Katten
Katten Muchin Rosenman LLP

Corporate & Financial
Weekly Digest

January 12, 2018 Volume XIII, Issue 2

BROKER-DEALER

FINRA Releases 2018 Regulatory and Examination Priority Letter

On January 8, the Financial Industry Regulatory Authority (FINRA) released its annual Regulatory and Examination Priority Letter detailing various issues that will be the subject of particular regulatory focus and scrutiny this year. Many of the areas noted are carry-overs from previous years, including the protection of senior investors and other retail customers, new product suitability reviews, and enhanced scrutiny of high-risk brokers. However, the letter also reflects various new issues that have caught FINRA's attention and will require increased attention by FINRA member firms. Highlights include:

- Cybersecurity and anti-money laundering continue to be areas of primary concern for FINRA. Firms can expect the regulator to assess the sufficiency of their cybersecurity preparedness, technical defenses, and resiliency measures. In terms of AML, FINRA noted ongoing concerns about, among other things, the adequacy of firms' policies and procedures to detect and report suspicious transactions and of firms' independent testing of their AML programs.
- FINRA will closely monitor developments in the rapidly expanding market for digital assets such as cryptocurrencies and initial coin offerings (ICOs). When member firms are involved in effecting transactions in such assets or ICOs and such assets are securities or the ICO involves the offer or sale of securities, firms should have the appropriate supervisory, compliance, and operational infrastructure in place to ensure compliance with regulatory obligations. Nonetheless, it remains unclear how various regulatory obligations might apply in this context.
- FINRA intends to review member firms' business continuity plans (BCPs), including how and when firms activate their BCPs, how they accomplish data back-up and recovery, and how they restore systems and records after a business disruption. FINRA also expressed concerns about increased incidences of customer service and regulatory problems arising from deficiencies in firms' information and technology change management policies and procedures.
- With respect to SEC Rule 15c3-5 (the Market Access Rule), FINRA noted that many firms have not maintained reasonable documentation to support pre-trade financial controls and have not conducted the necessary periodic reviews to assess the appropriateness of the thresholds adopted.
- FINRA intends to evaluate firms' compliance with Rule 201 of Regulation SHO, which requires member firms to implement policies and procedures to prevent the execution or display of a short sale order at a price that is equal to or less than the national best bid when a short sale circuit breaker is in effect. Member firms should test to confirm that their controls work properly and, if a firm relies on an exemption to Rule 201, it must ensure that its activity or short sale transactions qualify for such exemption.

The Regulatory and Examination Priority Letter also identifies several planned enhancements to FINRA's examination program, new compliance resources for member firms, and various new rules set to become effective in 2018. Katten will host a webinar on January 24 addressing the Regulatory and Examination Priority Letter in greater detail, including insights concerning how firms can prepare themselves for the noted areas of regulatory focus. Details to follow.

FINRA's 2018 Regulatory and Examination Priority Letter is available here.

DERIVATIVES

See "CFTC Approves Amendments to Commission Regulations Under Parts 3 and 9," "CFTC Staff Issues No-Action Relief to Futures Commission Merchants and Introducing Brokers Regarding Capital Treatment of Deferred Tax Liabilities From Changes in Accounting Principles," and "NFA Issues Notice of Additional Reporting Requirements for CPOs and CTAs That Trade Virtual Currency Products and IBs That Solicit or Accept Orders in Virtual Currency Products" in the CFTC section and "ISDA Announces Plans for French and Irish Law Governed Master Agreements After Brexit" in the Brexit/EU Developments section.

CFTC

CFTC Approves Amendments to Commission Regulations Under Parts 3 and 9

On January 9, the Commodity Futures Trading Commission announced it had unanimously approved final rules that update Parts 3 (Registration) and 9 (Review of Exchange Disciplinary, Access Denial or Other Adverse Actions). These updates integrate existing advisory guidance, incorporate swap execution facilities, and update provisions currently applicable to designated contract markets. The CFTC also approved an updated notice and order for the National Futures Association (NFA) to manage exchange disciplinary and access denial notices.

The amended rules will be effective 60 days after publication in the *Federal Register*.

CFTC's Release is available here.

CFTC Staff Issues No-Action Relief to Futures Commission Merchants and Introducing Brokers Regarding Capital Treatment of Deferred Tax Liabilities From Changes in Accounting Principles

On January 5, the Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight issued a no-action letter authorizing registered futures commission merchants and introducing brokers to exclude deferred tax liabilities that are directly related to the capitalized costs of certain non-allowable assets when computing their adjusted net capital under Regulation 1.17. The tax deferred liabilities reflect differences between book accounting and tax accounting that result from changes to generally accepted accounting principles that require the capitalization of certain costs that are immediately expensed for income tax purposes.

CFTC Letter No. 18-01 is available here.

NFA Issues Notice of the Effective Date of Amendments to NFA Compliance Rule 2-36: Requirements for Forex Transactions and NFA Compliance Rule 2-43: Forex Orders

On January 11, the National Futures Association (NFA) issued a Notice that the amendments to NFA Compliance Rules 2-36 and 2-43 submitted to the Commodity Futures Trading Commission on December 4, 2017 (as reported in the December 8, 2017 edition of *Corporate & Financial Weekly Digest*) were approved. The amendments will apply to forex dealer members and will go into effect on April 5.

NFA's Notice I-18-02 is available here.

NFA Issues Notice of Additional Reporting Requirements for CPOs and CTAs That Trade Virtual Currency Products and IBs that Solicit or Accept Orders in Virtual Currency Products

On December 14, 2017, the National Futures Association (NFA) issued Notices regarding commodity pool operators (CPOs), commodity trading advisors (CTAs) and introducing brokers (IBs), outlining new reporting requirements for CPOs, CTAs and IBs that deal in virtual currencies.

Effective December 14, 2017, any CPO or CTA must notify the NFA by amending the firm-level section of its annual questionnaire, after it executes its first transaction involving any virtual currency or virtual currency

derivatives contract on behalf of a pool or managed account. Beginning the first quarter of 2018, within 15 days of the end of a quarter, CPOs and CTAs must report the number of their pools or managed accounts that executed transactions involving a virtual currency or virtual currency derivatives contract during such quarter. This report should be made through the firm's questionnaire. (Notice I-17-28)

Effective December 14, 2017, any IB must notify the NFA, by amending the firm-level section of its annual questionnaire, after it first solicits or accepts any orders in a virtual currency derivatives contract. Beginning the first quarter of 2018, within 15 days of the end of the quarter, IBs must report the number of accounts they introduced that executed trades in a virtual currency derivatives contract during such quarter. (Notice I-17-29)

NFA's Notice I-17-28 is available here.

NFA's Notice I-17-29 is available here.

UK DEVELOPMENTS

FCA Publishes Guidance and Updated Forms and Webpages Reflecting MiFID II Implementation

On January 3, the UK Financial Conduct Authority (FCA) published a document containing general guidance on the authorization process, forms and prudential categories following the FCA's implementation of the revised Markets in Financial Instruments Directive (MiFID II). The document provides guidance on applications for authorization as a MiFID investment firm made by a first-time applicant and variations of permission by a non-MiFID firm seeking to become a MiFID investment firm.

The document also contains flowcharts to assist MiFID investment firms with determining the prudential categorizations that will apply to them, depending on the regulated activities that they perform and the nature of their businesses.

On January 2, the FCA updated its webpages on change in control notifications (FCA's Webpage on Change in Control Notifications) and change of legal status applications (FCA's Webpage on Change of Legal Status Forms) to reflect its implementation of MiFID II, and then on January 3, it also updated its webpage and related webpages on transaction reporting (FCA's Webpage on Transaction Reporting).

The FCA's Webpage on Change in Control Notifications announces the publication of new forms to be used by persons wishing to become a controller of a firm authorized under MiFID II. The new forms contain reduced notification requirements that apply where the prospective controllers and the target firms satisfy certain conditions.

The FCA's Webpage on Change of Legal Status Forms contains new application forms that firms must use from April 1 if they are seeking to change their legal status. The FCA will accept any applications that were already being completed in draft using the previous forms, up until March 31.

A copy of the FCA's Document is available here.

The FCA's Webpage on Transaction Reporting is available here.

The FCA's Webpage on Change in Control Notifications is available here.

The FCA's Webpage on Change of Legal Status Forms is available here.

BREXIT/EU DEVELOPMENTS

Implementation of MiFID II Still Incomplete Across Europe

Further updating the *Corporate &Financial Weekly Digest* edition of December 8, 2017, as of January 8, there were still only 14 European Union (EU) Member States (i.e., only 50 percent of the EU) that have fully transposed

the revised Markets in Financial Instruments Directive (MiFID II) into their national law (as reported on the European Commission's (EC) MiFID II Transposition Status Webpage).

Under EU law, European directives have to be implemented into each country's national law before it is binding on market participants in that jurisdiction. MiFID II was supposed to have been implemented in full into national legislation before July 3, 2017—a full six months before MiFID II was to have taken effect on January 3, 2018.

The MiFID II Transposition Status Webpage states that as of January 8, only partial transposition measures have been communicated to the EC by Lithuania, Luxembourg, Portugal, Spain and Sweden, while transposition measures still have not been communicated to the EC at all by nine Member States, including the Netherlands, Poland and Greece, among others.

Consequently, infringement proceedings have been launched by the EC against 19 Member States, including Belgium, Luxembourg and the Netherlands, for their lack or delay of notification of national transposition measures or their incompleteness.

A link to the EC's MiFID II Transposition Status Webpage is available here.

Further commentary on the practical impact of EU Member States not fully implementing MiFID II can be viewed here in an interview of Katten partner, Neil Robson, on CNBC Europe's 'Squawk Box' program which aired on January 5.

UK Government Publishes Response to Feedback on Trade White Paper

On January 5, the UK Department for International Trade (DIT) published the UK government's response to feedback on the DIT's Trade White Paper on "Preparing for our future UK trade policy" published on October 9, 2017.

The Trade White Paper:

1. outlined the basic principles that will shape the UK's future trading framework and the government's developing approach to a future trade policy;
2. indicated areas in which the government was preparing legal powers to ensure that the UK is ready to operate independently as the UK exits the European Union (EU);
3. asked for views on the government's developing approach and the legal powers, and for feedback on the government's:
    a. commitments to an inclusive and transparent trade policy;
    b. approach to unilateral trade preferences; and
    c. approach to trade remedies.

Following the publication of the Trade White Paper, the government introduced the following bills to the UK Parliament:

1. Trade Bill 2017-19; and
2. Taxation (Cross-border Trade) Bill 2017-19, previously known as the Customs Bill.

The DIT published the government's response summarizing the feedback received, and sets out the government's response and follow-up actions it will take. Of particular note are the following points:

UK's Membership in the World Trade Organization (WTO)

Once the UK leaves the EU, it will be an independent member of the WTO and will need to establish its own WTO goods schedule and services schedule, which will provide the baseline from which the UK will negotiate free trade agreements with other countries. The Trade White Paper confirmed the government's intention to replicate its existing commitments as set out in the EU's schedules of commitments, as far as possible, and submit these for certification in the WTO ahead of leaving the EU. If the schedules are uncertified by the time the UK leaves the EU, the government has stated that they do not anticipate there to be any problems, as "it is not uncommon for WTO members to operate on uncertified schedules for periods of time."

UK Trade Relationships

Those responding to the Trade White Paper welcomed the government's commitment to seek a time-limited implementation period after Brexit, as this will allow businesses time to adjust and allow new systems to be put in place. The business community asked for greater clarity to allow for planning. The government also welcomed Donald Tusk's, the President of the European Council's, call for discussions on the implementation period to start immediately and that it should be agreed as soon as possible. The government also reiterated that "nothing is agreed until everything is agreed" but that they hope that the agreements reached so far will form part of a final package that "establishes a deep and special partnership between the UK and the EU for the future."

A copy of the Trade White Paper is available here, and the government's responses are available here.

Chief Brexit Negotiators Discuss Post-Brexit Treatment of UK Financial Regulations

On January 9, Michel Barnier, the European Union's (EU's) chief Brexit negotiator, delivered a speech at the "Trends Manager of the Year 2017" event in Brussels, and on January 10, the UK's Chancellor of the Exchequer, Philip Hammond, and the UK's Secretary of State for Exiting the EU, David Davis, published a joint article that originally appeared in *Frankfurter Allgemeine Zeitung*, a German newspaper. Both the speech and the article commented on future economic ties between the EU and the UK, covering a broad range of services industries, focusing in particular on financial services.

Mr. Hammond and Mr. Davis wrote that the UK will be seeking to "ensure that financial authorities across the world can cooperate in rule-setting and supervising systemically important global firms." Therefore they will be re-doubling their efforts to get "a deal that supports collaboration within the European banking sector, rather than forcing it to fragment." They have proposed a time-limited implementation period after the UK leaves the EU so that access to the EU from the UK and vice versa can continue in its current form, using the EU's existing regulations and agencies. The European Commission has proposed that the implementation period last for 21 months, from the date of the UK's withdrawal on March 29, 2019 to December 31, 2020, to allow businesses and public administrations the time to prepare themselves for the finalized withdrawal agreement.

In his speech, M. Barnier said that by using "a proportionate and risk-based approach." the EU would be able to consider some of the UK's financial rules as equivalent to those of the EU. But he also reiterated that once the UK exited the EU on March 29, 2019, the EU would not give UK financial firms a general "passport" to do business in the single market. Therefore, a system of generalized equivalence of standards would not be enjoyed by the UK's financial service providers. Mr. Barnier also warned that a "trading relationship with a country that does not belong to the European Union will never be frictionless."

Mr. Barnier concluded that the EU27 will need to continue to work together in a united way to reform Europe and to overcome challenges, including building a real Capital Markets Union and a "global Europe" prepared to offer its businesses new opportunities to export to Australia and New Zealand.

A copy of Mr. Barnier's speech is available here.

A copy of the article by Mr. Hammond and Mr. Davis is available here.

ISDA Announces Plans for French and Irish Law Governed Master Agreements After Brexit

On January 8, the International Swaps and Derivatives Association, Inc. (ISDA) published a blog post providing insight into how it is preparing for the UK's departure from the European Union and how this will impact the use of the industry-standard ISDA Master Agreement.

The blog explains that, as it currently stands, virtually all of the ISDA Master Agreements entered into between counterparties that are both located in the EU or EEA are governed by English law. Counterparties typically also submit to the jurisdiction of the English courts. Because the UK is currently part of the EU and European Economic Area (EEA), any English court judgement is automatically recognized and enforced across those member states. Without a Brexit deal that replicates the effects of EU/EEA membership, English law would

become a third-country law after Brexit. One of the consequences is that English court judgements would not be automatically recognized in EU/EEA countries which could translate into additional costs and delays for cross-border enforcement.

The blog goes on to state that some swaps market participants in the EU and EEA may want to retain the convenience of automatic recognition across the EU/EEA by using the jurisdiction of an EU/EEA country, rather than English law, in its agreements. Counterparties may also want to retain specific benefits of EU legislation—for example, protections under certain EU national insolvency laws that require use of an EU member-state-law agreement in order to receive those protections. In response, the blog states that ISDA is drafting French and Irish law governed Master Agreements, along with French and Irish court jurisdiction clauses. This would be in addition to the existing English, Japanese and New York law choices. The blog explains that in order to be representative of the civil and common law systems across the EU, French and Irish law have been suggested.

The blog states that working groups have been established, and are making good progress in considering the issues and identifying what changes might be necessary to the Master Agreements.

The blog is available here.

ESMA Consults on Guidelines on Anti-Procyclicality Margin Measures for CCPs

On January 8, the European Securities and Markets Authority (ESMA) published a consultation paper on draft guidelines on anti-procyclicality margin measures for central counterparties (CCPs).

The European Market Infrastructure Regulation (EMIR) recognizes that margin calls and haircuts on collateral by CCPs may have procyclical effects. EMIR therefore requires CCPs to regularly monitor and, if necessary, revise the level of margins to reflect current market conditions, taking into account any procyclical effects of such revisions. EMIR and its delegated regulations require CCPs to adopt at least one of three anti-procyclicality (APC) margin measures to address this issue.

The aim of the guidelines is to clarify the application of EMIR in the context of the procyclicality of margins with the aim of ensuring common, uniform and consistent application of the requirements of EMIR. The guidelines cover the monitoring of margin procyclicality, the implementation of APC margin measures and disclosures intended to facilitate margin predictability.

ESMA notes in the consultation paper that it is important to recognize that it is not the intention of regulation to prevent a CCP from revising its margins to address changes in volatility. Instead, the regulations propagate the notion that CCPs should prevent big-stepped, unanticipated calls on clearing members during periods of extreme stress. The guidelines should therefore be read in this context.

The deadline for responses is February 28. ESMA expects to publish the final guidelines by the first half of 2018.

The consultation paper is available here.

ESMA Delays Publication of Data on Double Volume Cap Mechanism Under MiFID II

On January 9, the European Securities and Markets Authority (ESMA) published a press release announcing that it has decided to delay the publication of data on the double volume cap (DVC) mechanism as required under the revised Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR).

The DVC mechanism, introduced by MiFIR, caps the amount of securities trading that can benefit from the use of waivers from pre-trade transparency in so-called “dark pools” of liquidity. All trading venues listing particular equity or equity-like instruments must provide ESMA with data on the trading activity in those instruments for the complete previous year. ESMA then uses this data to make the relevant DVC calculations.

Since January 3, (when MiFIR and MiFID II went into effect), ESMA had been performing an analysis of the quality and completeness of the data received from trading venues to perform DVC calculations. The press

release highlights that ESMA expected to receive data for around 30,000 instruments. At the time of the press release, it had received files from 75 percent of trading venues, but, in most cases, there had been only partial delivery of the information needed. ESMA only received complete data for approximately 650 instruments, comprising around 2 percent of the expected total and encompassing relatively illiquid instruments, which have a limited amount of dark trading.

In light of the above, ESMA concluded that the quality and completeness of the data that it had received does not allow for a sufficiently meaningful and comprehensive publication of DVC calculations. ESMA believed that publication would have resulted in a biased picture covering only a very limited number of instruments and markets. In addition, as publication triggers other transparency related legal obligations, ESMA states it would not be appropriate for it to initiate the new regime at this stage.

The press release states that ESMA is engaging with national competent authorities (NCAs) and trading venues to close the gaps in reporting as soon as possible. Having analyzed the data received, ESMA is aware of which venues have not succeeded in submitting an adequately complete set of data and will address those venues first to improve the completeness of the dataset. ESMA intends to publish the data covering the missing periods in March 2018.

The press release is available here.

FCA "Dear CEO" Letter to CFD Providers and Distributors Highlights Concerns Following Review of CFD Market

On January 10, the UK Financial Conduct Authority (FCA) published a "Dear CEO" letter that it has sent to providers and distributors of contract for difference (CFD) products to retail customers.

The letter reminds firms that CFDs are high-risk, complex financial products and refers to the FCA's recent review of the CFD market. During the review, the FCA assessed the conduct of firms providing the CFD service and firms that distribute the product and deal with the retail customer.

The review uncovered a number of areas of concern regarding the following:

- target market identification and aligning this group to the characteristics of the product;
- communication, oversight and challenge on the part of providers dealing with distributors;
- providers' process for taking on new distributors;
- distributors' management of conflicts of interest;
- providers' and distributors' use of management information and key performance indicators;
- client categorization by distributors; and
- remuneration arrangements within distributors.

Given what the FCA considers are "significant weaknesses" across the sample of firms assessed for the review, the FCA believes that there is a high risk that firms across the sector are not meeting its rules and expectations when providing and distributing CFDs. As a result, the FCA states that consumers may be at serious risk of harm from poor practices.

The FCA goes on to state that firms must consider the issues raised and whether they comply with the FCA's requirements when providing or distributing CFDs to retail customers on an advisory or discretionary basis. In particular, the FCA thinks that firms need to improve a number of oversight and control arrangements to reach the standards that the FCA would consider adequate.

The FCA advises firms to pay specific attention to the FCA's new Product Intervention and Product Governance sourcebook (PROD), which implements the product governance requirements of the revised Markets in Financial Instruments Directive (MiFID II). When the FCA follows up on CFD provision and distribution in the future, it will assess firms' arrangements against PROD.

The letter 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:

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/EU/BREXIT 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

* Click here to access the *Corporate & Financial Weekly Digest* archive.