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DUE TO THE HOLIDAYS, *CORPORATE & FINANCIAL WEEKLY DIGEST* WILL NOT BE PUBLISHED ON DECEMBER 22 OR DECEMBER 29. THE NEXT ISSUE WILL BE DISTRIBUTED ON JANUARY 5.

DERIVATIVES

See "CFTC Approves Exemption From SEF Registration Requirements for Multilateral Trading Facilities and Organized Trading Facilities Authorized Within the EU" and "CFTC Staff Issues Interpretive Guidance Clarifying Commodity Trading Advisor Registration Requirements Resulting from the European Union's MiFID II Research Compensation Provisions for Investment Managers" in the CFTC section; and "FCA Publishes Issue 55 of Market Watch Newsletter" in the UK Developments section.

CFTC

CFTC Approves Exemption From SEF Registration Requirements for Multilateral Trading Facilities and Organized Trading Facilities Authorized Within the EU

On December 8, in response to a request by the European Commission (EC), the Commodity Futures Trading Commission issued an order exempting certain multilateral trading facilities (MTFs) and organized trading facilities (OTFs) authorized within the European Union (EU) from the requirement to register with the CFTC as swap execution facilities (SEFs).

The CFTC determined that requirements under the EU's (1) new Markets in Financial Instruments Regulation (MiFIR); (2) amended Markets in Financial Instruments Directive (MiFID II); and (3) Market Abuse Regulation establish regulatory frameworks for MTFs and OTFs which satisfy the requirements of Section 5h(g) of the Commodity Exchange Act, which provides that the CFTC may exempt from SEF registration a foreign SEF that is subject to comparable, comprehensive supervision and regulation in the foreign SEF's home country.

The order will go into effect on January 3, 2018, when requirements under MiFIR and MiFID II begin to apply. On that date, transactions that are subject to the CFTC's trade execution requirements will be able to be executed on MTFs and OTFs listed in the order. The exempted SEFs will be able to offer trading in swaps that are not subject to the CFTC's trade execution requirement to U.S. person counterparties.

The order provides that the EC may request that additional MTFs and OTFs that satisfy the requirements of Section 5h(g) of the CEA be added to the list of MTFs and OTFs that are granted exempt SEF status under the order.

The CFTC's order is available here.

CFTC Staff Issues Interpretive Guidance Clarifying Commodity Trading Advisor Registration Requirements Resulting from the European Union's MiFID II Research Compensation Provisions for Investment Managers

On December 11, at the request of the Futures Industry Association (FIA), the Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight (Division) issued an interpretive letter regarding the "solely incidental" exclusion from registration as a commodity trading advisor (CTA). Under the relevant provisions of the Commodity Exchange Act and CFTC rules, a futures commission merchant (FCM), swap dealer (SD) or introducing broker (IB) that provides commodity trading advice is required to be registered separately as a CTA unless such advice is "solely incidental" to the conduct of such registrant's business as an FCM or SD (or "solely in connection with" such registrant's business as an IB).

As of January 3, 2018, the European Union's (EU) Market in Financial Instruments Directive II (MiFID II) will require EU investment managers to unbundle payments for investment research (including commodity trading advice) from payments for execution services. FIA requested the Division to confirm that such separate payments would not affect the ability of FCMs, SDs and IBs to continue to rely on the "solely incidental" exclusion from registration as a CTA.

In its response, the Division stated that, although direct payment for commodity trading advice may be one factor in determining if a FCM, SD or IB would be required to register as a CTA, receipt of separate compensation would not be dispositive on its own. Instead, the analysis of whether the commodity trading advice is "solely incidental" to the FCM's or SD's conduct of its business, or "solely in connection with" the IB's business must be based upon the particular facts and circumstances of the relationship between the parties. The Division further noted that, although the request for interpretation was made as a result of the requirements that EU investment managers unbundle payments for investment research from payments for execution services, the interpretation "is not limited to entities who are bound by the MiFID II directive."

The CFTC interpretive letter is available here.

CFTC Requests Comment on Proposed Exemptive Order to Permit ICE Clear Credit, ICE Clear US and ICE Clear Europe to Invest Customer Funds in French and German Sovereign Debt

On December 12, the Commodity Futures Trading Commission requested comment on a proposed exemptive order, pursuant to Section 4(c) of the Commodity Exchange Act (CEA), which would grant ICE Clear Credit, ICE Clear US and ICE Clear Europe (ICE DCOs) limited exemptions from Section 4d of the CEA and CFTC Rule 1.25. Subject to the conditions set out in the proposed order, the ICE DCOs would be permitted: (1) to invest euro-denominated futures and cleared swap customer funds in sovereign debt issued by the French Republic and Federal Republic of Germany (Designated Foreign Sovereign Debt); (2) to use customer funds to enter into repurchase agreements with foreign banks and foreign securities brokers or dealers; and (3) to hold securities purchased under a repurchase agreement in a safekeeping account at a foreign bank.

The comment period for the proposed exemption ends 30 days after the proposal's publication in the *Federal Register*.

The CFTC proposed order and request for comment is available here.

CFTC Seeks Public Comment on Proposed Amendments to Chicago Mercantile Exchange Inc. Rules Regarding Direct Funding Participants

On December 14, the Commodity Futures Trading Commission requested comment on proposed amendments submitted by the Chicago Mercantile Exchange Inc. (CME) under CFTC Regulation 40.10.

The proposed amendments would create a new type of clearing membership, the "direct funding participant" (DFP). A DFP would be allowed to clear trades for its own account directly with the CME without becoming a full clearing member. To participate, a DFP's clearing obligations to the CME must be guaranteed by a clearing member that is registered with the CFTC as a futures commission merchant and entitled to directly clear the relevant products.

Comments should be submitted on or before January 12, 2018 through the CFTC's Comment Online process.

The CFTC's press release available here.

The CME's rule submission is available here.

UK DEVELOPMENTS

FCA Publishes Issue 55 of Market Watch Newsletter

On December 12, the UK Financial Conduct Authority (FCA) published issue 55 of Market Watch, its newsletter on market conduct and transaction reporting issues.

Similar to Issue 54 of Market Watch (reported in the *Corporate & Financial Weekly Digest* edition of November 10, 2017), Issue 55 contains articles of relevance to the implementation of the revised Markets in Financial Instruments Directive (MiFID II) and Markets in Financial Instruments Regulation (MiFIR). The articles provide a useful reminder of the following areas in the lead up to the implementation of MiFID II and MiFIR on January 3, 2018:

1. Transaction reporting at the block or allocation level—transaction reports of an investment firm in a chain should accurately reflect the elements of the execution that have been confirmed as an execution by their immediate counterparty:
    a. if the immediate counterparty confirms the block as the execution, the investment firm should report the block;
    b. if each allocation or market execution is confirmed as an execution, then the investment firm should also report each allocation or market execution.
2. Applicable legislation from January 3, 2018—firms are reminded of legislation relating to transaction reporting, order record keeping for trading venues and clock synchronization.
3. Data Reporting Service Providers (DRSPs) supervision forms—DRSPs are required to notify the FCA of their initial authorization and other notifications, all of which form the basis of the FCA's supervisory forms, such as the FCA's Material Change in Information Form.
4. Transitional arrangements relating to transaction reporting—investment firms are reminded that they have an obligation to report transactions as quickly as possible and no later than the close of the working day following the day that the transaction took place (T+1).
5. Application of the Market Abuse Regulation to Emission Allowance Market Participants (EAMPs)—EAMPs who meet the thresholds of 6 million tonnes of carbon dioxide equivalent per year or a rated thermal input of 2,430 megawatts, are reminded that they will need to disclose inside information on emission allowances they hold. EAMPs must also notify the FCA of any delayed notification. Additionally, persons discharging managerial responsibilities within EAMPs will need to notify the FCA of transactions conducted on their own account relating to emission allowances, auction products based on them, or derivatives related to them.

Issue 55 of Market Watch is available here.

FCA Consults on Transitioning Firms and Individuals to SM&CR

On December 13, the UK Financial Conduct Authority (FCA) published three consultation papers (CPs) on the transition from its existing Approved Persons Regime (APR) to the new Senior Managers and Certification Regime (SM&CR).

The CPs follow the FCA's July 2017 consultation papers, which consulted on extending the SM&CR regime to all regulated firms (including both FCA solo-regulated firms and insurers) (for further information, please see the *Corporate & Financial Weekly Digest* of July 28, 2017). However, in these most recent consultations, the FCA accepts that proportionate approaches are required to extend the SM&CR to different firms.

The FCA also is consulting on its plans to offer guidance on the introduction of the "duty of responsibility" for FCA solo-regulated firms and insurers (such duty of responsibility currently only applies to senior managers of banks). Under the duty of responsibility, senior managers are both responsible and accountable for their business. This means that the FCA can take action against the senior manager responsible for a firm's contravention of an FCA requirement relating to the part of the business the senior manager is responsible for. In doing so, the FCA would have to be able to prove that the senior manager did not take reasonable steps to avoid the occurrence or continuation of a breach.

Notably, the CPs also state that for the majority of FCA regulated firms, current senior managers will be converted automatically into the relevant senior management function, meaning that there will be no need for these firms to submit an application. Instead, the FCA suggests that these firms focus on embedding the cultural changes that the SM&CR introduces, as well as ensuring their respective staffs are aware of their responsibilities. Furthermore, FCA solo-regulated firms also have up to 12 months from the SM&CR's introduction to certify their employees as "fit and proper."

The starting date for SM&CR has yet to be set; however, the FCA states that it is hoping to finalize its approach in the summer of 2018, and will announce the date for implementation in due course (likely sometime in 2019). Firms can comment on the CPs until February 21, 2018.

The CPs are available here.

FCA Publishes "Dear CEO" Letter on Payment for Order Flow

On December 13, the UK Financial Conduct Authority (FCA) published a "Dear CEO" letter expressing its concerns over the practice of brokers demanding payments from counterparties in exchange for conducting client business with them, also known as payment for order flow (PFOF). The letter follows the FCA's September 2016 update, published in their Market Watch newsletter, which reiterated the requirement of firms to continue to meet their obligation with regards to conflicts of interest management in the FCA's Systems and Controls Handbook Rules (SYSC) (for further information, please see the *Corporate & Financial Weekly Digest* of September 30, 2016).

PFOF involves firms (most often brokers) executing client orders and charging and receiving fees for execution from: (1) the client initiating the order; and (2) the counterparty to the trade (often market makers). In the letter, the FCA emphasizes that such arrangements introduce a conflict of interest which ultimately can cause harm to both clients and markets. The FCA reiterates in the letter that PFOF substantially undermines a broker's ability to act as a good agent. Similarly, it is made clear that any firms that continue to charge PFOF will ultimately breach the new standards implemented in the revised Markets in Financial Instruments Directive (MiFID II), which goes into effect on January 3, 2018 (i.e., PFOF prevents best execution from occurring).

The FCA highlights Article 27(2) of MiFID II, which relates to restrictions on third-party payments when executing orders on behalf of retail and professional clients. The FCA also notes that MiFID II will ultimately strengthen conflicts of interest requirements, which will be of particular significance for firms providing investment services to eligible counterparties, but also of relevance to professional and retail client business.

The letter also provides examples of structures which seek to avoid requirements preventing PFOF that the FCA has become aware of, specifically:

- linking charges to market makers for non-execution services, such as research products or market analysis software, to the amount of business transacted, in an attempt to replicate the PFOF previously received, or insisting that market makers subscribe to such non-essential services to continue to see the broker's flow;
- establishing arrangements with intermediaries or overseas affiliates with a view to getting around FCA requirements on conflicts of interest, inducements and best execution in order to continue to charge PFOF from market makers; and
- only contacting market makers who have been required to send alternative order flows to brokers (which would not normally be executed through brokers, e.g., hedge trades) for the sole purpose of generating a fee to replicate PFOF.

Significantly, the letter also states that market makers who are approached by brokers with proposals that attempt to circumvent these regulations must not engage in these arrangements, and adds a new requirement that market makers should report any such attempts to the FCA.

The letter is available here.

EU DEVELOPMENTS

ESMA Provides Update on MiFID II Registers

On December 8, the European Securities and Markets Authority (ESMA) published a press release confirming that it will provide updated registers in line with the revised Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR).

On January 3, 2018, the effective date of MiFID II and MiFIR, ESMA will update existing registers and provide for the new registers required under MiFID II. However, ESMA states that a new register release will not be fully available because of IT functionality until later in Q1 2018. As an interim solution, ESMA will publish register information on a fortnightly basis. The list of affected registers is as follows:

- regulated markets;
- multilateral trading facilities;
- organized trading facilities (new for MiFID II);
- systematic internalizers;
- approved publication arrangements (new for MiFID II);
- consolidated tape providers (new for MiFID II);
- approved reporting mechanisms (new for MiFID II); and
- suspension and restorations.

The current list of central counterparties will be removed and the list of shares admitted to trading on EU regulated markets will be replaced.

ESMA encourages market participants to review the data provided and contact their national competent authority in case of any discrepancies.

The press release is available here.

European Commission Implementing Decisions Recognizing Certain Third-Country Equities Markets Under MiFID II Published in *OJ*

On December 14, the following decisions (Implementing Decisions) on the equivalence of the legal and supervisory frameworks of certain third countries, in accordance with Article 25(4)(a) of the revised Markets in Financial Instruments Directive (MiFID II), were published in the *Official Journal of the EU* (*OJ*):

- European Commission Implementing Decision ((EU) 2017/2318) on the equivalence of the legal and supervisory framework in Australia applicable to financial markets in accordance with MiFID II.
- European Commission Implementing Decision ((EU) 2017/2319) on the equivalence of the legal and supervisory framework applicable to recognised exchange companies in Hong Kong Special Administrative Region in accordance with MiFID II.
- European Commission Implementing Decision ((EU) 2017/2320) on the equivalence of the legal and supervisory framework of the United States of America for national securities exchanges and alternative trading systems in accordance with MiFID II.

Article 23(1) of the Markets in Financial Instruments Regulation (MiFIR) requires investment firms to undertake trades in certain shares only on regulated markets, multilateral trading facilities (MTFs), systematic internalizers (SIs) or third-country trading venues that have been assessed by the European Commission as equivalent in accordance with Article 25(4)(a) of MiFID II (as amended by Directive (EU) 2016/1034).

The Implementing Decisions deem the legal and supervisory frameworks of Australia, Hong Kong and the US applicable to the markets specified in each of the Implementing Decisions to be equivalent to the EU's frameworks for the purposes of Article 25(4)(a) of MiFID II.

The Implementing Decisions go into effect on December 15.

Delegated Regulation Amending MiFID II Definition of Systematic Internalizer Published in *OJ*

On December 13, as reported in the *Corporate & Financial Weekly Digest* edition for September 1, 2017, Delegated Regulation (EU) 2017/2294 amending Delegated Regulation (EU) 2017/565 as regards the specification of the definition of systematic internalizers for the purposes of the revised Markets in Financial Instruments Directive (Delegated Regulation), was published in the *Official Journal of the European Union* (*OJ*).

The Delegated Regulation is available here.

ESMA Updates Q&A on Benchmark Regulations

On December 14, the European Securities and Markets Authority (ESMA) published an updated version of its Questions & Answers (Q&As) on the implementation of the EU Benchmark Regulation (BMR). The Q&As aim to promote common supervisory approaches and practices in the day-to-day application of the BMR.

The Q&As include new answers on the following two topics:

1. Authorization and registration—applicability of BMR requirements
    a. Q&A 6.1 addresses the issue of Article 34(2) of the BMR requiring that "an authorized or registered administrator shall comply at 'at all times' with the conditions laid down" in the BMR. ESMA's opinion is that the wording of this provision suggests that only an authorized or registered administrator is required to comply with the BMR's conditions which, in this context, should be understood to encompass the requirements imposed by the BMR on administrators.
    b. The same Q&A addresses the issue of Article 34(4) of the BMR, which sets out that "the applicant [index provider] shall provide all information necessary to satisfy the competent authority that the applicant has established, at the time of authorization or registration, all the necessary arrangements to meet the requirements laid down in [the BMR]". ESMA's view is that this is a clear indication that index providers must be in a position to meet the requirements of the BMR at the time of authorization or registration, to then become authorized or registered. Therefore, EU index providers are required to comply with the obligations laid down in the BMR only at the time of authorization or registration.
2. Requirements for users of benchmarks—written plans for the cessation or material changes of a benchmark
    a. In Q&A 7.1, ESMA confirms that Article 28(2) of the BMR applies from January 1, 2018. Therefore, from this date, supervised entities, other than administrators, will be required to produce and maintain robust written plans (Plans) setting out the actions that they would take in the event of a benchmark they are using materially changing or ceasing to be provided.
    b. ESMA considers that supervised entities, other than administrators, are required to reflect the Plans in contracts entered into with clients after January 1, 2018. For contracts entered into prior to January 1, 2018 and still existing at that date, ESMA expects supervised entities, other than administrators, to amend them where practicable and on a best efforts basis.

The updated version of the Q&As is available here.

ESMA Publishes New/Updated Q&As on MiFID II, Commodity Derivatives, EMIR and MAR

On December 14 and 15, the European Securities and Markets Authority (ESMA) published a number of new and updated question and answer documents (Q&As) relating to, among other things, the revised Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR).

The Q&As relate to the following topics:

- MiFID II and MiFIR post-trading topics: This Q&A has been updated to include a new question and answer on indirect clearing, specifically on the treatment of certain forms of segregation level for indirect clearing account in the event of a clearing member default.

- MiFID II and MiFIR commodity derivatives topics: This update includes new answers regarding position limits and position reporting.
- Implementation of the European Market Infrastructure Regulation (EMIR): This Q&A has been updated to include a word-for-word reflection of the new MiFID II post-trading Q&A question, above. It also includes a new question relating to trade repositories.
- The Market Abuse Regulation (MAR): This Q&A now features a new question relating to emission allowances and emission allowances market participants.

For additional coverage on financial and regulatory news, visit ***Bridging the Week***, authored by Katten's Gary DeWaal.

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