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BROKER-DEALER

SEC Disapproves BZX Proposed Rule Change to List Shares of Bitcoin-Based Exchange-Traded Product

On July 26, the Securities and Exchange Commission disapproved a Bats BZX Exchange proposed rule change that would have permitted the listing and trading of shares of the Winklevoss Bitcoin Trust (Trust) on BZX. This is the SEC's second disapproval of the proposed rule change as it has previously disapproved the exchange's original proposal in March 2017. Notably, Commissioner Hester Peirce dissented from the SEC's most recent disapproval.

As proposed, the investment objective of the Trust would be for the shares to track the price of bitcoin on the Gemini Exchange. The Trust would hold only bitcoins as an asset, and the bitcoins would be in the custody of, and secured by, the Trust's custodian.

The SEC disapproved the proposed rule change because BZX did not demonstrate that the rule proposal is consistent with the requirements of the Securities Exchange Act of 1934. Specifically, exchange rules must be designed to prevent fraudulent and manipulative acts and practices and to protect investors and the public interest. The SEC indicated, however, that its disapproval was not an assessment of the utility or value of bitcoin or blockchain as an investment.

The SEC order disapproving the rule proposal is available here.

The dissent of Commissioner Peirce is available here.

NYSE Proposes to Amend Rule Requiring Registered Broker-Dealers to be Members of FINRA or Another Exchange

On July 12, the New York Stock Exchange (NYSE) proposed an amendment to NYSE Rule 2, which requires that an NYSE member also be a member of the Financial Industry Regulatory Authority (FINRA) or another registered securities exchange. As a part of the consolidation of the National Association of Securities Dealers and NYSE Regulation to form FINRA, NYSE Rule 2 was revised in 2007 to require each NYSE member organization to become a FINRA member. Eventually, NYSE amended the rule so that NYSE members could be members of FINRA or a registered securities exchange.

Following the consolidation, NYSE contracted with FINRA to perform certain market surveillance, investigation and enforcement functions on behalf of NYSE pursuant to a Regulatory Services Agreement. Today, some of the market surveillance, investigation and enforcement functions once performed by FINRA are now carried out by NYSE. Given that the initial reasons for NYSE to require FINRA or exchange membership no longer exist, NYSE is now proposing to amend the definition of "member organization" under Rule 2 to remove the requirement.

More information is available here.

FINRA Amends Rules to Provide an Option for Simplified Arbitration

On July 23, the Financial Industry Regulatory Authority (FINRA) released Regulatory Notice 18-21, which summarizes recent amendments to the Code of Arbitration Procedure for Customer Disputes (Customer Code) and the Code of Arbitration Procedure for Industry Disputes (Industry Code).

The Codes offer two options for administering cases that have claims of $50,000 or less (excluding interest and expenses). In the default option, a single arbitrator makes a decision based on the parties' pleadings and other materials submitted by the parties. Alternatively, the parties have a full hearing with a single arbitrator. Under the Customer Code, a customer may request a hearing, regardless of whether the customer is a claimant or respondent. Under the Industry Code, only the claimant may request a hearing. Hearings are generally held in person, and there are no limits on the number of hearing sessions.

Claimants can now select a third hearing option known as a "Special Proceeding" for cases involving claims of $50,000 or less (excluding interest and expenses), which is designed to give parties an opportunity to present cases to an arbitrator in a convenient and cost-effective manner. A Special Proceeding is held by telephone and limits the time parties can present their cases, rebuttals and closing statements. FINRA expects that arbitrators will follow the usual order of proceedings.

Notice 18-21 is available here.

FINRA Board of Governors Approves Four Rule Proposals

During its July 18 and 19 meeting, the Board of Governors of the Financial Industry Regulatory Authority (FINRA) approved four new rule proposals. The proposals relate to the following topics:

1. Expansion of books and records custodians—The Board approved filing with the Securities and Exchange Commission proposed rule amendments to expand the categories of persons eligible to serve as books and records custodians.
2. Electronic signatures—The Board approved filing with the SEC proposed rule amendments to permit electronic signatures to authorize discretion over a customer's account.
3. Expansion of over-the-counter (OTC) equity volume data published online—The Board approved publication of a Regulatory Notice that will seek comment on a proposal to expand the summary firm data published on the FINRA website relating to OTC trading volume.
4. Identifying and reporting hedge transactions in US Treasury securities—The Board approved filing with the SEC a proposal that would provide firms with additional time to report to the Trade Reporting and Compliance engine (TRACE) transactions in US Treasury securities to hedge primary-market transactions. The proposal would also adopt a new modifier to identify such transactions.

More information about the recent meeting is available here.

DERIVATIVES

See "NFA Interpretive Notice Regarding Engaging in Virtual Currency" in the CFTC section.

CFTC Proposes Improvements to Initial Margin Segregation Rule

The Commodity Futures Trading Commission KISS initiative has finally produced some substantive results for swap dealers in the form of proposed amendments to Subpart L of the CFTC's regulations ("Segregation of Assets in Uncleared Swap Transactions") that were issued for comment on July 24. Subpart L (which encompasses CFTC Regulations 23.700-704) has been problematic for swap dealers since it was adopted early in 2014 because of the compliance challenges created by the extremely complicated and prescriptive nature of these provisions.

The purpose of Subpart L is to implement Section 4s(l) of the Commodity Exchange Act (CEA). That provision was added to the CEA by the Dodd–Frank Wall Street Reform and Consumer Protection Act, requiring a swap dealer to notify each counterparty that the counterparty has a "right" to require segregation at an independent

custodian of initial margin it is required to post to the swap dealer. The proposed amendments eliminate most (but not all) of the most cumbersome requirements of Subpart L by (1) making the notice a one-time requirement; (2) eliminating the mandated hierarchy for identifying an appropriate recipient of the notice; and (3) allowing the parties to negotiate the terms of segregation, including the way in which the segregated margin will be invested. The requirement that the swap dealer must give a quarterly report to any counterparty that does not elect segregation remains unchanged (because it comes from the CEA provision and not a CFTC rule), but the amendments clarify that the reports are due in arrears no later than the 15 business day after the end of the relevant quarter.

According to the CFTC, the proposed amendments are intended to (1) reduce unnecessary burdens on market participants; (2) facilitate more efficient swap execution; and (3) encourage more segregation by allowing parties more flexibility in setting the terms of their segregation arrangements.

The proposed amendments are available here.

CFTC

See "CFTC Proposes Improvements to Initial Margin Segregation Rule" in the Derivatives section.

CFTC Proposes Amendments to Its Position Limit Rules

The Commodity Futures Trading Commission is proposing to amend its position limits rules for security futures products (SFPs) to provide exchanges that list SFPs with greater discretion in setting limit levels, allowing the exchanges to provide a more effective risk management tool.

Specifically, the proposed CFTC amendment would: (1) increase the default level of equity SFP position limits to 25,000 (100-share) contracts, from 13,500 (100-share) contracts; and (2) modify the criteria for setting a higher level of position limits and position accountability levels.

Pursuant to the proposed amendment, a designated contract market (DCM) listing an SFP could (1) set a specific position limit level, generally equivalent to no more than 12.5 percent of estimated deliverable supply; or (2) in lieu of position limits, set position accountability levels when six-month total trading volume in the underlying security exceeds 2.5 billion shares and there are more than 40 million shares of estimated deliverable supply. In addition, the proposed amended position limit regulation would provide discretion to a DCM to apply limits to either a person's net position or a person's positions on the same side of the market. Finally, the CFTC proposes criteria for setting position limits on an SFP on other than an equity security, generally based on an estimate of deliverable supply.

Comments will be due 60 days after the proposal is published in the *Federal Register*. More information on the proposed amendment is available here.

NFA Interpretive Notice Regarding Engaging in Virtual Currency

On July 20, the National Futures Association (NFA) submitted to the Commodity Futures Trading Commission for approval a proposed interpretive notice regarding *Disclosure Requirements for NFA Members Engaging in Virtual Currency Activities*. The new disclosure obligations will apply to all NFA members engaging in transactions in virtual currency derivatives and virtual currency, as well as other activities in underlying or spot virtual currencies.

The proposed interpretive notice addresses NFA's concerns that investors may not fully understand the nature of virtual currencies and virtual currency derivatives, the substantial risk of loss that may arise from trading these products, and the limitations of NFA's regulatory authority over the spot market in virtual currencies.

NFA is invoking the "ten-day" provision of Section 17(j) of the Commodity Exchange Act and plans to make this Interpretive Notice effective 10 days after filing with the CFTC, unless the CFTC notifies NFA that it has determined to review the proposed Interpretive Notice for approval.

More details relating to the interpretive notice are available in Gary DeWaal's July 27, 2018 Between Bridges issue of *Bridging the Week*.

DIGITAL ASSETS AND VIRTUAL CURRENCIES

See "SEC Disapproves BZX Proposed Rule Change to List Shares of Bitcoin-Based Exchange-Traded Product" in the Broker-Dealer section and "NFA Interpretive Notice Regarding Engaging in Virtual Currency" in the CFTC section.

BREXIT/UK DEVELOPMENTS

HM Treasury Publishes Draft Version of the EEA Passport Rights Regulations 2018

On July 24, HM Treasury published its draft version of the European Economic Passports Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018 (draft Regulations).

The purpose of the draft Regulations is to remove references to the passporting framework set out in the Financial Services and Markets Act 2000 and in other UK legislation. The reason for this is if the United Kingdom leaves the European Union without a deal, there will be no agreed legal framework on which the passporting system can continue; therefore references in UK legislation to the passporting system would become "deficient" for purposes of the European Union (Withdrawal) Act 2018 (for further details, see the *Corporate & Financial Weekly Digest* edition of June 29, 2018).

The draft Regulations also establish a temporary permissions regime (TPR) to enable EEA firms currently operating in the United Kingdom using a passport to continue their activities in the United Kingdom for a period after the date of the United Kingdom's withdrawal from the European Union, March 29, 2019 (Exit Day). The draft Regulations envisage that the TPR will be in place for three years after Exit Day, with a power to extend if necessary.

HM Treasury intends to lay the draft Regulations before Parliament in fall 2018. The draft Regulations may be expanded to include provisions on other relevant issues. The majority of the provisions in the draft Regulations concerning the TPR will go into effect one day following the effectiveness of the draft Regulations. The remainder of the draft Regulations will go into effect on Exit Day. The UK Financial Conduct Authority and UK Prudential Regulation Authority also will update their rulebooks to reflect the changes introduced once the draft Regulations are made, and to address any deficiencies as a result of the United Kingdom leaving the European Union.

The draft Regulations are available here.

HM Treasury's guidance on the draft Regulations is available here.

Bank of England and PRA Publish Their Approach to Temporary Permissions Regime and Temporary Recognition Regime

On July 24, the Bank of England (BoE) published a webpage on its and the UK Prudential Regulation Authority's (PRA's) approach to the temporary permissions regime (TPR) and the temporary recognition regime (TRR).

The TPR aims to enable EEA firms currently using a passport operating in the United Kingdom to continue their activities in the United Kingdom for a limited period after the United Kingdom's withdrawal from the European Union on March 29, 2019 (Exit Day).

The purpose of the TRR is to provide a similar framework for non-UK central counterparties (CCPs) that are currently permitted to offer clearing services in the United Kingdom, either from elsewhere in the European Union or from a third country. To enter the TRR, eligible CCPs will need to inform the BoE before Exit Day of their intention to provide clearing services in the United Kingdom. CCPs in the TRR will be deemed recognized to provide clearing services in the United Kingdom for a maximum of three years, extendable by HM Treasury in increments of 12 months.

The BoE's webpage provides details of the approach of the BoE and the PRA to notifications by firms intending to use the TPR or the TRR and the rules that will apply to firms in the TPR.

The BoE and the PRA expect to provide further guidance to firms on the TPR and the TRR in due course, including the notification process for entry. The PRA intends to consult in fall 2018, in co-ordination with the UK Financial Conduct Authority as appropriate, on proposed changes to its broader rules relating to the TPR.

The BoE's and the PRA's approach to the TPR and TRR is available here.

EU DEVELOPMENTS

European Supervisory Authorities Release Guidance on PRIIPS KID

On July 20, the Joint Committee of the European Supervisory Authorities (ESAs), which comprises the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, updated its Q&As on the key information document (KID) required to be issued in connection with packaged retail and insurance-based investment products (PRIIPs) when such products are made available to retail investors in the EU.

The ESAs also published updated flow diagrams for the risk and reward calculation disclosures to be provided in any such PRIIPs KID.

The updated Q&As are available here.

The updated flow diagrams are available here.

ESMA Updates UCITS and AIFMD Q&As

On July 23, the European Securities and Markets Authority (ESMA) issued a press release announcing updates to two of its sets of Questions and Answers (Q&As): (1) Q&As relating to the Undertakings for the Collective Investment in Transferable Securities (UCITS) Directive; and (2) those relating to the Alternative Investment Fund Managers Directive (AIFMD).

The updated UCITS Directive Q&As feature four new questions and answers with respect to:

1. UCITS investing in other UCITS or collective investment undertakings which have different investment policies;
2. whether netting and hedging arrangements can be taken into account in the calculation of issuer concentration limits;
3. re-use of assets held in custody by a UCITS depositary; and
4. the supervision of branches of UCITS management companies providing investment services.

The updated AIFMD Q&As include one new question and answer which concerns the supervisory responsibilities of competent authorities in host EU member states when an alternative investment fund manager provides investment services through a branch established in that member state, effectively repeating the fourth item above in the context of alternative investment fund managers.

ESMA previously updated both Q&As in October 2017 (further details of that update are available in the *Corporate & Financial Weekly Digest* edition of October 13, 2017).

ESMA's press release is accessible here.

The UCITS Directive Q&As are available here and the AIFMD Q&As, here.

ESMA Releases Template to Determine Whether Investment Firms Are Systematic Internalizers

On July 20, the European Securities and Markets Authority (ESMA) released a template (Template) to determine whether investment firms are systematic internalizers (SIs). Under the revised Markets in Financial Instruments Directive (MiFID II), an SI is an investment firm which, on an organized, frequent systematic and substantial basis, deals on its own account when executing client orders outside a regulated market, a multilateral trading facility or an organized trading facility without operating a multilateral system.

The Template will be used to publish the first set of figures necessary for investment firms to assess whether they are SIs in specific financial instruments on August 1.

The Template can be downloaded here, with ESMA's accompanying press release available here.

EC Refers Spain and Slovenia to ECJ for Failure to Implement EU Directives

On July 19, the European Commission (EC) issued a press release, announcing that it has referred Spain and Slovenia to the Court of Justice of the European Union (ECJ) for their failure to fully enact the revised Markets in Financial Instruments Directive (MiFID II) and certain MiFID II implementing legislation. The deadline for implementation by all EU member states was January 3, 2018.

On the same day, the EC separately confirmed that it has referred Spain to the ECJ for its failure to fully implement the EU Capital Requirements Directive (CRD IV) into national law. EU member states had until December 31, 2013 to do so. Following the EC's formal request to transpose the CRD IV into national law in January 2015 and issuance of a reasoned opinion in January 2018, Spain has not subsequently notified the EC of the relevant missing measures.

The EC's press release regarding the failure to implement MiFID II is available here.

The EC's press release with respect to Spain's failure to implement the CRD IV 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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BREXIT/UK/EU DEVELOPMENTS

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