

BROKER-DEALER

FINRA Shares Practices Firms Use to Protect Customers from Online Account Takeover Attempts

On April 11, the Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 21-18 (Notice) in response to increasing reports from customers experiencing customer account takeover (ATO) incidents. These incidents involve bad actors using compromised customer information, including login credentials, to gain unauthorized entry to customers' brokerage accounts. FINRA reported the increase in ATOs comes as more firms offer online accounts.

FINRA published the Notice to remind members of their regulatory obligations to protect customer information. The Notice also summarizes the findings of roundtable discussions FINRA organized with member firms to identify best practices to mitigate risks associated with ATO attacks.

The existing regulatory obligations FINRA highlighted include FINRA Rule 2090, which requires firms to use "reasonable diligence" when opening and maintaining each account and to know the "essential facts" about each customer. Additionally, SEC Regulation S-P, Rule 30, requires firms to have written policies and procedures addressing administrative, technical and physical safeguards for the protection of customer records and information that are reasonably designed to keep customer records and information secure and confidential. These policies must also protect against anticipated threats or hazards to customer records and information, including unauthorized access by bad actors. SEC Regulation S-ID requires firms to develop and implement a written program designed to detect, prevent and mitigate identity theft. In designing these programs, firms should consider, among other things, the methods of accessing covered accounts and detecting red flags of identity theft. Finally, pursuant to FINRA Rule 3310(b), firms' anti-money laundering compliance programs must establish, document and maintain written Customer Identification Programs (CIPs). These CIPs must include, among other things, risk-based procedures that enable firms to form a reasonable belief that they know the actual identity of each person opening a new account.

The Notice discussed key practices identified at the roundtable discussions that firms adopted to mitigate ATO-related risks. For example, firms that onboard customers online can verify potential customers' identities by validating identifying information or documents, including Social Security numbers, addresses and driver's licenses, asking follow-up questions, or requesting additional documents to validate their identities. Firms can also require its customers to use multifactor authentication (MFA), which significantly reduces the likelihood that bad actors can gain access to a customer's account. The Notice also discussed various back-end monitoring and controls firms can implement, including monitoring at the customer account level for anomalies such as increases in the number of failed login attempts, monitoring emails received from customers for red flags of social engineering such as grammar issues, unexpected attachments or links, and establishing back-end controls to prevent bad actors from removing money from customer accounts, such as requiring a phone call with the customer on an established phone number.

[FINRA Regulatory Notice 21-18.](#)

FINRA Dispute Resolution Services to Reopen Most Hearing Locations for In-Person Arbitration and Mediation

Beginning on June 5, the Financial Industry Regulatory Authority Dispute Resolution Services (FINRA DRS) will permit in-person hearings to resume at most of its hearing locations for in-person arbitration and mediation proceedings. In-person hearings scheduled for Augusta, Boca Raton, Buffalo, Detroit, Philadelphia, Providence and Wilmington are postponed through July 30 and all affected parties will be contacted by FINRA DRS to discuss virtual hearing options or to reschedule in-person hearings.

FINRA DRS also detailed safety protocols to be implemented at each in-person hearing venue. For example, hearings will be held in venues large enough to allow for social distancing and cleaning, and sanitizing stations will be located in each room. Masks will be required for all participants. Plexiglas dividers or face shields will also be provided in the event testifying witnesses need to remove their masks. Participants will be required to complete a written health questionnaire.

FINRA DRS will continue to monitor the public health conditions in each of its 69 hearing locations.

[FINRA DRS Reopening Announcement.](#)

SEC Division of Investment Management Staff Publishes Public Statement on Funds Registered Under Investment Company Act Investing in Bitcoin Futures Market

On May 11, the Securities Exchange Commission's (SEC) Division of Investment Management (IM) staff issued a Public Statement (Statement) strongly encouraging any investor interested in investing in mutual funds exposed to the Bitcoin futures market to carefully consider the risks involved with such investments. IM staff emphasized, among other things, that Bitcoin is a highly speculative investment, and, therefore, investors should consider the volatility of Bitcoin and the Bitcoin futures market and the lack of regulation and potential fraud or manipulation in the underlying Bitcoin market prior to making an investment.

The Statement also summarized IM staff's prior guidance from its Engaging on Fund Innovation and Cryptocurrency Related Holdings Letter from January 2018 (Letter). In the Letter, IM staff highlighted five areas of questions implicated by funds registered under the Investment Company Act of 1940 (ICA) potentially investing in digital assets including cryptocurrencies or cryptocurrency-related investments: valuation, liquidity, custody, arbitrage mechanisms for exchange traded funds (ETFs), and potential manipulation and other potential risks of cryptocurrency-related markets. The Statement also discussed the development of the Bitcoin futures market since it issued the Letter, recognizing that trading volumes and open-interests positions have increased. Additionally, the Statement acknowledged that the Bitcoin futures market has not presented the custody challenges associated with some cryptocurrency-based investing because the futures are cash-settled.

IM staff also emphasized investor protection and assessing ongoing compliance of mutual funds seeking to invest in Bitcoin futures will remain a top priority. IM staff plan to monitor the impact of mutual funds' investments in Bitcoin futures on investor protection, capital formation and the fairness and efficiency of markets. IM staff expect this monitoring will include, among other things, analyzing the liquidity and depth of the Bitcoin futures market, analyzing mutual funds' ability to liquidate Bitcoin futures positions to meet daily redemption demands, monitoring funds' valuations of holdings in the Bitcoin futures market, considering mutual funds' liquidity classification of any position in the Bitcoin futures market including the basis for those classifications, assessing the ongoing impact of the potential for fraud or manipulation in the underlying Bitcoin markets, and considering whether the Bitcoin futures market could accommodate ETFs.

IM staff concluded by emphasizing that only mutual funds with appropriate strategies supporting this type of investment and full disclosure of material risks should invest in the Bitcoin futures market at this time. The Statement represents IM staff views and is not a rule, regulation or statement of the SEC.

[SEC Bitcoin Futures Market Public Statement.](#)

Consolidated Audit Trail Publishes New Roadmap to Assist Small Firms With Reporting Obligations

On May 7, Consolidated Audit Trail, LLC and FINRA CAT, LLC (CAT) published a new roadmap to assist Small Firms with their reporting obligations for CAT Reportable Securities by the compliance date of December 13. The roadmap has two parts, each with separate steps depending on whether the Small Firm must report data to the CAT Transition System or the CAT Customer and Account Information System (CAIS).

In Part 1 (to report order data to the CAT Transaction System), firms should determine whether the firm handles orders in CAT Reportable Securities, if the firm meets the definition of Small Firm for CAT reporting purposes (firms with total capital of less than \$500,000), and if the firm is currently reporting to FINRA's Order Audit Trail System (OATS). Part 1 then lays out the next steps for registering with the CAT Transaction System, granting entitlement to personnel within the firm, how to submit data to CAT, establishing a CAT reporting relationship with the firm's CAT Reporting Agent, and certifying data for production.

In Part 2 (to report customer and account data to CAIS), firms should determine whether the firm has accounts associated with Large Trader ID (LTID) and if the firm meets the definition of Small Firm for CAT reporting purposes. Part 2 then lays out the next steps for registering for CAT CAIS, granting entitlement to personnel within the firm, how to submit data to CAT CAIS, establishing a CAT CAIS reporting relationship with the firm's CAT Reporting Agent, and certifying data for CAIS LTID Production.

A webinar has been scheduled for June 10 at 11:00 a.m. (ET) to review the roadmap.

[CAT Roadmap.](#)

[CAT Webinar.](#)

CFTC

CFTC Announces Energy and Environmental Markets Advisory Committee Meeting

The Commodity Futures Trading Commission (CFTC) has announced that its Energy and Environmental Markets Advisory Committee (EEMAC) will hold a meeting on June 3 at 9:00 a.m. (ET). At this meeting, the EEMAC will examine how derivatives markets can facilitate the transition to a low-carbon economy, including the status of carbon reduction through cap-and-trade and other carbon trading market mechanisms. The EEMAC will also hear a staff presentation on recent events in the energy markets. The meeting will be held via teleconference in accordance with CFTC's implementation of social distancing due to COVID-19.

[The CFTC's EEMAC meeting on June 3.](#)

UK DEVELOPMENTS

FCA Consults on New Authorized Fund Regime for Investing in Long-Term Assets

On May 7, the Financial Conduct Authority (FCA) published a consultation paper on a new UK-authorized fund regime for investing in long-term assets (CP21/12). These assets are often called productive finance and include venture capital, private equity, private debt, real estate and infrastructure investments.

The FCA proposes a new category of open-ended fund called a long-term asset fund (LTAF). A new chapter in the Collective Investment Schemes sourcebook will contain LTAFs rules. Authorized fund managers will also need to comply with rules in other sourcebooks, including PRIN, FUND, COBS and SYSC.

LTAFs will be alternative investment funds (AIFs). They may make investments in complex and risky assets, which means that their managers will need to have appropriate resources as well as good systems and controls. Therefore, the FCA proposes to require that only firms that are authorized as full-scope UK alternative investment fund managers (AIFMs) can manage LTAFs.

The FCA's proposed LTAF framework is principles-based, and it does not propose to set many detailed rules. LTAFs will facilitate investment through a UK-authorized fund in assets that are less liquid and potentially higher risk than assets that are available for mainstream retail funds.

Pending feedback, the FCA initially proposes to restrict the LTAFs distribution to professional investors and sophisticated retail investors. However, the proposed rules enable wider distribution if the FCA subsequently decides that this would be appropriate.

The FCA plans to enable LTAFs to invest in a range of long-term illiquid assets, with few restrictions on eligible investments. It proposes additional disclosures to help potential investors understand the management of the fund and explain its important features.

The FCA also proposes to amend the permitted links rules in COBS 21.3 to allow defined contribution pension schemes to invest in LTAFs.

Appendix 1 to CP21/12 contains the draft Long-Term Asset Fund Instrument 2021, which will amend the relevant rule.

CP21/12 closes on June 25. The FCA plans to publish a policy statement and final rules later in 2021.

[CP21/12.](#)

UK Government Publishes Guidance on Supply of Emissions Allowances in UK ETS

On May 10, the UK Government published its guidance on the supply of emissions allowances in the UK Emissions Trading Scheme (UK ETS). The UK ETS was introduced on January 1, replacing the United Kingdom's participation in the EU Emission Trading System following the end of the post-Brexit transition period.

The guidance set forth by the UK Government includes:

- hosting UK ETS auctions every two weeks from May 19;
- announcing the first trade date on the secondary market: the UK Allowance Futures Contract is May 19, and the UK Allowance Daily Futures is May 21;
- announcing that the 2022 auction calendar will be published by July 15;
- publishing the allocation table setting out stationary installations' entitlement to free allowances for 2021-25. The aviation allocation table will be published in June and will set out the entitlement for aircraft operators. Free allocations will follow after the publication of the tables. Free allocations for 2022 will be issued by February 28, 2022 for both stationary and aircraft operators; and
- managing the UK ETS through an auction reserve price (the minimum price for bids is set at £22) and using the cost containment mechanism (CCM) to mitigate sustained high prices. For the CCM to be triggered, the average December 2021 futures contract price as traded on the Intercontinental Exchange would need to remain above £46 for three consecutive months.

[The UK Government guidance on UK ETS.](#)

FCA Replaces Data Collection Platform Gabriel With RegData

On May 11, the Financial Conduct Authority (FCA) updated its webpage announcing the replacement of Gabriel, its data collection platform for gathering regulatory data from firms.

The FCA confirmed that Gabriel has been replaced by its new platform, RegData, which is intended to be faster and easier to use and built with flexible technology. RegData is also intended to fix issues more quickly and make ongoing improvements to user experience.

[The FCA webpage announcing the replacement of Gabriel.](#)

COVID-19: FCA Updates Webpage on Changes to Regulatory Reporting

On May 11, the Financial Conduct Authority (FCA) updated its webpage on changes to regulatory reporting during the COVID-19 pandemic.

The FCA explained on its webpage in February 2021 that firms could apply for a two-month extension to the deadline for FIN-A (annual report and accounts) submissions due up to and including July 31. This February 2021 entry has now been removed and replaced with a May entry, which makes it clear that for this return only, firms will have an “automatic” two-month extension to the deadline for submissions up to and including July 31.

The FCA continues to advise that this flexibility is intended to cover situations where COVID-19 has made it impractical to finalize audited financial statements. If firms are able to submit FIN-A on time, then they should do so. In any event, firms should submit FIN-A as soon as they are reasonably able to, and no later than September 30.

[The FCA website on changes to regulatory reporting during COVID-19.](#)

EU DEVELOPMENTS

ESG: European Commission Consults on Draft Delegated Regulation of Disclosure Obligations Under Taxonomy Regulation

On May 7, the European Commission (Commission) published its consultation on a draft Delegated Regulation expanding Article 8 of the Taxonomy Regulation ((EU) 2020/852) by specifying the disclosure obligations associated with environmentally sustainable economic activities relating to large corporations.

In the draft Delegated Regulation, the Commission suggests:

- specifying the content and presentation of information to be disclosed by non-financial undertakings, insurance and reinsurance undertakings, asset managers, credit institutions and investment firms; and
- outlining common rules relating to key performance indicators.

The consultation closes on June 2. The Delegated Regulation is set to be implemented from January 1, 2022.

The draft Delegated Regulation 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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FINANCIAL MARKETS AND FUNDS

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