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BROKER-DEALER

FINRA Proposes Amendments to Rule Pertaining to Communications with the Public

The Financial Industry Regulatory Authority (FINRA) is seeking comment with respect to proposed amendments (the "Proposed Amendments") to FINRA Rule 2210 (Communications with the Public). The Proposed Amendments would create an exception to FINRA's general prohibition on projected performance and would be applicable to all FINRA-member firms. The Proposed Amendments would allow firms to present to prospective and current customers illustrations that show the projected performance of an asset allocation or investment strategy (although it remains impermissible to present the projected performance of individual securities). All illustrations would have to have a "reasonable basis" and be accompanied by prominent disclosures that the illustration is hypothetical and that there is no assurance that the projected performance will actually be achieved. An illustration also must explain any material assumptions or limitations. FINRA explained that a "reasonable basis" for an illustration may be established by reference to, among other things, historical performance or volatility of relevant asset classes, macroeconomic factors, and expected contribution and withdrawal rates of customers. Registered principals would be required to approve the illustrations or approve a template illustration and supervise the production of illustrations from that template.

FINRA noted that while the prohibition on projected performance is generally designed to protect retail investors, the Proposed Amendments could better inform an investor as it relates to the assumptions upon which investment strategy recommendations are based.

Comments on the Proposed Amendments are due March 27. FINRA's Regulatory Notice is available here.

SEC Approves Pricing Disclosures for Fixed Income Securities

The Securities and Exchange Commission has approved amendments to Financial Industry Regulatory Authority (FINRA) Rule 2232 (Customer Confirmations) that require FINRA-member firms to disclose additional information to retail customers with respect to transactions in certain fixed income securities (the "Final Rules"). The Final Rules require the disclosure in customer confirmations of (1) the mark-up or mark-down applicable to certain transactions in corporate or agency debt securities; (2) a reference and hyperlink (if the confirmation is electronic) to the website established by FINRA, which contains publicly available trade data; and (3) the execution time of the transaction such that a customer may locate its individual transactions when accessing FINRA's website.

More specifically, the Final Rules require that a firm disclose to a non-institutional customer the amount of mark-up or mark-down paid by such customer on a transaction in corporate or agency debt securities if such firm executes one or more offsetting principal transactions in the same security on the same trading day which in the aggregate meet or exceed the size of the customer transaction. A non-institutional customer is a customer that is not a bank, savings and loan association, insurance company, registered investment company, registered investment adviser (either at the state or federal level), or a person with total assets of at least $50 million. This disclosure obligation also may be triggered to the extent that the offsetting principal transaction is executed by a firm's affiliated broker-dealer if such transaction did not occur at arm's length.

There are two exceptions to the mark-up or mark-down disclosure requirement. Principal transactions executed on a trading desk separate from the trading desk that executes customer transactions would not trigger a mark-up or mark-down disclosure as long as the firm has policies and procedures reasonably designed to ensure that the

trading desk that executes principal transactions does not have knowledge of the customer transactions. The mark-up or mark-down disclosure also is not triggered by bonds acquired by a firm in a fixed-price offering. FINRA notes the applicable mark-up or mark-down should be calculated consistent with FINRA Rule 2121 (Fair Prices and Commission) and supplementary material thereunder and should include the mark-up or mark-down both as a dollar amount and a percentage of the prevailing market price. Disclosures required under (2) and (3) above apply to all transactions in corporate and agency debt securities, regardless of whether the requirement to disclose the amount of mark-up or mark-down is triggered.

The Final Rules become effective May 14, 2018. FINRA's Regulatory Notice is available here.

FINRA Files Proposed Rules With The SEC To Implement Consolidated Audit Trail Plan

The Financial Industry Regulatory Authority (FINRA) has filed proposed rules with the Securities and Exchange Commission to adopt FINRA Rule 6800 Series, which is designed to implement the compliance rule regarding the National Market System (NMS) Plan Governing the Consolidated Audit Trail.

Pursuant to Regulation NMS, various exchanges have filed with the SEC a plan to create, implement and maintain a consolidated audit trail (CAT) to capture information related to customers and order events for transactions in NMS securities and over-the-counter (OTC) equity securities. The CAT will capture order information across all markets and throughout the life of an order (from inception to execution). Each exchange must enforce compliance with the plan with respect to its members or trading permit holders.

Members of a national security exchange or a national securities association required to comply with the Proposed Rules (Members) must submit identification information related to accounts that have had activity in NMS securities or OTC equity securities in the previous six months. Under the Proposed Rules, Members also must submit details of an order during the lifecycle of the order, including origination of the order, routing of the order, receipt of the routed order and execution of the order. Data to be reportable includes the data and time of such events, material terms of the order, identifying information of the customer and the market, and information around the cancellation, modification or allocation of orders. Material terms of an order include, among other things, security symbol, type, price and size; order type; and special handling instructions. Broker-dealers designated by the exchanges for the purpose of market making in certain options contracts are required to report the time at which their quotes in options contracts are sent to the exchange, material terms and information about subsequent modifications and cancellations. The Proposed Rules allow Members to use third parties to assist them in reporting and contain requirements around the synchronization of clocks used to record the date and time of events contained in the CAT.

If the Proposed Rules are approved by the SEC, most Members would be required to begin connectivity and acceptance testing as well as order data submission no later than August 15, 2018. Members that qualify as small broker-dealers under Securities Exchange Act Rule 01-10(c) would be required to begin connectivity and acceptance testing, as well as order data submission, no later than August 15, 2019. The *Federal Register* Notice related to and text of the Proposed Rules are available here.

DERIVATIVES

See "CFTC Provides Time-Limited Relief for Variation Margin and Minimum Transfer Amount Provisions" in the CFTC section.

CFTC

CFTC Provides Time-Limited Relief for Variation Margin and Minimum Transfer Amount Provisions

On February 13, the Division of Swap Dealer and Intermediary Oversight (Division) of the Commodity Futures Trading Commission (CFTC) provided time-limited no-action relief for failure of a swap dealer (SD) that does not have a prudential regulator to comply with the CFTC's variation margin requirements by the March 1 compliance date (March 1 Requirements). (There are now a total of 104 swap dealers registered with the CFTC, and 51 of these have a prudential regulator.) Under the CFTC margin rules, SDs must collect and post variation margin with

each counterparty that is an SD, major swap participant or financial end user starting March 1. SDs now have a grace period expiring September 1 to come into compliance if:

1. the SD uses best efforts to comply with the March 1 Requirements as soon as possible after March 1;
2. failure to comply is solely caused by an inability to finalize necessary documentation and to implement operational processes despite good faith efforts;
3. in situations where the SD already exchanges variation margin with a counterparty, it continues to do so until the SD can comply with the March 1 Requirements; and
4. the SD complies with the March 1 Requirements for every swap entered after March 1.

The no-action letter has no effect on the initial and variation margin requirements subject to the earlier September 1, 2016 deadline. More details are available in Letter 17-11.

Additionally on February 13, the Division granted no-action relief relating to the minimum transfer amount (MTA) requirements. Under CFTC Regulations 23.152(b)(3) or 23.153(c), SDs may apply an MTA of up to $500,000 to transfers of initial and variation margin to reduce the burdens associated with *de minimis* margin transfers. The no action relief permits SDs entering swaps with separately managed accounts to treat each account as a separate counterparty for purposes of applying the MTA, even if the separately managed accounts are owned by the same counterparty.

Letter 17-12 addressing the minimum transfer amount requirements is available here.

UK DEVELOPMENTS

HM Treasury Publishes Response to the Transposition of MiFID II Consultation

On February 9, HM Treasury published its response (Response) to the consultation that ran from March 27, 2015, to June 18, 2015, on the transposition of the revised Markets in Financial Instruments Directive (MiFID II) into UK domestic law. The Response summarizes responses submitted to the consultation by market participants, as well as the government's position.

The Response states that the government plans to present finalized statutory instruments for implementing MiFID II before parliament in early 2017. The response covers a number of different areas, including:

- Third countries—Article 39 MiFID II (allowing member states to require a third country firm to establish a branch in their jurisdiction when they provide MiFID investment services and activities to retail or elective professional clients) will not be implemented and the United Kingdom's current third-country regime, known as the "overseas persons exclusion," will be maintained.
- Data reporting services—An amendment has been made to the definition of "data reporting service" to refer directly to the services. The government will maintain a direct copy-out approach in relation to the definitions of Approved Reporting Mechanisms (ARMs), Approved Publication Arrangements (APAs) and Consolidated Tape Providers (CTPs).
- Position limits and reporting—Contracts traded on a UK trading venue and a third-country market will follow the approach in MiFID II, and a trading entity authorized under MiFID II will be classified as an investment firm (for the purposes of aggregated position reporting by different categories of person). The Financial Conduct Authority (FCA) will separately publish its policy statement regarding the position reporting and management regime.
- Unauthorized persons—Consideration will be given alongside the EU Benchmark Regulation, as to whether an amendment to the Financial Services and Markets Act 2000 (FSMA) is necessary with respect to unauthorized persons with proprietary rights to a benchmark in order to appropriately enforce the obligations in Article 37 of the Markets in Financial Instruments Regulation (MiFIR).
- Power to remove board members—A standalone power in relation to investment firms has been created that is aligned with Article 69(2) (u) of MiFID II, giving regulators the power to require the removal of a natural person from the management board of an investment firm or market operator.
- Organized trading facilities (OTF)—A notification regime will be provided for in the FCA rules in relation to recognized investment exchanges, investment firms and credit institutions operating an OTF and undertaking matched principal trading.

- Binary options—Binary options will be treated as financial instruments.

The Response is available here.

EU DEVELOPMENTS

ESMA Publishes Revised Draft ITS on MiFID II Position Reporting

On February 9, the European Securities and Markets Authority (ESMA) published a revised draft implementing technical standards (ITS) on position reporting under the revised Markets in Financial Instruments Directive (MiFID II).

The ITS were originally published in 2015. Since then, ESMA has identified a number of technical amendments necessary for the correct functioning of the position reporting of commodity derivatives. This includes amendments to the format of position reports. The changes themselves are highlighted in the revised ITS, which has been sent by ESMA to the European Commission for endorsement.

The revised ITS are available here.

ESMA Publishes Letter to the European Commission on Potential Exploitation of MiFID II Systematic Internalizer Regime

On February 14, the European Securities and Markets Authority (ESMA) published a letter (Letter), dated February 1, to the European Commission (EC) in relation to the systematic internalizer (SI) regime under the revised Markets in Financial Instruments Directive (MiFID II) and the associated Markets in Financial Instruments Regulation (MiFIR).

In the letter, ESMA highlights its concerns regarding the potential establishment of networks of SIs to circumvent certain MiFID II obligations. ESMA states that such arrangements would allow SIs to cross third-party buying and selling interests via matched principal trading, or other types of back-to-back transactions. In addition, those arrangements would be supported by liquidity provision agreements between members of the networks. These arrangements would be in violation of the MiFID II and MiFIR objectives, bringing the majority of trading activity onto MiFID-authorized trading venues and away from so-called “dark pools.”

ESMA states that it will continue to monitor the situation and may clarify the scope of SIs’ permitted activities in question and answer publications. It also asks the EC to consider the issues presented and whether or not it should use its regulatory tools to close any potential loopholes.

The Letter 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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