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# Corporate & Financial Weekly Digest

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## BROKER-DEALER

### SEC and CFTC Chairman Issue Joint Letter Regarding CFTC Orders Implicating Regulations A and D

On October 23, Chairman Jay Clayton of the Securities and Exchange Commission and Chairman Heath P. Tarbert of the Commodity Futures Trading Commission issued a joint letter creating a one-year pilot program to formalize the practices between the Chairmen relating to CFTC orders that implicate the "bad actor" disqualification provisions of Regulations A and D under the Securities Act of 1933 (the SEC Disqualification Rules). Under the SEC Disqualification Rules, individuals or firms are disqualified from relying on certain exemptions from registration for securities offerings if certain triggering events occur, such as certain securities law violations or final orders issued by the CFTC in connection with certain enforcement proceedings.

However, the SEC Disqualification Rules also establish circumstances under which disqualification will not be triggered if the CFTC advises in writing that a disqualification is not a necessary consequence of a CFTC order. Through the joint letter, the Chairmen agree to use reasonable efforts to formalize and memorialize the coordination of their respective staffs with respect to CFTC orders that implicate the SEC's Disqualification Rules. More specifically, the CFTC staff will provide notice to the SEC staff as soon as practicable if a CFTC order may involve the SEC Disqualification Rules, will share relevant information regarding the CFTC order, and will permit the SEC staff to comment on the potential for a waiver of automatic disqualification under the SEC Disqualification Rules. If the SEC staff fails to provide its view or comments within the timeframe stipulated in the letter, the CFTC will automatically provide language advising that disqualification should not arise as a consequence of the CFTC order.

The pilot program is currently set to expire on October 23, 2021, although Chairman Clayton, Chairman Tarbert or a future chair may opt to terminate the pilot program unilaterally at any time before the expiration date.

The joint letter is available here.

### SEC Staff Issues No-Action Relief Addressing Customer Protection Rule Violations Despite the Objection of Two Commissioners

On October 22, the staff of the Division of Trading and Markets of the Securities and Exchange Commission (DTM) issued a no-action letter (the No-Action Letter) to the Financial Industry Regulatory Authority (FINRA) providing time-limited relief for broker-dealers operating fully paid lending programs (FPL Programs) in which they borrow fully paid and excess margin securities from their customers without complying with the requirement that the broker-dealer physically deliver collateral supporting the loan to the customer making the loan. Paragraph (b)(3) of SEC Rule 15c3-3 (the customer protection rule) requires that a broker-dealer that borrows fully paid or excess margin securities from a customer enter an agreement with such customer that requires the broker-dealer to:

1. provide the lender with appropriate forms of collateral that fully secures the loan (cash, US Treasury bills or notes, an irrevocable letter of credit issued by a bank, or such other collateral as the Commission designates as permissible);
2. mark the loan to market not less than daily and provide additional collateral as necessary; and

3. notify the lender that the provisions of the Securities Investor Protection Act of 1970 may not protect the lender (meaning collateral delivered to the lender may be the only means of satisfaction of the broker-dealer's obligation to return the securities).

Rather than transferring actual physical possession of collateral to customers, some broker-dealers are depositing the required collateral into accounts at the broker-dealer or in omnibus accounts at a bank in the name of the broker-dealer. The DTM Staff views this arrangement as impermissible because it permits the broker-dealer to retain control over the collateral that is used to secure their borrowings of fully paid and excess margin securities.

The DTM staff is now granting time-limited relief for the requirement in paragraph (b)(3) of Rule 15c3-3 that a broker-dealer physically deliver to the customer, collateral that fully secures the loan (i.e., by delivering the collateral away from the broker-dealer). To rely on the No-Action Letter, the broker-dealer must have an FPL Program that was in existence before October 22; adhere to all other aspects of Rule 15c3-3(b)(3); and comply with Rule 15c3-3(b)(3) as soon as practicable (but in no event later than April 22, 2021).

Promptly following the issuance of the No-Action Letter, on October 23, SEC Commissioners Allison Herren Lee and Carolina A. Crenshaw issued a joint response letter criticizing the DTM staff's reliance on no-action relief as a mechanism to remediate violations of the customer protection rule. While the Commissioners agree that the practices described in the No-Action Letter are inconsistent with the customer protection rule, Commissioners Lee and Crenshaw indicate that no-action relief should be granted to clarify gray areas of regulation and should not be used to "provide a grace period for compliance with clear violations of law." The commissioners suggest that violations that put investor funds directly at risk "should be remediated without delay."

The No-Action Letter is available here. The Commissioners' joint statement is available here.

### FINRA Adopts Rule to Restrict Registered Person's Ability to be a Beneficiary or Hold Position of Trust

On October 29, the Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 20-38, announcing FINRA's adoption of a new rule to limit any associated person of a member who is registered with FINRA (a "registered person") from being named a beneficiary, executor or trustee, or having a power of attorney or similar position of trust on behalf of a customer. New FINRA Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer) is designed to protect investors from undue and inappropriate influence over important financial decisions by requiring members to review its registered persons who are beneficiaries or hold positions of trust for customers.

Upon learning of his or her status as a customer's beneficiary or a position of trust for a customer, a registered person must provide written notice to and receive written approval from the relevant member firm (or decline the bequest or appointment). Notably, the rule does not apply to scenarios in which the customer is a member of the registered person's "immediate family."

Rule 3241 will require members to establish and maintain written procedures to comply with the rule's requirements. Members must also maintain the written notice and approval for at least three years after the date the beneficiary status or position of trust has terminated or the bequest received or for at least three years (whichever is earlier) after the registered person's association with the firm has terminated.

Rule 3241 becomes effective February 15, 2021. Regulatory Notice 20-38 is available here.

## DERIVATIVES

*See "CFTC Announces Organizational Changes" in the CFTC section and "ESMA Adds UK Venues to Third-Country Trading Venues Under MiFIR and MiFID II" in the Brexit/EU Developments section.*

### ISDA Publishes IBOR Fall Back Supplement and Related Protocol

On October 23, the International Swaps and Derivatives Association, Inc. (ISDA) published two important documents that give swap market participants a convenient way to modify their swap agreements to account for

the expected discontinuation of the London Inter-bank Offered Rate (LIBOR) and other interbank offered rates (collectively, IBORs). The two documents are the IBOR Fallbacks Supplement to the 2006 ISDA Definitions (Supplement) and the 2020 IBOR Fallbacks Protocol (Protocol). The effective date for both the Supplement and the Protocol is January 25, 2021.

The Supplement is (officially) Supplement No. 70 to the 2006 ISDA Definitions. It amends the IBOR definitions for all major currencies to provide more precise outcomes when an "Index Cessation Event" has occurred with respect to a particular IBOR rate or a fallback. The designated fallback for US Dollar LIBOR in such an event is "Fallback Rate (SOFR)", which is defined as "the term adjusted SOFR plus the spread" provided by Bloomberg Index Services Limited. Any swap that incorporates the 2006 Definitions will include the new definitions on the effective date.

The Protocol provides a convenient means by which parties to agreements that do not already incorporate the 2006 Definitions can amend them to add the new definitions. The Protocol can even be used to amend agreements other than ISDA documents that reference the IBORs being replaced. An Annex to the Protocol list 74 types of capital markets agreement that could be "Protocol Covered Agreements," including repurchase and securities lending agreements.

The ISDA press release concerning the Supplement and the Protocol is available here.

The text of the Supplement is available here.

The text of Protocol is available here.

Information about the Protocol (including FAQs, a list of adherents and instructions for adherence) is available here.

## CFTC

*See "SEC and CFTC Chairman Issue Joint Letter Regarding CFTC Orders Implicating Regulations A and D" in the Broker-Dealer section.*

### CFTC Chairman Tarbert Issues Statement on the Use of Staff Letters and Guidance

On October 27, the Chairman of the Commodity Futures Trading Commission issued a public directive to clarify the CFTC's use of staff letters and guidance. In his remarks, Chairman Tarbert highlighted the purpose and binding nature of no-action letters, interpretive letters, staff guidance (including advisories and FAQs) and exemptive letters. Specifically:

- Chairman Tarbert emphasized that staff letters should be limited to those circumstances that are not suitable for general rulemaking and instructed staff to consider whether rulemaking would be a more appropriate vehicle for responding to an inquiry where a situation is encountered on a repeated basis and has industry-wide implications.
- Chairman Tarbert clarified that a no-action letter may be relied upon only by the addressee of the letter, and that the public at large may not otherwise rely upon the letter, but rather should look to the letter as instructive of the views of the staff with respect to that particular matter.
- With respect to interpretive letters, Chairman Tarbert clarified that this is a vehicle through which the staff can explain its interpretation of ambiguous terms in the regulation, but unlike a no-action letter, this letter may be relied upon by the public.
- Staff guidance, advisories, and FAQs (collectively, Guidance) communicate the staff's expectation regarding how regulated parties may comply with a particular requirement, or inform regulated parties about staff's regulatory priorities. The CFTC's issuance of Guidance is neither binding on the division nor the public.
- Chairman Tarbert distinguished the above letters from exemptive letters, through which staff exercises exemptive authority that the CFTC has delegated to the staff. Similar to no-action letters, an exemptive letter may be relied upon only by the recipient, but the public may look to the letter as instructive of the views of the issuing division or office with regard to the particular matter, and as a basis for understanding the views of the CFTC.

Finally, the Chairman confirmed that the CFTC may issue staff letters in response to requests from trade associations or groups that represent similarly situated persons (i.e., persons or entities that share the same or substantially the same facts and circumstances).

Chairman Tarbert's full statement is available here.

### CFTC's Enforcement Division Issues Guidance on Recognition of Self-Reporting, Cooperation and Remediation

On October 29, the Commodity Futures Trading Commission announced that the Division of Enforcement (Division) issued new guidance for its staff related to the recognition of a registrant's self-reporting, cooperation or remediation in CFTC enforcement orders. The Division has not changed its existing process of how the enforcement staff will consider reductions in penalties in connection with self-reporting, cooperation or remediation; rather, the Division has clarified certain situations in which the staff will recognize a registrant's actions in CFTC enforcement orders. Specifically, the guidance describes potential scenarios where the enforcement staff may recommend the recognition of a respondent's action to be reflected in the CFTC enforcement order: (1) no self-reporting, cooperation or remediation; (2) no self-reporting, but cognizable cooperation and/or remediation that warrant recognition but not a recommended reduction in penalty; (3) no self-reporting, but substantial cooperation and/or recognition resulting in a reduced penalty; and (4) self-reporting, substantial cooperation and remediation resulting in a substantially reduced penalty.

The CFTC's press release with a link to the Division's guidance is available here.

### CFTC Announces Organizational Changes

On October 29, the Commodity Futures Trading Commission announced certain reorganizational changes designed to enhance the CFTC's operational effectiveness. Specifically:

- the Division of Swap Dealer and Intermediary Oversight and the Office of Customer Education and Outreach have been combined to form the new Market Participants Division;
- personnel from various operating units including the Office of Data and Technology and the Division of Market Oversight have been merged into the new Division of Data to centralize the CFTC's data functions;
- the Office of General Counsel and the Office of the Executive Secretariat have been merged to form the new Legal Division; and
- the Office of the Executive Director and the customer service elements of the Office of Data and Technology have been combined to form the new Division of Administration.

The mission (and names) of the Division of Clearing and Risk, Division of Market Oversight, and Division of Enforcement remains unchanged.

The press release announcing the reorganization is available here.

### CFTC to Hold an Open Commission Meeting on November 2

The Commodity Futures Trading Commission will hold an open meeting on Monday, November 2, from 10:00 a.m. to 12:30 p.m. ET, to consider amendments to Part 50 clearing requirement exemptions for central banks, sovereigns, international financial institutions, bank holding companies and community development financial institutions.

The meeting is open to the public via streaming or phone. The live feed will be streamed at www.cftc.gov.

More information, including streaming and listening instructions, is available here.

# BANKING

### OCC Issues Final "True Lender" Rule

The Office of the Comptroller of the Currency (OCC) published a final rule on October 27 that adopts a "bright line test" for determining when a national bank or federal savings bank (bank) is the "true lender" in connection with a loan originated pursuant to a third-party partnership (Final Rule). Under the Final Rule, a Bank makes a loan when it, as of the date of origination, (1) is named as the lender in the loan agreement; or (2) funds the loan. In cases where one bank is named as the lender in the loan agreement and another bank funds the loan, the bank named as the lender in the loan agreement is deemed to have "made" the loan.

In issuing the Final Rule, the OCC noted that its publication was intended to provide the "legal certainty necessary for banks to partner confidently with other market participants and meet the credit needs of their customers." In acknowledging concerns raised by certain commenters regarding claims that the rule permits "inappropriate" rent-a-charter or rent-a-bank schemes, the Final Rule states that the OCC's position is that such arrangements have "absolutely no place in the federal banking system" and that the OCC's "robust supervisory framework effectively targets predatory lending, achieving the same goal as a more complex true lender test."

The OCC also noted in its commentary that the Final Rule "operates together with the OCC's recently finalized '*Madden*-fix' rulemaking. When a bank makes a loan pursuant to the test [set forth in the Final Rule], the bank may subsequently sell, assign, or otherwise transfer the loan without affecting the permissible interest term, which is determined by reference to state law."

In total, more than 4000 comments were submitted to the OCC in connection with the Final Rule's adoption.

The final rule will be effective 60 days after publication in the *Federal Register*.

More information is available here.

# UK DEVELOPMENTS

### FCA Extends SM&CR Deadlines and Confirms Publication Dates for SM&CR Directory Person Data

On October 28, the UK's Financial Conduct Authority (FCA) published a policy statement on the extension of implementation deadlines for solo-regulated firms under the Senior Managers and Certification Regime (SM&CR) regarding the certification regime and conduct rules (the Policy Statement).

The deadlines extended in the Policy Statement from December 9, 2020 to March 31, 2021 by the FCA include:

- the date the conduct rules go into effect for employees who are not senior managers, certification staff or board directors;
- the date relevant employees are required to have received training on the conduct rules;
- the deadline for submission of information about directory persons to the Financial Services Register (Register);
- the requirement for firms to assess certified persons as fit and proper; and
- the deadline for claims management companies (CMC) by an equivalent period. A CMC that received full authorization on or after December 9, 2019 will have over 15 months after the date of its full authorization to meet the same requirements above.

Firms are encouraged, wherever possible, to meet the original deadline of December 9, 2020.

Further to the extension of deadlines, on October 27, the FCA updated its webpage on its directory of certified and assessed persons (the Directory) confirming the publication dates for directory persons data submitted by firms under the SM&CR (the Webpage).

Dual-regulated firms are required to submit their data via the FCA's online portal — 'Connect' by November 13. From November 23, the FCA will begin to publish the data on the Register.

Solo-regulated firms are required to submit their data via Connect by March 31, 2021 using the single-entry submission form. If a firm intends on submitting multiple entry submission forms or wishes for its data to appear on the Register from December 2020, the firm can submit ahead of the deadline. From December 14, the FCA will publish the data submitted on the Register. The last date for single entry submissions to appear from the outset is December 9, 2020.

Under the SM&CR, the FCA will publish and maintain the directory on the Register. Consumers and professionals can check the details of key individuals working in financial services.

The Policy Statement and the Webpage are available here and here.

## BREXIT/EU DEVELOPMENTS

### AIFMD II – European Commission Consultation on AIFM Directive Review

On October 22, the European Commission (Commission) launched its formal public consultation (Consultation) on its review of the Alternative Investment Fund Managers Directive (AIFMD).

The Consultation follows the Commission's June 10 report on the application and scope of the AIFMD (see the June 12, 2020 edition of *Corporate & Financial Weekly Digest*) and aims to achieve a more efficient, effective and competitive European market for alternative investment funds (AIFs) as a part of a stable financial system. The Consultation also notes that it may result in adjustments the existing European mutual fund rules (UCITS).

The Consultation asks 102 questions on seven topics:

1. **Scope and authorization.** This section contains the Commission's questions on improvements to the AIFM passport and whether there is a level playing field between EU AIFMs and other financial intermediaries.
2. **Investor protection.** In this section, the Commission questions (1) if it is possible to enable access to AIFs to a wider pool of investors; (2) whether investor disclosures are redundant or insufficient; and (3) whether the depositary rules require clarification (noting that a depositary passport is desirable).
3. **International relations.** This section asks about (1) non-EU AIFMs and national private placement regimes; and (2) asks thinly veiled Brexit-related questions about delegation rules and the prevention of 'letterbox entities' in the EU, asking if specific core or critical functions should always be performed by AIFMs in the EU.
4. **Financial stability.** This section focuses on the exposure of funds to the leveraged loan and collateralized loan obligation markets, and leverage calculation methods.
5. **Investing in private companies.** In this section, the Commission questions whether the AIFMD rules on AIFs investing in private companies, and the associated 'asset-stripping' rules, are fit for purpose.
6. **Sustainability/ESG.** The Commission asks whether AIFMs should quantify sustainability risks, and if AIFMs should be required to take account of sustainability-related impacts beyond what is currently required by EU law.
7. **Miscellaneous.** This section focuses on the role and powers of the European regulator-of-regulators, the European Securities and Markets Authority (ESMA), and if it should authorize and supervise all European AIFMs. It also asks if the UCITS and AIFM rules should be merged.

The deadline for responses is January 29, 2021. The Commission intends to put forward an amending directive (i.e., AIFMD II) in mid-2021.

The Consultation is available (with ancillary materials) here.

## ESMA Publishes Statement on Trading Obligation for Shares Under MiFIR After Brexit

On October 26, the European Securities and Markets Authority (ESMA) published a statement on the impact of the UK's departure from the EU on December 31, relating to the requirement for EU investment firms only to trade shares on an EU trading venue, with an EU systemic internalizer or on an equivalent third-country exchange (known as the share trading obligation or STO) under Article 23 of the Markets in Financial Instruments Regulation (MiFIR) (the Statement).

In the Statement, ESMA indicates that in the absence of an equivalence decision in respect of the UK by the European Commission, the same potential adverse effects on the application of the STO would occur as ESMA also considers what would occur in the event of a no-deal Brexit. ESMA originally published its statement on a no-deal Brexit on May 29, 2019 and reiterated in the Statement that its earlier guidance to mitigate risks for market participants remain relevant.

ESMA predicts that all EU shares with an ISIN starting with a country code corresponding to an EU member state or shares with an ISIN from Iceland, Liechtenstein or Norway (EEA ISINs) will be within the EU STO at the end of the transition period. GB ISINs, which correspond to the UK, will therefore fall outside the EU STO.

The Statement also clarifies that trading of GBP-denominated shares with an EEA ISIN on a UK trading venue is not expected to be subject to the EU STO under Article 23 of MiFIR because of its rarity. This will prevent the overlapping of STO obligations if the UK adopts an approach excluding EEA ISINs under UK STO and minimize potential disruption for market participants. However, ESMA highlights that the scope of the UK STO after the end of the transition period remains unclear at this stage.

The application of the STO to shares with a different ISIN should continue to consider the previous ESMA guidance published on November 13, 2017.

The Statement is available here.

## ESMA Adds UK Venues to Third-Country Trading Venues Under MiFIR and MiFID II

On October 27, the European Securities and Markets Authority (ESMA) published a press release announcing it had added UK venues to the list of third-country venues in respect of the opinions on post-trade transparency and position limits under Markets in Financial Instruments Regulation (MiFIR) and the revised Markets in Financial Instruments Directive (MiFID II) (the Press Release).

ESMA's positive assessment follows a statement published on October 1 on the impact of Brexit relating to transparency and the position limits provisions under MiFIR and MiFID II.

Therefore, from January 1, 2021, EU investment firms will not be obligated to make transactions public in the EU if the transaction is executed on one of the UK trading venues on the transparency list. Additionally, commodity derivative contracts traded on UK trading venues will not be recognized as economically equivalent over-the-counter contracts for the EU position limit regime.

ESMA further updated its guidance on determining third-country trading venues for the purpose of transparency under MiFIR. It includes feedback received from market participants on identification of bonds, US treasuries and treatment of venues without a market identifier code.

The deadline for applying to the transparency list is November 10.

The Press Release 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 MARKETS AND FUNDS

| | | |
|---|---|---|
| **Henry Bregstein** | +1.212.940.6615 | henry.bregstein@katten.com |
| **Wendy E. Cohen** | +1.212.940.3846 | wendy.cohen@katten.com |
| **Guy C. Dempsey Jr.** | +1.212.940.8593 | guy.dempsey@katten.com |
| **Gary DeWaal** | +1.212.940.6558 | gary.dewaal@katten.com |
| **Kevin M. Foley** | +1.312.902.5372 | kevin.foley@katten.com |
| **Mark D. Goldstein** | +1.212.940.8507 | mark.goldstein@katten.com |
| **Jack P. Governale** | +1.212.940.8525 | jack.governale@katten.com |
| **Christian B. Hennion** | +1.312.902.5521 | christian.hennion@katten.com |
| **Carolyn H. Jackson** | +44.20.7776.7625 | carolyn.jackson@katten.co.uk |
| **Susan Light** | +1.212.940.8599 | susan.light@katten.com |
| **Richard D. Marshall** | +1.212.940.8765 | richard.marshall@katten.com |
| **Paul McCurdy** | +1.212.940.6676 | paul.mccurdy@katten.com |
| **Fred M. Santo** | +1.212.940.8720 | fred.santo@katten.com |
| **Christopher T. Shannon** | +1.312.902.5322 | chris.shannon@katten.com |
| **Robert Weiss** | +1.212.940.8584 | robert.weiss@katten.com |
| **Allison C. Yacker** | +1.212.940.6328 | allison.yacker@katten.com |
| **Lance A. Zinman** | +1.312.902.5212 | lance.zinman@katten.com |
| **Krassimira Zourkova** | +1.312.902.5334 | krassimira.zourkova@katten.com |

BANKING

| | | |
|---|---|---|
| **Christina J. Grigorian** | +1.202.625.3541 | christina.grigorian@katten.com |

BREXIT/UK/EU DEVELOPMENTS

| | | |
|---|---|---|
| **Carolyn H. Jackson** | +44.20.7776.7625 | carolyn.jackson@katten.co.uk |
| **Nathaniel Lalone** | +44.20.7776.7629 | nathaniel.lalone@katten.co.uk |
| **Neil Robson** | +44.20.7776.7666 | neil.robson@katten.co.uk |

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