financial stability at an early stage, allowing them and ESMA to address such threats in case of signs of exacerbated market stress.

Subsequently, net short positions of 0.1 percent and above held until December 18 are to be disclosed to the relevant EU financial regulator(s), no later than 9:30 a.m. (ET) on December 19 (i.e., T+1).

The ESMA decision of June 11 is available here.
The ESMA decision of September 16 is available here.
The EFTA decision of September 17 is available here.
The ESMA Register of Exempted Shares under Short Selling Legal Framework 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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