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BROKER-DEALER

"Trade Match" and "Trade Acceptance" Clearing Submissions on FINRA's Alternative Display Facility

On October 7, the Financial Industry Regulatory Authority issued a Trade Reporting Notice regarding its Alternative Display Facility (ADF). In particular, member firms that use the ADF to report over-the-counter trades in national market system stocks can elect to have their trades submitted by the ADF to the National Securities Clearing Corporation (NSCC) for clearance and settlement. However, to make this election, such trades must either be locked in prior to submission via agreement by both parties to the trade, or may be locked in by the system in accordance with FINRA rules.

FINRA Rule 7140(a) describes being locked in by the ADF in accordance with FINRA rules. For "Trade by Trade Match," both parties to the trade submit transaction data and the system performs an on-line match. For "Trade Acceptance," after the reporting party enters its version of the trade into the system, the other party reviews the submission and either accepts or declines the trade. An acceptance results in a locked-in trade that is sent to NSCC. Reporting firms submitting trades to the ADF using the Trade Match or Trade Acceptance functionality need to identify another ADF participant with access to the ADF and the ability to view and take action with respect to the reporting party's submission. To become an ADF participant, member firms must execute the FINRA Participation Agreement (FPA). Pursuant to the FPA, reporting parties agree that if they submit a trade to the ADF for Trade Match or Trade Acceptance against a party that is not an ADF participant, they accept any and all potential liability resulting from the failure of such non-ADF participant to honor the trade. A list of ADF participants is provided on FINRA's website.

The ADF system does not prevent the entry of a trade against a party that is not an ADF participant, and as such, FINRA also announced the disablement of the automatic lock-in functionality on the ADF as of October 24, 2016. If an alleged contra party takes no action on a clearing-eligible trade submitted to the ADF for Trade Acceptance, the trade will be carried over and remain open.

To see the notice, click here.

DERIVATIVES

CFTC Proposes New Rules for Cross-Border Swaps

On October 10, the Commodity Futures Trading Commission proposed new rules for cross-border swaps (the Proposed Rules) that are intended to supersede the non-binding guidance with respect to such swaps that it issued in in 2013. (See Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (July 26, 2013) (Guidance)). The key elements of the Proposed Rules are as follows:

1. The Proposed Rules contain an explicit definition of the term "U.S. Person" that will replace the "interpretation" of that term found in the Guidance. The proposed U.S. person definition is generally consistent with the interpretation, with certain exceptions. In particular, the proposed definition does not include the prong of the interpretation that turned any commodity pool, pooled account, investment fund, or other collective investment vehicle that is majority-owned by one or more U.S. persons into a U.S. person. In the interest of providing

legal certainty, the proposed definition does not have the "catchall" provision found in the interpretation, thereby limiting the definition of "U.S. person" to persons enumerated in the rule. The preamble to the Proposed Rules confirms that the explanation in the Guidance of how the principal place of business test applies with respect to funds will continue to be operative in the context of the Proposed Rules.

2. The Proposed Rules clarify and simplify the circumstances under which an entity must count dealing swaps against the swap dealing *de minimis* registration threshold. The most novel element of the Proposed Rules in this regard is the requirement that any non-U.S. person (a "Foreign Consolidated Subsidiary," or FCS) that is consolidated into the financials of an ultimate U.S. parent entity must count all of its dealing swaps against the *de minimis* threshold, including swaps with other non-U.S. persons. Under the Guidance, only a conduit affiliate (not mentioned in the Proposed Rules) or a guaranteed affiliate had to count dealing swaps with non-U.S. persons. That obligation will now apply as a practical matter to virtually all non-U.S. entities dealing in swaps that are subsidiaries of U.S. persons. The Proposed Rules will also require other non-U.S. persons to count dealing swaps with an FCS towards the *de minimis* threshold, thus potentially making all FCSs less attractive as counterparties. The Proposed Rules also modify the circumstances under which an entity must count swaps for purposes of determining if it is a major swap participant.

3. The Proposed Rules clarify and simplify the extent to which the CFTC's external business conduct rules apply to cross-border swaps. Under the Proposed Rules, a swap dealer registered with the CFTC that is a non-U.S. person or a foreign branch of a U.S. person will not be subject to any of the external business conduct rules with respect to any transaction in swaps (or any swap that is offered but not entered into) when its counterparty is another non-U.S. person or a foreign branch of a U.S. person that is a swap dealer. However, §§ 23.410 (Prohibition on Fraud, Manipulation and Other Abusive Practices) and 23.433 (Fair Dealing) of the external business conduct rules relating to fair dealing will apply if the swap dealer uses personnel located in the United States to arrange, negotiate, or execute a transaction in swaps or a swap that is offered but not entered into. The preamble to the Proposed Rules contains an interpretation concerning the type of activity that constitutes arranging, negotiating and executing a swap.

The Proposed Rules do not address the cross-border application of any substantive Dodd-Frank requirements beyond the SD/MSP registration thresholds and external business conduct standards. The CFTC expects to address the cross-border application of other Dodd-Frank requirements, including the availability of substituted compliance, in subsequent rulemakings.

The Proposed Rules is available here.

See "CFTC Sets Phase-In De Minimis Amount Termination Date" and "CFTC Further Extends Time-Limited Relief to SEFs for Block Trades" in the CFTC section.

CFTC

CFTC Sets Phase-In *De Minimis* Amount Termination Date

On October 13, the Commodity Futures Trading Commission issued an order to establish December 31, 2018 as the new *de minimis* threshold phase-in termination date under its swap regulations. This order is the follow-up to the proposal in this regard made by CFTC Chairman Timothy Massad in a speech on September 15. More details relating to the phase-in and the Chairman's proposal can be found in the September 16 edition of the *Corporate & Financial Weekly Digest*.

CFTC Regulation 1.3(ggg)(4)(i) exempts from the definition of a swap dealer a person that engages only in a *de minimis* amount of swap dealing activity. Specifically, a person that, over the course of the preceding 12 months, enters into swaps that have an aggregate gross notional value of no more than $8 billion, will not be a swap dealer. Under the CFTC's order, this *de minimis* threshold will drop to $3 billion on December 31, 2018, unless the CFTC takes action to confirm or modify the current threshold.

The CFTC order is available here.

CFTC Further Extends Time-Limited Relief to SEFs for Block Trades

On October 7, the Commodity Futures Trading Commission's Division of Market Oversight and Division of Clearing and Risk issued No-Action Letter No. 16-74 granting relief to Swap Execution Facilities (SEFs) from the requirement in CFTC Regulation 43.2 that a swap block trade must take place away from a SEF's trading system or platform. The No-Action letter extends relief previously granted to SEFs in CFTC Letter No. 15-60 and Letter No. 14-118.

The relief is subject to the following conditions: 1) the block trade is not executed on a SEF's order book, as defined in CFTC Regulation 37.3(a)(3); 2) the SEF adopts rules for cleared block trades that indicate the SEF is relying upon this relief and require each cleared block trade to comply with the notional size and other requirements of CFTC Regulation 43.2; 3) the futures commission merchant (FCM) completes a pre-execution credit check at the time the order enters the SEF trading system or platform; and 4) the block trade is subject to void *ab initio* requirements if the trade is rejected for clearing on the basis of credit.

CFTC Letter No. 16-74 extends the relief until the earlier of November 15, 2017, at 11:59 p.m. or the effective date of any CFTC action with respect to swap block trades.

More information on CFTC Letter No. 14-118 is available in the *Corporate & Financial Weekly Digest* edition of September 26, 2014.

CFTC Letter No. 15-60 is available here.

CFTC Letter No. 16-74 is available here.

CFTC Releases Rule Enforcement Review of the New York Mercantile Exchange, Inc. and the Commodity Exchange, Inc.

On October 13, the Division of Market Oversight (Division) of the Commodity Futures Trading Commission released the results of its rule enforcement review of the market surveillance program of the New York Mercantile Exchange, Inc. and the Commodity Exchange, Inc. (collectively, the Exchanges). The review, which focused on the period from March 1, 2014 through March 1, 2015, focused on the Exchanges' compliance with Core Principle 2 (Compliance With Rules), Core Principle 4 (Prevention of Market Disruption), Core Principle 5 (Position limitations or Accountability) and regulations related to the Exchanges' market surveillance program. The purpose of the review was to determine 1) whether the program complies with the Core Principles and CFTC regulations; 2) whether there are any deficiencies in the program; and 3) whether the Division should make any recommendations to improve the program. For the purposes of rule enforcement reviews, a "deficiency" is an area where the Division believes an exchange is not in compliance with a CFTC regulation and must take corrective action; and a "recommendation" is in an area where the Division believes the exchange should improve its compliance program. The Division is conducting a separate review of the Exchanges' procedures relating to Exchange for Related Positions.

The Division found that the Exchanges maintain experienced market surveillance staff and an adequate market surveillance program to demonstrate compliance with Core Principles 2, 4 and 5. The Division did not identify any deficiencies but made one recommendation—that the Exchanges should consider implementing a formal review process by which the market surveillance department can verify that a market participant, who has a position larger than a position limit is, in fact, making use of an exemption, consistent with the strategy described in their exemption application.

To see the full report, click here.

UK DEVELOPMENTS

FCA Publishes Discussion Paper on Firms' Legal Function Under the Senior Managers Regime

On October 3, the UK Financial Conduct Authority (FCA) published a discussion paper (Discussion Paper) on the application of the UK Senior Managers Regime (SMR) to persons responsible for the legal function of a UK regulated firm.

The UK Senior Managers and Certification Regime (SM&CR) went into effect on March 7 and is broadly designed to strengthen accountability for senior managers and their areas of responsibility, and to lift the standard of conduct expected of individuals at all levels. The SMR (a subset of the SM&CR) requires (among other things) that a senior manager is appointed with overall responsibility for every part of a firm's activities and business areas (including the legal function).

The Discussion Paper follows an announcement from the FCA in January, which acknowledged confusion raised by firms, as well as concerns that applying the SMR to the legal function could compromise the function's independence and prejudice the principle of legal professional privilege. In response to these concerns, the FCA has published the Discussion Paper seeking feedback on arguments for and against bringing those with overall responsibility for the legal function within the ambit of the SMR.

Notably, the FCA acknowledges in the Discussion Paper that confusions expressed by firms on the application of the SMR to persons responsible for the legal function have been "exacerbated by inconsistent FCA communications on the subject." The FCA notes that it will clarify what is required with respect to the legal function once responses to the Discussion Paper have been received and analyzed.

For further information, see our *Corporate & Financial Weekly Digest* editions of January 29, 2016 and October 30, 2015.

Comments on the Discussion Paper must be submitted to the FCA by January 9, 2017.

The Discussion Paper can be found here.

The FCA's January 2016 announcement is available here.

FCA Publishes Feedback Statement on Smarter Consumer Communications

On October 11, the UK Financial Conduct Authority (FCA) published a feedback statement (Statement) on smarter consumer communications. The Statement follows a discussion paper on smarter consumer communications published by the FCA in June 2015, and a further consultation paper published by the FCA in October 2015.

The Statement is divided into five chapters, covering smarter approaches to consumer communications (including examples of communications in financial services, what "good disclosure" constitutes for consumers and digital communications, among others), a summary of feedback received on the FCA's previous consultations, a summary of feedback received on disclosure rules in the FCA's *Handbook*, and the FCA's planned next steps.

While the Statement focuses on communications with consumers (i.e., natural persons acting for purposes outside their trade, business or profession), the FCA regulated firms operating in the wholesale sector (i.e., firms with professional clients and eligible counterparties) would be advised to take the principles in the Statement into account for their own financial promotions in the United Kingdom (particularly with respect to the use of social media and the Internet).

The Statement is available here.

EU DEVELOPMENTS

ESMA Publishes Final Guidelines on the Implementation of MiFID II Transaction Reporting

On October 10, the European Securities and Markets Authority (ESMA) published final guidelines (Guidelines) on transaction reporting, order record keeping and clock synchronization under the amended and restated Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR). The Guidelines follow a consultation paper published by ESMA in December 2015.

The Guidelines cover investment firms, trading venues, approved reporting mechanisms and EU regulators, and aim to ensure consistency in compliance with MiFIR provisions and associated regulatory technical standards.

The Guidelines are divided into three broad sections covering transaction reporting, order record keeping and clock synchronization. In terms of transaction reporting, the Guidelines set out detailed points on trading capacity (including dealing on own account, trading in a matched principal trading capacity, trading in any other capacity and restrictions on trading capacities), chains and transmission, execution on a trading venue, identifiers for parties, the meaning of "transaction," mechanics for reporting and submitting transaction reports.

The Guidelines will apply from January 3, 2018 (which coincides with the application dates for MiFID II and MiFIR).

The Guidelines can be found here.

ESMA Publishes Draft Guidelines on MiFID II Product Government Requirements

On October 5, the European Securities and Markets Authority (ESMA) published a consultation paper (Consultation) on draft guidelines for product governance under the amended and restated Markets in Financial Instruments Directive (MiFID II).

MiFID II introduces product governance requirements for firms manufacturing and distributing EU financial instruments. Article 16(3) of MiFID II specifically requires firms to implement product approval processes, which specify an "identified target market" for each financial instrument and ensure all relevant risks for that market are assessed (among other points). The Consultation focuses on the target market assessment aspect of the MiFID II product governance requirements and contains separate draft guidelines for: 1) manufacturers; 2) distributors; and 3) issues applicable to both manufacturers and distributors. Annex 4 of the Consultation also sets out three case studies on the application of the draft guidelines, with respect to: 1) structured investment products; 2) structured deposit product target markets; and 3) target market assessments for distributions in wholesale markets.

Comments on the Consultation must be submitted by January 5, 2017, and ESMA expects to publish a final report in the first or second quarter of 2017.

The Consultation is available here, and ESMA's accompanying press release, here.

ESMA Publishes Q&A's on Transparency Under MiFID II and MiFIR

On October 3, the European Securities and Markets Authority (ESMA) published new questions and answers (Q&A) on transparency obligations under the amended and restated Markets in Financial Instruments Directive and the Markets in Financial Instruments Regulation (MiFIR). The new Q&A currently contains four questions on the double volume cap mechanism under MiFIR, and will be updated by ESMA as and when new questions are received.

The Q&A's are available here.

European Commission Publishes G7 Fundamental Elements on Cybersecurity for the Financial Sector

On October 11, the European Commission (Commission) published a list of fundamental elements (Elements) on cybersecurity, developed by the G7 Cyber Expert Group. The Commission actively contributed to the development of the Elements, which are designed to form a high-level framework for private and public entities in the financial services sector to adapt to their particular operations, the relevant/applicable "threat landscape" and other legal and regulatory requirements. The eight Elements cover topics such as cybersecurity strategy and framework, governance, risk and control assessments, monitoring, response, recovery, information sharing and continuous learning.

For more information on cybersecurity in the European Union, see our *Corporate & Financial Weekly Digest editions* of July 29, 2016, May 20, 2016 and December 11, 2015.

The Elements are available here, and the Commission's accompanying supporting statement, here.

ESMA Advice to ECON on the Application of the AIFMD Passport to Non-EU AIFMs and AIFs

On October 11, the European Securities and Markets Authority (ESMA) published the text of a speech made by its chairman, Steven Maijoor, to the European Parliament on ESMA's work on the application of the Alternative Investment Fund Managers Directive (AIFMD) passport to non-EU AIFMs and AIFs. In this latest update on the proposed extension of the AIFMD marketing passport, Mr. Maijoor recapped ESMA's initial advice published in July 2015 on extending the AIFMD passport (in relation to Guernsey, Hong Kong, Jersey, Switzerland, Singapore and the United States), and a second advice published in July 2016 (covering 12 non-EU countries). Mr. Maijoor confirmed that ESMA's next three key areas of focus for the AIFMD passport are: 1) continuing its assessment of whether to extend the passport to Bermuda and Cayman Islands; 2) starting an assessment of a third group of non-EU countries; and 3) implementing an "extensive framework" for extending the passport to non-EU countries, including strengthening supervisory cooperation and ESMA's role in the passporting system.

For more information, see our *Corporate & Financial Weekly Digest* editions of July 22, 2016, January 22, 2016, October 16, 2015 and July 31, 2015.

Mr. Maijoor's update 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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UK DEVELOPMENTS

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