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BROKER-DEALER

SEC Amends CAT NMS Plan

On May 15, the Securities and Exchange Commission adopted amendments to the national market system plan governing the consolidated audit trail (the CAT NMS Plan). The Financial Industry Regulatory Authority (FINRA) and the national securities exchanges that are CAT NMS Plan participants (the Participants) are now required to publish and file with the SEC a complete implementation plan for the Consolidated Audit Trail (CAT) and quarterly progress reports. The reports include financial accountability provisions that establish target deadlines for four critical implementation milestones, and must be approved by the operating committee established by the CAT NMS Plan and submitted to the CEO, president, or an equivalently situated senior officer at each participant.

The SEC sought to improve transparency and financial accountability to the CAT's implementation.

The amendments will become effective 30 days after publication of the adopting release in the *Federal Register*.

For more information, the amendments are available here.

FINRA Amends Rules Related to Membership Application Program to Promote Payment of Arbitration Awards

The Financial Industry Regulatory Authority (FINRA) amended its Membership Application Program (MAP) rules to incentivize payment of arbitration awards by preventing an individual from switching firms, or a firm from using asset transfers or similar transactions, to avoid payment of arbitration awards. The MAP rules govern the way in which FINRA reviews a new membership application and a continuing membership application; through these applications, applicants show their ability to comply with applicable securities laws and FINRA rules. To address the issue of customer recovery of unpaid arbitration awards, FINRA made the following key changes:

- member firms must receive a materiality consultation for specified changes in ownership, control or business operations involving a covered pending arbitration claim or unpaid arbitration awards or settlements;
- a rebuttable presumption to deny an application for new FINRA membership where the applicant or its associated person is the subject of a pending arbitration claim;
- to overcome the rebuttable presumption, the applicant must demonstrate its ability to satisfy unpaid awards, settlements or claims, and guarantee that these funds will be used for that purpose; and
- the applicant must notify FINRA of any arbitration claim involving the applicant or its associated persons that is filed, awarded, settled or becomes unpaid.

These changes go into effect on September 14, 2020.

The notice is available here.

FINRA Issues Regulatory Notice Regarding Sales Practice Obligations With Respect to Oil-Linked Exchange-Traded Products

On May 15, the Financial Industry Regulatory Authority (FINRA) issued a regulatory notice (the Notice) reminding firms of their obligations in connection with oil-linked exchange-traded products (ETPs). In light of the practical difficulties involved in investing directly in commodities such as oil, commodity-linked ETPs, which often track commodity futures or futures indices rather than the underlying spot commodity, can provide investors with exposure to such commodities. Due to their complexity, ETPs may not be well understood by investors, as the products may be linked to unfamiliar indices or reference benchmarks. As the crude oil market has recently endured extraordinary conditions, several oil-linked ETPs have experienced significant volatility and lost a substantial percentage of their value.

The Notice serves as a reminder to firms of their sales practice obligations in connection with oil-linked ETPs. Specifically, (1) recommendations to customers must be based on a full understanding of the terms, features and risks of the product recommended; (2) firms must have fair and accurate communications with the public; and (3) firms must have reasonably designed supervisory procedures in place to ensure that these obligations are met. Additionally, firms that offer complex ETPs, such as oil-linked ETPs, must train registered representatives who sell these products about the terms and risks of these products.

In addition, the Notice acknowledges that, starting on June 30, 2020, recommendations of these ETPS will be governed by SEC Regulation Best Interest. Among other obligations, Reg BI will require firms to (1) have a reasonable basis to believe that the recommended security is suitable for at least some investors; and (2) have a reasonable basis that the recommended security in the specific retail customer's best interest at the time the recommendation is made.

The notice is available here.

FINRA Updates COVID-19 FAQs

The Financial Industry Regulatory Authority (FINRA) has updated its FAQs regarding coronavirus-related regulatory relief to address:

- situations in which a member firm is unable, as required by FINRA Rule 3110(e), to verify some of the information in an initial or transfer Form U4 due to the COVID-19 outbreak;
- the extension of expiring qualification examination windows until June 30, 2020, including for individuals who were designated to function as Operations Professionals under Rule 1220(b)(3)(B) or as principals under Rule 1210.04, in either case, prior to February 2, 2020 and who, under Rule 1220(b)(3)(B) or Rule 1210.04, respectively, otherwise would have had 120 days to pass the appropriate qualification examination;
- the extension of deadlines for Rule 3120 reports until June 30, 2020 for member firms with reports that would otherwise be due between March 1 and June 1, 2020;
- the extension of deadlines for Rule 3130 certifications until June 30, 2020 for member firms with certifications that would otherwise be due between March 1 and June 1, 2020 (and CCO meetings, as required as a condition for those certifications, can be conducted virtually); and
- the extension, until June 30, 2020, of the currently-available temporary exemption from fingerprinting requirements, provided that certain notification requirements are met (see the full order here).

Note that FINRA also has emphasized that member firms must document their reliance on any temporary relief provided by FINRA during the COVID-19 pandemic.

The FINRA FAQs are available here.

DERIVATIVES

See "CFTC Holds Open Commission Meeting" and "NFA Proposes Technical Amendments to Various Rules and Interpretive Notices" in the CFTC section.

LIBOR Transition Best Practices Statement Issued by ARRC

On May, 27, the Alternate Reference Rate Committee (ARRC) that works under the auspices of the Federal Reserve Bank of New York issued a set of "Best Practices for Completing Transition Away from LIBOR." The Best Practices reinforce the ARRC's position that markets should cease using the London Inter-bank Offered Rate (LIBOR) as a reference rate in financial transactions well before the December 31, 2021 end date identified by UK regulators by providing specific dates by which specific products should be LIBOR-free.

The key best practices identified by the ARRC are:

1. To the extent not already utilized, new USD LIBOR cash products should include ARRC-recommended, or substantially similar, fallback language as soon as possible.

2. As previously announced, third-party technology and operations vendors relevant to the transition should complete all necessary enhancements to support the Secured Overnight Financing Rate (SOFR) by the end of this year.

3. New use of USD LIBOR should stop, with timing depending on specific circumstances in each cash product market. Specifically, the ARRC recommends that LIBOR not be used in floating rate notes issues after December 31, 2020, and not be used in derivatives after June 30, 2021.

4. For contracts specifying that a party will select a replacement rate at their discretion following a LIBOR transition event, the determining party should disclose their planned selection to relevant parties at least six months prior to the date that a replacement rate would become effective.

The ARRC materials make no mention of market issues such as the concern that some financial structures will not remain viable without the introduction of forward-looking risk-free rates.

The ARRC press release is available here.

The ARRC Best Practices are available here.

A summary of the Best Practices are available here.

A graphical time line of LIBOR transition is available here.

FINRA Requests Comments on Security-Based Swaps

On May 22, the Financial Industry Regulatory Authority (FINRA) issued an open invitation for member firms and other interested parties to provide views and information about the security-based swap (SBS) market, with particular focus on broker-dealer SBS activities and the application of FINRA rules to those activities. The invitation, which is not a mandatory information request, includes the following questions:

- Does your firm, or an affiliate of your firm, plan to register with the Securities and Exchange Commission as an SBS dealer or a major SBS participant? Does your firm, or an affiliate of your firm, plan to engage in SBS activity below the SEC registration threshold? If so, how will your firm monitor for compliance with the *de minimis* thresholds for SBS as established under SEC rules?
- In what capacity does your firm participate or plan to participate in SBS transactions? For example, as principal, agent or both? Does your firm engage in, or plan to engage in, non-dealing SBS activity, such as entering into SBS for hedging or risk management purposes?
- Do personnel of your firm arrange, negotiate or execute SBS transactions on behalf of affiliates or clients, or plan to arrange, negotiate or execute such transactions in the future? Are there other SBS-related activities that personnel of your firm engage in, or plan to engage in, such as providing market color, processing trades, engaging in other back-office activities, or Rule 15a-6 activities for foreign affiliates?
- What type of SBS products does your firm handle or expect to handle? For example, does your firm handle or expect to handle credit default swaps, equity swaps or other types of products?

- Is your firm's SBS activity conducted within your firm's broker-dealer unit or in affiliate entities, or both? If in affiliate entities, what types of affiliates? Are these US affiliates or foreign affiliates, or both?
- How should FINRA think about the application of its rules to SBS activities? For example, should the application of FINRA rules depend on the capacity in which a member participates in SBS activity or the type of counterparty involved? Should the application of FINRA rules depend on whether the firm also registers as an SBS dealer or major SBS participant?

The invitation says that FINRA would appreciate receiving responses by July 31, 2020.

The FINRA request is available here.

CFTC

CFTC Holds Open Commission Meeting

On May 28, the Commodity Futures Trading Commission (CFTC) held an open meeting to consider staff recommendations regarding amendments to two CFTC regulations. Both recommendations were approved by a unanimous 5-0 vote. Neither staff document is currently available.

Exemption from registration for certain non-US pool operators. The CFTC approved for publication a proposal to amend Regulation 3.10(c)(3) to provide an exemption from registration for foreign persons acting as commodity pool operators (CPOs) on behalf of offshore commodity pools with non-US participants that trade in US derivatives markets. The proposed amendments are designed to provide regulatory flexibility for non-US CPOs operating offshore commodity pools by taking into account the global nature of their operations without compromising the CFTC's mission of protecting US pool participants.

Under the proposal, the exemption would be available to a foreign entity, even if that entity also operates other commodity pools with US participants for which the entity would be required to be registered as a CPO. The amendment would also permit certain US control affiliates of a non-US CPO to contribute capital to the CPO's offshore pools as seed money without affecting the non-US CPO's eligibility for the 3.10(c) exemption.

Recognizing that a pool operator may not always have the ability to assure that a particular pool has only non-US participants, the CFTC has also proposed a safe-harbor, pursuant to which a non-US CPO may claim an exemption under proposed Regulation 3.10(c)(3) provided the non-US CPO takes reasonable steps designed to ensure that participation units in the operated offshore pool are not being offered or sold to persons located in the United States. Specifically:

- the offshore pool's offering materials and any underwriting or distribution agreements include must clear, written prohibitions on the offshore pool's offering to participants located in the US and on US ownership of the offshore pool's participation units;
- the offshore pool's constitutional documents and offering materials: (1) must be reasonably designed to preclude persons located in the US from participating therein; and (2) include mechanisms reasonably designed to enable the CPO to exclude any persons located in the US who attempt to participate in the offshore pool notwithstanding those prohibitions;
- the non-US CPO must use non-US intermediaries exclusively for the distribution of participations in the offshore pool;
- the non-US CPO must use reasonable investor due diligence methods at the time of sale to preclude persons located in the US from participating in the offshore pool; and
- the offshore pool's participation units must be directed and distributed to participants outside the US, including by means of listing and trading such units on secondary markets organized and operated outside of the US, and in which the non-US CPO has reasonably determined participation by persons located in the US is unlikely.

Comments on the proposed amendments must be filed with the CFTC within 60 days following publication in the *Federal Register*.

Extension of Phase 5 compliance schedule. In response to the COVID-19 pandemic, and following the lead of the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities

Commissions (IOSCO), the CFTC approved an interim final rule amending Regulation 23.161 to extend by one year, until September 1, 2021, the initial swap margin compliance deadline for Phase 5 financial entities that was set for September 1, 2020 by a CFTC rule that just became effective on May 11. Currently, Phase 5 entities are (1) covered swap entities (CSEs) (i.e., swap dealers and major swap participants for which there is no prudential regulator, combined with their margin affiliates); and (2) their counterparties combined with their respective margin affiliates, that have a daily average aggregate notional amount (AANA) of uncleared swaps, uncleared security-based swaps, foreign exchange forwards and foreign exchange swaps in March, April and May of 2020 that exceeds $50 billion. The interim final rule defers both the measurement period and the compliance date for Phase 5 entities so that an entity with AANA exceeding $50 billion for March, April and May of 2021 must comply with the initial margin rules staring on September 1, 2021.

The CFTC, however, declined at this time to take the other action recommended by BCBS and IOSCO, namely a similar one-year deferral of the initial margin compliance date for all remaining CSEs and their counterparties (i.e., those CSEs and their counterparties with AANA of $50 billion or less (the “Phase 6” entities)). As a result, Phase 5 and Phase 6 entities will, at least temporarily, have the same compliance date of September 1, 2021. However, the CFTC noted that it intends to address deferral of the Phase 6 compliance date through a notice of proposed rulemaking and public comment process.

The interim final rule will take effect upon publication in the *Federal Register*. Comments on the interim final rule must be filed with the CFTC within 60 days following publication in the *Federal Register*.

More information and links to the Voting Drafts of each of the approved rules are available here.

CFTC Issues COVID-19 Customer Advisory on Commodity ETPs and Funds

On May 22, the Commodity Futures Trading Commission issued a Customer Advisory addressing the unique risks associated with certain trading vehicles that use futures contracts or other commodity interests. The CFTC noted that recent market volatility arising from the COVID-19 pandemic has led many investors to purchase shares of trading vehicles that use futures contracts or other commodity interests. It cautioned that, while certain trading vehicles using futures contracts or other commodity interests may be organized as exchange-traded products or mutual funds, they may not behave like traditional exchange-traded funds or mutual funds that invest in stocks, bonds or other asset classes, nor provide investors the opportunity to profit from long-term price gains in the underlying commodity.

The Customer Advisory is available here.

NFA Proposes Amendments to Part 3 of NFA’s Compliance Rules Regarding Disciplinary Process

On May 19, the National Futures Association (NFA) submitted to the Commodity Futures Trading Commission proposed amendments to Part 3 of NFA's Compliance Rules regarding the compliance procedures that control NFA’s disciplinary process. Specifically, the proposed amendments (1) revise NFA Compliance Rule 3-14 to increase the maximum penalty fine amount from $250,000 to $500,000 per violation; (2) modify the rules related to certain Business Conduct Committee's practices; and (3) make minor technical amendments.

NFA has invoked the “ten-day” provision of Section 17(j) of the Commodity Exchange Act and, subject to possible CFTC review for approval, may issue a Notice to Members establishing an effective date for this proposal as early as 10 days after receipt of this submission by the CFTC.

The proposed amendments are available here.

NFA Proposes Technical Amendments to Various Rules and Interpretive Notices

On May 19, the National Futures Association (NFA) submitted to the Commodity Futures Trading Commission proposed technical amendment to several of NFA’s Rules and Interpretive Notices. In addition to correcting numerous cross-references and eliminating obsolete provisions, the proposed technical amendments add a definition of Swap Execution Facility (SEF) to NFA Compliance Rule 1-1 and require the electronic filing of certain documents and notices under NFA Compliance Rule 2-13.

The proposed technical amendments are available here.

UK DEVELOPMENTS

FCA Statement on Continuing Professional Development During the COVID-19 Pandemic

On May 27, the UK's Financial Conduct Authority (FCA) published a new webpage that sets out its approach to individual's continuing professional development (CPD) (the Webpage).

According to the Webpage, the FCA expects firms to demonstrate that individuals remain competent to carry out their work and that individuals should continue completing CPD during the COVID-19 pandemic. However, the FCA notes that there could be exceptional circumstances when individuals may struggle to complete the required minimum CPD hours.

The FCA has therefore temporarily permitted firms in exceptional circumstances to let individuals carry over any uncompleted CPD hours before April 1, 2021 to the next CPD year. The FCA deems the following circumstances as exceptional:

1. when individuals are required to carry out extra duties to manage risks or to provide support to consumers and businesses, have caring responsibilities, and have difficulties accessing CPD material due to the COVID-19 pandemic; and
2. where it is not realistic to expect the individual to also fulfill the CPD requirements.

Firms should record their decision and the reasons for it, but are not required to report this to the FCA.

The Webpage is available here.

FCA Publishes Market Watch Newsletter

On May 27, the UK's Financial Conduct Authority (FCA) published issue 63 of its *Market Watch* newsletter in relation to market conduct and transaction reporting issues (the Newsletter).

In the Newsletter, the FCA sets out its expectations around the identification and handling of inside information in light of increased capital raisings and working from home arrangements as a result of the COVID-19 pandemic. The FCA notes that market participants should continue to comply with their obligations under the relevant regulations, including the Market Abuse Regulation. In particular, market participants should:

1. ensure that inside information continues to be appropriately identified and handled by all persons involved in the information chain;
2. ensure that inside information is appropriately disclosed by issuers so that investors are not misled;
3. maintain robust market surveillance and suspicious transaction and order reporting by relevant market participants, in the context of changes in market conditions and the current use of alternative working arrangements;
4. meet the transparency and short position covering requirements under the Short Selling Regulation; and
5. identify and manage conflicts of interest that may arise around capital raising events.

In the Newsletter, the FCA emphasizes that during the COVID-19 pandemic, it will continue to monitor inside information disclosures and price movements to identify any actions which may impact the integrity and orderly functioning of the market and, where necessary, the FCA may take enforcement action.

The Newsletter is available here.

EU DEVELOPMENTS

ESMA Clarifies Reporting of Repos With EU Central Banks Under MiFIR

On May 21, the International Capital Market Association (ICMA) published a response received from the European Securities and Markets Authority (ESMA) in relation to proposals for reporting of central bank repurchase transactions (Repos) under the Market in Financial Instruments Regulation (MiFIR) (the Response).

The key points of ESMA's Response include:

1. collateral should be reported, not the Repo itself;
2. Repos with multiple collateral securities should be reported as a complex trade;
3. where the collateral allocation is only available after the T+1 reporting deadline, EU financial regulators can assess whether the delay is justified; and
4. pledge-based Repos must be reported.

The Response is available here.

ECB Publishes Bi-Annual Financial Stability Review

On May 26, the European Central Bank (ECB) published its 2020 bi-annual financial stability review (the Review).

In the Review, the ECB provides an overview of the potential risks to financial stability in the EU. A summary of the ECB's key points are set out below:

1. the COVID-19 pandemic prompted extreme financial market sell-offs and stress;
2. corporations and households face lower income and rising debt burdens;
3. fiscal measures provide essential support to the EU economy and its participants, but they have increased the public debt burdens;
4. EU banks are well capitalized with reasonable liquidity buffers, but are nonetheless likely to face significant losses and further pressure to profitability as a result of the COVID-19 pandemic; and
5. policy measures alleviate near-term risks to financial stability, but certain medium-term vulnerabilities have risen, including tighter financial conditions and fragile functioning in some markets, and a significant increase in debt burdens.

The Review 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/EU DEVELOPMENTS

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