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BROKER-DEALER

Nasdaq Has Proposed a New Rule Change To Modify Its System of Volume-Based Credits

The Nasdaq Stock Market LLC (Nasdaq) has filed with the Securities and Exchange Commission a proposed rule change to modify the current system of credits Nasdaq offers to members that add liquidity in securities that are listed on exchanges other than Nasdaq or the New York Stock Exchange. In particular, Nasdaq is seeking to modify one and eliminate another one of the volume-based credits that it offers for displayed quotes/orders that provide liquidity on Nasdaq in Tape B Securities.

Nasdaq offers a member a credit of $0.0001 per share executed if the member provides liquidity in securities that are listed on exchanges other than Nasdaq or NYSE during the month representing at least .06 percent, but less than 0.12 percent, of consolidated volume during the month through one or more of the member's Nasdaq Market Center Market Participant Identifiers. Nasdaq has proposed to change the lower threshold from .06 percent to 0.10 percent, and remove the upper 0.12 percent threshold entirely.

Additionally, Nasdaq proposes to eliminate the $0.0002 per share executed credit that it currently provides for members that provide liquidity in securities that are listed on exchanges other than Nasdaq or NYSE during the month representing at least 0.12 percent of consolidated volume during the month.

Nasdaq has designated the proposed rule change to be effective on April 2.

The text of the proposed rule change is available here.

FINRA Proposed a Rule Change With Respect to the Establishment of a Second Trade Reporting Facility

The Financial Industry Regulatory Authority recently filed a proposed rule change with the Securities and Exchange Commission to adopt rules relating to the creation of a second Trade Reporting Facility (TRF) to be operated in conjunction with Nasdaq, Inc. (Nasdaq". The second FINRA/Nasdaq TRF (FINRA/Nasdaq TRF Chicago) would provide FINRA members with another facility to which they may report over-the-counter (OTC) trades in National Market System (NMS) stocks. Currently, FINRA has three facilities that allow its members to report such trades.

The establishment of the proposed FINRA/Nasdaq TRF Chicago would provide FINRA members with another mechanism to facilitate compliance with member firms' OTC equity trade reporting obligations outline in the Trade Reporting Notice published by FINRA on January 20, 2016. The Notice explained that a firm that routinely reports its OTC trades in NMS stocks to only one FINRA facility must maintain connectivity and report to a second FINRA facility if the firm intends to continue to support OTC trading as an executing broker, while its primary facility is experiencing a widespread systems issue. The proposed FINRA/Nasdaq TRF Chicago would provide members with an additional available facility for such reporting.

If the SEC approves the proposed rule change, the proposed rule change will be effective the date on which the FINRA/Nasdaq TRF Chicago commences operations. As stated in the proposed rule, it is anticipated that the FINRA/Nasdaq TRF Chicago will commence no earlier than August 1.

The text of the proposed rule change is available here.

SEC Confirms Record Retention Requirements With Third-Party Recordkeeping Services

On April 12, the staff of the Securities and Exchange Commission issued a letter in response to an inquiry from staff of the Financial Industry Regulatory Authority, concerning broker-dealers' recordkeeping obligations under Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-4 thereunder.

Paragraph (i) of Rule 17a-4 imposes various requirements on broker-dealers that use third-party recordkeeping services to prepare or maintain records that the broker-dealer is required to preserve under Rules 17a-3 or 17a-4. The requirements are designed to assure that regulators have access to the broker-dealer's records even where, for example, the third-party recordkeeping service refuses to surrender the records due to non-payment of fees. FINRA staff raised concerns regarding broker-dealers entering into contracts with such third-party recordkeeping services that include provisions permitting the service provider to delete or discard the broker-dealer's records due to non-payment or under other circumstances.

In response, the SEC staff advised that such contractual provisions are inconsistent with the record retention requirements of Rule 17a-4 and with the service provider provisions in paragraph (i) of the Rule. Moreover, the staff indicated that the deletion of required records by a third-party service provider, exercising its rights under such a contractual provision, would constitute a primary violation of the Rule by the broker-dealer and could subject the service provider to secondary liability for aiding and abetting the violation.

The SEC staff's letter is available here.

UK DEVELOPMENTS

FCA and PRA Publish 2018/19 Business Plans

On April 9, the UK Financial Conduct Authority (FCA) published its business plan for 2018/19. The business plan divides key priorities for the FCA over the coming year into three main areas: (1) the United Kingdom's withdrawal from the European Union (Brexit); (2) cross-sector priorities; and (3) sector-specific priorities.

The FCA's business plan anticipates that the level of resource required with respect to Brexit will inevitably reduce the amount of work the FCA can complete in other areas. The FCA has therefore prioritized areas where the risk of harm to consumers, market integrity or competition are greatest, and its intervention will be most impactful.

Regarding Brexit, the FCA has stated that it aims to work with the UK government and ensure an appropriate transition for European Economic Area firms, while working with regulated firms to monitor the risks to its objectives.

The FCA prescribes cross-sector priorities, which include the following:

- firms' culture and governance—which includes extension of the Senior Managers and Certification Regime to all firms authorized under the UK Financial Services and Markets Act 2000;
- financial crime (fraud and scams) and anti-money laundering;
- data security, resilience and outsourcing;
- innovation, big data and competition—which includes the FCA's role as part of the new "cryptoassets task force" launched at the UK government's International Fintech Conference last month; and
- treatment of existing customers.

On the same day, the UK Prudential Regulation Authority (PRA) also published its own business plan for 2018/19. The PRA's business plan covers: (1) Brexit; (2) the implementation of ring-fencing for banks; and (3) technology, as key areas of change to which the PRA will respond this year.

Notable strategic goals in the PRA's business plan include:

- having in place robust prudential standards comprising the post-financial crisis regulatory regime;
- ensuring that firms are adequately capitalized, and have sufficient liquidity, for the risks they are managing or planning to take;

- ensuring that banks and insurers have credible plans in place to enable them to recover from stress events, and that the PRA has a credible resolution strategy to manage a firm's failure—proportionate to the firm's size and systemic importance—in an orderly manner; and
- delivering a smooth transition to a sustainable and resilient UK financial regulatory framework following Brexit.

The FCA's business plan, including the sector-specific priorities on page 8, is available here.

The PRA's business plan is available here.

FCA Publishes Statement Regarding the Requirement for Firms Offering Cryptocurrency Derivatives To Be Authorized

On April 6, the UK Financial Conduct Authority (FCA) published a statement on the requirement that firms trading in cryptocurrency derivatives may need to be authorized. The statement confirms that performing activities or providing services that amount to regulated activities in relation to derivatives are likely to require FCA authorization when performed in relation to tokens that are issued through an initial coin offering, or cryptocurrencies.

Although cryptocurrencies (and other cryptoassets) are not currently specifically regulated by the FCA, cryptocurrency derivatives may constitute financial instruments within the revised Markets in Financial Instruments Directive (MiFID II). The FCA notes that it does not consider the underlying cryptocurrencies to be currencies or commodities for regulatory purposes under MiFID II.

Failure to obtain the necessary authorization for carrying on regulated activity is a criminal offense in the United Kingdom. The FCA recommends that, if firms are unclear as to whether they require authorization, the general regulatory perimeter guidance in its handbook (PERG) may be helpful and encourages firms to seek expert advice if they have any remaining questions.

The FCA's statement is available here.

PERG is available here.

EU DEVELOPMENTS

ESMA Seeks EC Clarification on Ancillary Activity Test Under MiFID II

The European Securities and Markets Authority (ESMA) published a letter to the European Commission (EC) dated April 9, requesting clarification with respect to the exemption available to non-financial entities (NFEs) from having to be authorized as an investment firm under the revised Markets in Financial Instruments Directive (MiFID II).

NFEs are eligible for this exemption where their commodity derivative trading activity is ancillary to their main business. However, there is uncertainty as to whether the "ancillary to main business" assessment should be made at group or single-entity level.

ESMA previously published an opinion, considered in the *Corporate & Financial Weekly Digest* edition of July 7, 2017, on the market size calculation for the assessment. In the opinion, ESMA refers to the assessment as being carried out at group level.

The letter to the EC highlights ambiguity between MiFID II (and related implementing legislation) and EC amendments to regulatory technical standards (RTSs), specifically RTS 20 (setting out the criteria establishing when an activity is considered to be ancillary to the main business). MiFID II supports the assessment at group level, while RTS 20 has been interpreted to indicate that the assessment should be carried out at single-entity level.

ESMA considers this a question of interpreting MiFID II and the related EC amendments and, as such, not appropriate for an ESMA question and answers document. Instead, ESMA invites the EC to provide further guidance on how and the level at which the assessment should be performed.

The letter is available here.

IOSCO Produces CCP Stress Test Framework

On April 10, the International Organization of Securities Commissions (IOSCO), in conjunction with the Bank for International Settlements' (BIS) Committee on Payments and Market Infrastructures, published a framework for supervisory stress testing of central counterparties (CCPs) in a single jurisdiction or across multiple jurisdictions. The framework's focus is stated to be the evaluation of "broad, macro-level impacts across multiple CCPs."

The framework divides the process that authorities would follow in coordinating a multi-CCP supervisory stress test (SST) into six stages:

- purpose and exercise specifications;
- governance arrangements;
- developing stress scenarios;
- data collection and protection;
- aggregating results and developing analytical metrics; and
- use of results and disclosure.

Reports have suggested that the framework may affect the European Union's proposed amendment of the European Market Infrastructure Regulation in relation to the supervision of CCPs, in particular third-country CCPs (EMIR 2.2).

However, EMIR 2.2 provides only for the assessment of individual CCPs. Under EMIR 2.2, the European Markets and Securities Authority may specify a CCP as "substantially systemic" and require that CCP to establish an EU venue to mitigate, by facilitating supervision, the substantial exposure risk to the European Union and its financial system.

A footnote in the framework adds that its purpose does not preclude the use of the framework, where "suitably adapted . . . for the design of tests with other objectives, including SSTs designed to analyze the individual financial resilience of CCPs".

An unnamed European Commission official confirmed that the framework would not impact EU plans for the introduction of EMIR 2.2.

The framework is available here.

The BIS press release in relation to the framework is available here.

ESMA Publishes Updated Double Volume Cap Public Register

On April 10, the European Securities and Markets Authority (ESMA) published updated results of the double volume cap (DVC) mechanism on its website—for the period of March 1, 2017 to February 28, 2018, and for already published DVCs.

The DVC mechanism is set out in the Markets in Financial Instruments Regulation (MiFIR) and is designed to limit the amount of "dark" trading under certain equity waivers, meaning trading that relies on the reference price waiver and the negotiated transaction waiver to avoid MiFIR transparency requirements.

In the updated DVC mechanism data, the number of new breaches is 47 equities for the 8 percent cap—which applies to all trading venues—and 8 equities for the 4 percent cap, which only applies to individual trading venues.

ESMA has received corrections to past DVC publications from trading venues that render a limited number of historic breaches incorrect; suspensions in relation to trading of such instruments under the waivers should be lifted. Conversely, 83 new breaches of the 8 percent cap and 18 breaches of the 4 percent cap have been identified for the same period. Trading under the waivers for those instruments should be suspended from April 13 to October 13.

Further background regarding the DVC mechanism is available in the *Corporate & Financial Weekly Digest* edition of March 9, which concerns ESMA's March 7 press release.

The updated public register regarding the DVC mechanism is available here.

ESMA's announcement in relation to the updated DVC register 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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