Katten
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BROKER-DEALER

FINRA Seeks Comment on Rule Proposal Regarding High-Risk Brokers

On May 30, the Financial Industry Regulatory Authority published Regulatory Notice 18-16, which seeks comment on proposed rule amendments that impose additional restrictions on members who have brokers who previously engaged in significant misconduct. FINRA seeks comments on the following proposals:

- The Rule 9200 Series (Disciplinary Proceedings) and the 9300 Series (Review of Disciplinary Proceedings by National Adjudicatory Council and FINRA Board; Application for SEC Review) to allow a Hearing Panel to impose restrictions on member and broker activities while a disciplinary matter is on appeal with the National Adjudicatory Council, and to require members to adopt heightened supervisory procedures for brokers while such appeal is pending;

- The Rule 9520 Series (Eligibility Proceedings) to require members to adopt heightened supervisory procedures for brokers while a statutory disqualification eligibility request is under FINRA review;

- Rule 8312 (FINRA BrokerCheck Disclosure) to disclose the status of a member as a "taping firm" under Rule 3170 (Tape Recording of Registered Persons by Certain Firms); and

- The NASD Rule 1010 Series (Membership Proceedings) to require members to seek a materiality consultation from FINRA's Department of Member Regulation through the Membership Application Program Group when a natural person has criminal or disciplinary history before becoming an owner, control person, principal or registered person of an existing member firm.

The comment period for these proposals expires on June 29.

Aside from the rule proposals, FINRA has published Regulatory Notice 18-15, which describes members' existing obligations to implement heightened supervisory procedures under Rule 3110 (Supervision) for high-risk brokers.

Regulatory Notice 18-15 is available here. Regulatory Notice 18-16 is available here.

FINRA Revises the Sanction Guidelines

On May 2, the Financial Industry Regulatory Authority announced revisions to its Sanction Guidelines that will instruct disciplinary adjudicators to consider customer-initiated arbitrations resulting in adverse arbitration awards or settlements when assessing sanctions.

The Sanction Guidelines currently explain that a respondent's sanctions should be higher if the respondent's disciplinary history is similar to the misconduct in the current case or evidences a "reckless disregard for regulatory requirements, investor protection, or market integrity." The revised guidelines will now require adjudicators to consider both disciplinary history and customer-initiated arbitrations that result in adverse arbitration awards or settlements when evaluating a respondent's background.

The revised Sanction Guidelines take effect for all complaints filed in FINRA's disciplinary system beginning on June 1. The Sanction Guidelines are available here.

FINRA Extends Effective Date of Margin Requirements for Covered Agency Transactions

In 2016, the Financial Industry Regulatory Authority announced the Securities and Exchange Commission's approval of a rule change to establish margin requirements for Covered Agency Transactions. These transactions include (1) To Be Announced transactions, inclusive of adjustable rate mortgage transactions; (2) Specified Pool Transactions; and (3) transactions in Collateralized Mortgage Obligations, issued in conformity with a program of an agency or Government-Sponsored Enterprise, with forward settlement dates. Katten provided coverage of the rule amendments in the September 22, 2017 edition of *Corporate & Financial Weekly Digest*.

The new requirements will now take effect on March 25, 2019. Previously, the requirements were scheduled to go into effect on June 25, 2018.

For more information, please see Regulatory Notice 18-18, which is available here.

CFTC

CFTC Staff Issues Interpretive Guidance Regarding Aggregation by Passive Pool Investors

On May 2, the Commodity Futures Trading Commission's Division of Market Oversight responded to a request for an interpretation regarding CFTC Rule 150.4(b)(1), which provides an exception from the CFTC's speculative position limit aggregation rules for certain "passive" investors in commodity pools. Generally, for purposes of calculating compliance with speculative position limits, the CFTC's rules require persons to aggregate "all positions in accounts for which [such] person, by power of attorney or otherwise, directly or indirectly controls trading or holds a 10 percent or greater ownership or equity interest." However, in recognition of the limited information and control typically provided to unaffiliated investors in collective investment funds, the rules recognize a limited exception for such investors.

In this case, the requested interpretation addressed a situation in which a large institutional investor, through its significant (but passive) ownership stake in a commodity pool that employs a private equity or venture capital investment strategy, might indirectly own more than 10 percent of an underlying "portfolio company" in which the pool was invested. Specifically, the investor sought clarification that it would not be required to aggregate any commodity interest positions that might be held by operating businesses in which the pool had invested—for example, businesses in the agricultural and energy industries. In its interpretation, the Division clarified that, so long as the investor was otherwise eligible for the exception under Rule 150.4(b)(1) (that is, a passive investor not specifically precluded from relying on the exception pursuant to CFTC Rules 150.4(b)(1)(i)-(iii)), and did not either control trading for, or have another relationship with, the portfolio company that would trigger aggregation, the investor would not be required to "look through" the pool to aggregate the positions of its underlying portfolio companies. The Division noted, however, that its interpretation would not apply in a situation in which a passive investor "invests in alternative or parallel funds with the intention to circumvent position limits."

The Division's response letter is available here.

UK DEVELOPMENTS

PRA Publishes Pillar 2 Reporting Requirements Policy Statement

On April 30,the UK Prudential Regulation Authority (PRA) published a policy statement regarding updates to the Pillar 2 reporting requirements of the EU Capital Requirements Regulation. The policy statement is relevant to banks, building societies and PRA-designated investment firms.

The policy statement refers to the following appendices:

- Appendix 1—final rules amending the Glossary, Regulatory Reporting Part, Reporting Leverage Ratio Part and Reporting Pillar 2 Part of the PRA Rulebook (available here);

- Appendix 2—final data item PRA111, which captures stress testing data currently included in a firm's Internal Capital Adequacy Assessment Process documents (available here);

- Appendix 3—updated supervisory statement on Pillar 2 reporting (available here); and

- Appendix 4—updated statement of policy regarding the PRA's methodologies for setting Pillar 2 capital (available here).

The final rules, updated supervisory statement and updated statement of policy will go into effect on October 1.

The PRA's policy statement is accessible here.

EU DEVELOPMENTS

ESMA Publishes First Liquidity Assessment for Bonds Subject to MiFID II Transparency Requirements

On May 2, the European Securities and Markets Authority (ESMA) published its first liquidity assessment for bonds that are subject to the pre- and post-trade requirements of the revised Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation.

Of the 71,000 bonds in the European bond market assessed for the first quarter of 2018, 220 were determined sufficiently liquid to be subject to MiFID II's real-time transparency requirements. The criteria for assessing liquidity include the number of days traded per quarter and daily average trading activity (trades and notional amounts).

ESMA notes that the data received so far is not fully complete for the majority of instruments. As a result, ESMA has identified fewer liquid instruments than in its earlier transitional transparency calculations. It expects to correct and update this, on an ad hoc basis, as additional data and corrections are submitted.

In addition, a regular update to the bond market liquidity assessment will occur quarterly.

For ESMA's press release, click here.

Details of the bonds calculated as exceeding the liquidity threshold can be found via ESMA's Financial Instruments Transparency System, which is available here.

LIBOR Administrator, IBA, Becomes Regulated Benchmark Administrator

In an April 30 press release, Intercontinental Exchange Inc. (ICE) announced the authorization of its subsidiary, ICE Benchmark Administration Limited (IBA), as a regulated benchmark administrator under the EU Benchmarks Regulation.

The authorization was granted on April 27by the UK Financial Conduct Authority as the United Kingdom's national competent authority.

IBA is responsible for the administration of the London Interbank Offered Rate LIBOR), the LBMA Gold and Silver Prices and ICE Swap Rate.

ICE's press release, announcing IBA's authorization, 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 DEVELOPMENTS

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