

SEC/CORPORATE

SEC Proposes Budget for Fiscal Year 2019

On February 12, the Securities and Exchange Commission issued a press release announcing its budget request for fiscal year 2019, which represents a 3.5 percent increase over the SEC's fiscal year 2018 budget request. In its press release, the SEC emphasized that its budget request reflects funding increases for enhancements to their "cybersecurity capabilities, risk and data analysis, enforcement and examinations, and automation of business processes," noting the need to keep up with significant advances in technology in the areas that it regulates.

The SEC's press release is available [here](#), and the SEC's fiscal year 2019 budget request is available [here](#).

BROKER-DEALER

FINRA Issues Regulatory Notice Regarding Extension of Time Requests Relating to FINRA Rule 4210

On February 14, the Financial Industry Regulatory Authority (FINRA) published a Regulatory Notice stating that it is updating the Regulatory Extension (REX) system to include increased functionality that will assist FINRA member firms in requesting extensions of time related to FINRA Rule 4210. This will include requests for extensions of time in connection with the margin requirements for Covered Agency Transactions that will become effective on June 25.

Beginning on June 25, member firms may submit requests for an extension of time pursuant to FINRA Rule 4210 by (1) completing an online form through the FINRA Firm Gateway, or (2) submitting a batch file by logging into the REX system. To support member firms in preparing for the update, FINRA has created a REX Customer Test Environment that member firms may use to test extension of time requests. FINRA is dividing testing into two phases and reminds firms to begin testing as soon as possible to ensure that they are ready to file extension of time requests when the updated REX system is implemented.

A copy of the Notice is available [here](#).

CFTC

CFTC Issues Interim Final Rule To Reorder and Alphabetize Definition Regulation

On February 15, the Commodity Futures Trading Commission published and requested comment on an interim final rule to amend the CFTC's primary definition regulation in an attempt to make such regulation user-friendly. Specifically, the CFTC amended Regulation 1.3 to remove lettered paragraphs and reorder defined terms in alphabetical order. Related cross-references to Regulation 1.3 in other CFTC regulations were revised to remove references to the lettered paragraphs.

Comments on the interim final rule must be submitted to the CFTC by March 17.

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

CFTC Issues Order of Registration to ICE Futures Singapore

On February 12, the Commodity Futures Trading Commission issued an Order of Registration (Order) granting ICE Futures Singapore Pte. Ltd. (ICEFS) registration as a foreign board of trade. The Order permits ICEFS to provide its identified members and other participants located in the United States with direct access to its electronic order entry and trade matching system. The Order is subject to continued compliance by ICEFS with the regulatory supervision of the Monetary Authority of Singapore.

The CFTC reserved the right to condition, modify, suspend, terminate or otherwise restrict the terms of the Order in the future.

The Order of Registration is available [here](#).

UK DEVELOPMENTS

FCA Publishes Report on Algorithmic Trading

On February 12, the UK Financial Conduct Authority (FCA) published a report on algorithmic trading compliance in wholesale markets.

The report highlights key requirements in the revised Markets in Financial Instruments Directive (MiFID II) relating to algorithmic trading activity, and contains examples of good and bad practices observed during the FCA's reviews of FCA regulated firms. The report identifies five core areas of focus:

- **Defining algorithmic trading.** Firms must establish an appropriate process to identify algorithmic trading, manage material changes and maintain a comprehensive inventory of algorithmic trading across the business.
- **Development and testing.** Firms must maintain robust, consistent and well-understood development and testing processes that identify potential issues across trading algorithms before full deployment.
- **Risk controls.** Firms must develop suitable and robust pre-trade and post-trade controls to monitor, identify and reduce potential trading risks across algorithmic trading activity.
- **Governance and oversight.** Firms must maintain an appropriate governance and oversight framework that demonstrates effective challenge from senior management, risk management and compliance.
- **Market conduct.** Firms must consider the potential impact of their algorithmic trading on market integrity, monitor for potential conduct issues and reduce market abuse risks.

The FCA states that it will continue to assess whether regulated firms have taken sufficient steps to reduce risks arising from algorithmic trading.

While the report comes after the effective date of MiFID II, the reviews undertaken by the FCA, which underlie the report, occurred before MiFID II implementation.

The fact that the report has been published now could indicate that, after the informal grace period offered to firms (see the *Corporate & Financial Weekly Digest* edition of [September 22, 2017](#)), the FCA will be stepping up its monitoring and enforcement in relation to MiFID II compliance.

The report is available [here](#).

EU DEVELOPMENTS

European Commission Publishes Survey About the Functioning of the AIFMD

On February 8, the European Commission published an online survey about the functioning of the Alternative Investment Fund Managers Directive (AIFMD). Article 69(1) of the AIFMD requires the EC to have commenced by July 22, 2017, its review of the AIFMD's scope and application. However, the review process has started late due to the EC's focus on competing priorities, such as Brexit.

The EC's Directorate General for Financial Stability, Financial Services and Capital Markets (DG FISMA) explains that it has contracted the professional service company, KPMG, to conduct research on how the AIFMD has worked in practice and to what extent its objectives have been met. The aim of the survey is to gather views of stakeholders on the AIFMD's requirements, stakeholders' experiences of applying those requirements and the impact of the AIFMD on the market.

In particular, the survey seeks the views of stakeholders on:

- AIFMD's impact on the information provided to investors before they invest;
- Whether retail investors are affected by AIFMD; and
- Whether other legislation, for example tax legislation, has assisted or hindered the achievement of the AIFMD's objectives.

DG FISMA does not specify when the survey will close to submissions, but the information from the survey will help to inform DG FISMA's final report on the functioning of the AIFMD.

The survey is available [here](#).

Warning to Consumers on Virtual Currency Risks Issued by EBA, EIOPA and ESMA

On February 12, the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) (collectively the three European Supervisory Authorities (three ESAs)) published a joint warning to consumers relating to the high risks of buying and/or holding virtual currencies (such as Bitcoin, Ether and Ripple).

In their warning, the three ESAs explain that virtual currencies:

- Are a digital representation of value that is not issued or guaranteed by a central bank or public authority;
- Do not have the legal status of currency or money; and
- Are generally not backed by any tangible assets and are unregulated under European Union (EU) law.

The three ESAs also set out the following risks that consumers face when buying virtual currencies or financial products that give consumers direct exposure to virtual currencies:

- Extreme price volatility and clear signs of a pricing bubble, which could result in consumers losing a large amount, or even all, of their money invested in virtual currencies;
- Absence of protection to cover consumers from losses, despite EU anti-money laundering requirements becoming effective later in 2018, which will apply to virtual currency wallet providers and virtual currency exchange platforms;
- Lack of exit options, as there is the risk of not being able to trade virtual currencies or exchange them for traditional currencies, such as the Euro, for long periods of time;
- Lack of price transparency, which could mean that consumers do not receive a fair and accurate price when buying or selling virtual currencies;
- Operational disruptions, such as trading disruptions, leaving consumers unable to buy or sell virtual currencies the moment they intend to;
- Misleading information, which is often incomplete, difficult to understand and does not properly disclose the risks of virtual currencies; and
- Unsuitability of virtual currencies for most purposes, including short-term investments or retirement planning.

The three ESAs advise that if consumers decide to buy virtual currencies or financial products giving exposure to virtual currencies, consumers should fully understand their characteristics and the risks taken. The three ESAs also remind consumers that buying virtual currencies from firms regulated for providing financial services does not mitigate the risks noted above.

The three ESAs' warning is available [here](#).

FCA Provides Update on EMIR United States Equivalence Decision and Intragroup Exemptions

On February 12, the United Kingdom Financial Conduct Authority (FCA) updated its webpage on the European Market Infrastructure Regulation (EMIR), about the equivalence decision for derivative transactions in the United States adopted by the European Commission on October 13, 2017. The equivalence decision determined that the rules promulgated by the Commodity Futures Trading Commission on risk monitoring and mitigation for over-the-counter derivatives not cleared by a central counterparty are equivalent to EMIR.

On its webpage, the FCA explains that the EC has confirmed to the FCA that the equivalence decision includes intragroup exemptions under Articles 11(8) and 11(9) of EMIR, and therefore such transactions are exempted from the obligation to exchange collateral. Although the temporary intragroup exemptions that the FCA granted for trades between UK and US firms technically expire on March 2, the EC's positive equivalence decision allows firms to apply for exemptions with no expiry date.

The FCA has adopted a streamlined process for firms wishing to apply for the new exemption to help alleviate any administrative burdens on such firms. Therefore, UK firms currently benefitting from the temporary intragroup exemption must:

- Notify the FCA of the entity pairs to which the equivalence decision applies; and
- Confirm whether there have been any other changes to the conditions under which the original intragroup exemption was granted.

The FCA's webpage on EMIR is available [here](#).

ESMA Publishes Recommendation on Leverage and Liquidity in Investment Funds

On February 14, the European Systemic Risk Board (ESRB) published a recommendation (dated December 7, 2017) on liquidity and leverage risks in investment funds managed by regulated EU managers (specifically open-ended alternative investment funds (AIFs) and undertakings for collective investment in transferable securities (UCITS)).

The ESRB raises concerns that increased financial intermediation by such investment funds may result in the amplification of any future financial crisis. This is because mismatches between the liquidity of funds' assets and their redemption profiles may result in "fire sales" in order to meet redemption requests in times of market stress. Such sales could adversely affect other financial market participants that own the same or closely correlated assets. The recommendation also highlights that in addition to such channels of indirect contagion, an investment fund can spread risk through interconnectedness (e.g., interconnections with its investors), a direct channel through which shocks can be transmitted to other financial institutions.

The recommendation is addressed to the European Securities and Markets Authority (ESMA) and the European Commission and includes the following specific recommendations to address the above concerns:

- The EC should develop legislation that sets out a legal framework governing liquidity management tools in the design of investment funds;
- The EC should develop legislation that includes measures to limit the extent to which the use of liquidity transformation in AIFs can contribute to the build-up of systemic risks or the risk of disorderly markets;
- ESMA should develop guidance for managers of AIFs and UCITS for the stress testing of liquidity risk for individual funds;
- The EC should develop legislation that requires reporting of UCITS liquidity risk and leverage data to national competent authorities; and
- ESMA should give guidance on the framework to assess the extent to which the use of leverage within the AIF sector contributes to the build-up of systemic risk in the financial system.

The recommendation contains timelines for ESMA and the EC to report on any actions they have taken for each specific recommendation, with suggested dates in 2019 and 2020.

The recommendation is available [here](#).

For additional coverage on financial and regulatory news, visit [Bridging the Week](#), authored by Katten's [Gary DeWaal](#).

For more information, contact:

SEC/CORPORATE

Mark J. Reyes	+1.312.902.5612	mark.reyes@kattenlaw.com
Mark D. Wood	+1.312.902.5493	mark.wood@kattenlaw.com

FINANCIAL SERVICES

Janet M. Angstadt	+1.312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	+1.212.940.6615	henry.bregstein@kattenlaw.com
Kimberly L. Broder	+1.212.940.6342	kimberly.broder@kattenlaw.com
Wendy E. Cohen	+1.212.940.3846	wendy.cohen@kattenlaw.com
Guy C. Dempsey Jr.	+1.212.940.8593	guy.dempsey@kattenlaw.com
Gary DeWaal	+1.212.940.6558	gary.dewaal@kattenlaw.com
Kevin M. Foley	+1.312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	+1.212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	+1.312.902.5241	arthur.hahn@kattenlaw.com
Christian B. Hennion	+1.312.902.5521	christian.hennion@kattenlaw.com
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Fred M. Santo	+1.212.940.8720	fred.santo@kattenlaw.com
Christopher T. Shannon	+1.312.902.5322	chris.shannon@kattenlaw.com
Robert Weiss	+1.212.940.8584	robert.weiss@kattenlaw.com
Lance A. Zinman	+1.312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	+1.312.902.5334	krassimira.zourkova@kattenlaw.com

UK DEVELOPMENTS

Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Neil Robson	+44.20.7776.7666	neil.robson@kattenlaw.co.uk
Nathaniel Lalone	+44.20.7776.7629	nathaniel.lalone@kattenlaw.co.uk

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