

BROKER-DEALER

FINRA Releases New Targeted Exam Letter Regarding Order Routing Conflicts

On November 10, the Financial Industry Regulatory Authority released the contents of a new Order Routing Conflicts targeted exam letter that certain member firms may receive. FINRA uses targeted exams (e.g., sweeps) to gather information on emerging issues and uses such information to pinpoint regulatory response to such issues. FINRA chooses the identity of member firms that will participate in a sweep based upon a number of factors.

The new Order Routing Conflicts letter requests information relating to receipt of order routing inducements and how they affect a firm's order routing practices and decisions. Information requested includes: 1) how the firm quantifies benefits to its customers from the firm's receipt order routing inducements; 2) how the firm fulfills its duty of best execution when routing orders to market centers with materially higher transaction costs than other market centers; and 3) how the firm handles conflicts between the firm's best execution obligation and the firm's financial interest in such inducements.

The full text of the letter is available [here](#).

FINRA Requests Comment on Proposal to Amend Rule 3110, to Provide Firms the Option to Conduct Remote Inspection of Offices and Locations That Meet Specified Criteria

On November 13, the Financial Industry Regulatory Authority requested comment on a proposed rule that would allow member firms to conduct remote inspections of certain "qualifying offices," in lieu of a physical, on-site inspection. The proposal would allow member firms to adopt policies and procedures to determine whether a given location could be deemed a "qualifying office" based upon the factors set forth in Rule 3110.12 and upon whether any associated person conducting business from that office has had a Form U4 disclosable event. Remote inspections would be subject to the same qualitative standards as on-site inspections.

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

FINRA Releases a Regulatory Notice That the SEC Approved the CAT Fee Dispute Resolution Process

On November 15, the Financial Industry Regulatory Authority issued a Regulatory Notice concerning the Securities and Exchange Commission's approval of SEC Rule 6898 (Consolidated Audit Trail (CAT) Fee Dispute Resolution). The new rule establishes a procedure under which an industry member that disputes a CAT fee must file a written application with the CAT NMS, LLC within 15 days after being notified of the disputed charge. The application must: 1) identify the disputed CAT fees; 2) state the specific reason why the applicant disputes such CAT fees; and 3) identify the relief sought. The Fee Review Subcommittee will then decide whether to review, and if so, what, if any, relief will be granted. This rule will be implemented on December 1 (but will not be in effect until CAT fees are operative).

More information is available [here](#).

FINRA Releases Summary of Phase 1 Changes to FINRA Advisory Committees Under FINRA360

On November 15, the Financial Industry Regulatory Authority released an update on actions it has thus far taken under the “FINRA360” initiative, which is an ongoing comprehensive review of FINRA’s operations. As of November 13, these actions include: 1) replacing the Technology Advisory Committee with an annual “CIO Summit”; 2) broadening the authority of the Operations Advisory Committee; 3) updating the public descriptions of certain advisory committees on FINRA’s website to clarify which committees are available as forums for discussion of specific issues; 4) issuing annual notices about committees and the application process to be considered for a vacant position; and 5) emailing election notices to a broader distribution group, including each member firm’s CEO, CCO and COO.

More information is available [here](#).

SEC Enforcement Division Issues Report on Priorities and Fiscal Year 2017 Results

On November 15, the Enforcement Division of the Securities and Exchange Commission issued a report highlighting its 2018 enforcement priorities and its enforcement results for 2017. In the report, the Enforcement Division stated the five core principles that will guide enforcement in 2018: 1) focus on the Main Street investor; 2) focus on individual accountability; 3) keep pace with technological changes; 4) impose sanctions that most effectively further enforcement goals; and 5) constantly assess the allocation of resources.

In 2017, the Enforcement Division brought 754 enforcement actions, including 446 stand-alone actions, which returned a record \$1.07 billion to harmed investors. In total, the SEC obtained judgements and orders totaling more than \$3.789 billion in disgorgement and penalties.

More information is available [here](#) and the report itself is available [here](#).

DERIVATIVES

See “CFTC Extends No-Action Relief to SEFs From Certain Block Trade Requirements” in the CFTC section.

CFTC

CFTC Extends No-Action Relief to SEFs From Certain Block Trade Requirements

On November 14, the Commodity Futures Trading Commission extended time-limited no-action relief to swap execution facilities (SEFs) from certain block trade requirements in the definition of “block trade” in CFTC regulation 43.2.

The relief is subject to (1) the block trade not being executed on the SEF’s order book functionality; (2) the SEF adopting rules on cleared trades requiring compliance with the other requirements of CFTC regulation 43.2; (3) the registered future commission merchant (FCM) completing the required pre-execution credit check at the time the order for the block trade enters the SEF’s non-order book trading system or platform; and (4) the block trade being subject to rejection based on credit.

In extending the no-action position, the CFTC staff noted that it understands that no mechanism currently exists to enable a pre-execution credit check where blocks are executed away from a SEF. The CFTC staff confirmed that, in these circumstances, an FCM clearing firm that does not have knowledge of a block trade and clears the trade would not be in violation of the pre-execution credit check requirement under CFTC Rule 1.73.

The relief is set to expire on November 5, 2020.

CFTC Letter No. 17-60 is available [here](#).

CFTC Announces 2018 Agricultural Commodity Futures Conference

On November 15, the Commodity Futures Trading Commission announced that it will host, together with the Center for Risk Management Education and Research at Kansas State University, a new two-day event called Protecting America's Agricultural Markets: An Agricultural Commodity Futures Conference on April 5–6, 2018.

The conference will take place in Overland Park, Kansas, and will feature presentations and discussions on current economic trends and issues affecting agricultural futures markets. A conference agenda and registration information will be released separately.

The CFTC press release is available [here](#).

UK DEVELOPMENTS

FCA Publishes Further Set of Position Limits for Commodity Derivative Contracts

On November 15, the UK Financial Conduct Authority (FCA) updated its webpage (webpage) in connection with position limits for commodity derivative contracts.

Under the revised Markets in Financial Instruments Directive (MiFID II), limits are required to be established on the size of a net position a person can hold (at all times) in commodity derivatives traded on EU/EEA trading venues and economically equivalent over-the-counter contracts. The webpage lists the commodity derivative contracts that the FCA has currently identified as trading on a UK trading venue, which, beginning January 3, 2018, will have a bespoke position limit set against them. The list will be subject to changes and updates from time to time, and firms are encouraged to check it regularly.

The FCA has also updated the position limits for Dated Brent, which it initially published on October 26, to reflect the aggregation of this contract with the daily Dated Brent contract (which has the same underlying), the inclusion in the definition of Brent oil of the Troll oilfield from January 2018, and the inclusion of stock data.

The webpage is available [here](#).

EU DEVELOPMENTS

ESMA Highlights ICO Risks

On November 13, the European Securities and Markets Authority (ESMA) published two statements (statements) in relation to initial coin offerings (ICOs); one was made in relation to the risks of ICOs for investors and the other is in relation to the rules for firms involved in ICOs. ICOs are a way for businesses or individuals to raise finance by issuing coins or tokens, the features and purposes for which can vary substantially.

ESMA stated that it has observed a rapid growth in ICOs, globally and in Europe, and is concerned that investors may be unaware of the high risks that they are taking when investing in ICOs. Additionally, ESMA is concerned that firms involved in ICOs may conduct their activities without complying with relevant applicable EU legislation. In relation to investors, ESMA noted the high risk of losing all invested capital due to the fact that ICOs are very risky and highly speculative investments, adding that the price of the coin or token is extremely volatile and may not be redeemable for prolonged periods. ICOs are also vulnerable to fraud and money laundering.

For firms, ESMA stated that where ICOs qualify as financial instruments, regulated activities are likely to occur, at which point a range of European legislation can apply. Such legislation would include the Prospectus Directive, the Markets in Financial Instruments Directive, the Alternative Investment Fund Managers Directive and the Fourth Anti Money Laundering Directive. ESMA stressed that firms should give careful consideration to such requirements.

The statements are available [here](#) and [here](#).

ESMA Publishes Updated MiFID II Q&As

On November 14–15, the European Securities and Markets Authority (ESMA) updated several question and answer documents (Q&As) relating to the revised Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR).

The updated Q&As cover the following topics:

- [Market Structure Issues](#): This Q&A has been updated for questions relating to the tick size regime, direct electronic access (DEA) and multilateral systems.
 - Notably, the Q&A has been updated to clarify ESMA's expectations relating to sub-delegation and authorization requirements for DEA. ESMA makes the distinction between “tier 1 DEA clients” and “tier 2 DEA clients,” where the former directly interacts with the DEA provider to obtain the provider's trading code, while the latter does not possess the trading code. ESMA states that such tier 2 DEA clients would not have DEA for the purposes of MiFID II. ESMA also states that trading venues should only permit members or participants to provide DEA where they are investment firms (authorized under MiFID II) or credit institutions (i.e., EU authorized banks).
- [Transparency](#): The updated Q&A contains questions and answers relating to pre- and post-trade transparency for equity and non-equity instruments, systematic internalizers, data reporting service providers, and third-country issues.
 - ESMA has clarified how chains of transmission of orders should be treated when it comes to the trading obligation for shares under Article 23(1) of MiFIR. Briefly, it is for each EU investment firm within that chain to ensure that ultimate execution of the order complies with the share-trading obligation.
 - The third-country issues section sets out a chart showing how varying scenarios involving third-country firms should be treated. The chart clarifies, for instance, when non-EU branches of EU investment firms should be treated in the same way as the EU investment firm itself.
- [MiFIR Data Reporting](#): This Q&A provides clarification regarding transaction reporting for primary issuances, corporate events, portfolio management and swaps-related to indices.
- [Commodity Derivatives](#): This update includes new answers regarding position limits, ancillary activities and position reporting.

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

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UK/EU DEVELOPMENTS

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