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BROKER-DEALER

SEC Releases Statement on Platforms Trading Digital Assets

On March 7, the Securities and Exchange Commission released an advisory regarding platforms used to trade digital assets. The SEC expressed concern that, in light of the rise in popularity of trading digital assets, including coins and tokens in initial coin offerings, investors could mistakenly believe that platforms used to trade such assets are registered with the SEC or are otherwise regulated. In order to protect investors, the SEC indicated that it plans to focus on such platforms and their compliance with federal securities laws.

One section of the SEC's statement is directed towards investors. The SEC notes that many platforms refer to themselves as "exchanges," which does not necessarily mean such platforms are regulated or that information from such platforms has the same integrity as information from registered exchanges. The SEC encourages investors to use registered platforms or entities, such as national securities exchanges, alternative trading systems and broker-dealers, to obtain the protections of federal securities laws and SEC oversight.

The second section of the SEC's statement addressing market participants that operate online platforms cautions such persons that, depending on whether the digital assets traded on such platforms are considered securities, SEC exchange registration requirements or requirements associated with operating as an alternative trading system may be triggered. The SEC also noted that trading platforms may not be considered exchanges under federal securities laws, but may be required to register in another capacity, such as a broker-dealer, transfer agent or clearing agency, depending on the functions they perform.

The SEC's announcement is available here.

FINRA Updates Criteria Regarding Business Continuity and Disaster Recovery Testing

On March 7, the Financial Industry Regulatory Authority published Regulatory Notice 18-09, which expands the criteria FINRA will use to designate member firms that must participate in business continuity and disaster recovery testing (BC/DR testing). Regulation SCI requires FINRA to designate firms that must participate in BC/DR testing. Regulatory Notice 18-09 indicates that the following firms must engage in BC/DR testing: firms that account for at least 5 percent or more of the average dollar volume of Treasury securities reported to the Trade Reporting and Compliance Engine (TRACE) over the six-month period preceding the designation (provided that the cumulative dollar volume represented by all such firms amounts to at least 50 percent of all dollar volume in Treasury securities reported to TRACE during the applicable six-month period). The Regulatory Notice indicates that FINRA expects to make designations in April and that testing will occur in October.

Regulatory Notice 18-09 is available here.

UK DEVELOPMENTS

FCA Webpage on Capital Requirements Adds Important Transitional Arrangement

On March 5, the UK's Financial Conduct Authority (FCA) published a webpage explaining that Article 493 of the Capital Requirements Regulation (CRR) has been updated by Article 1(2) of the IFRS 9 Regulation (an International Financial Report Standard promulgated by the International Accounting Standards Board). The CRR now incorporates a transitional arrangement, allowing firms such as IFPRU investment firms (as defined below), to be exempted from large exposure limits, subject to the approval of the relevant national competent authorities (NCAs).

IFPRU investment firms are FCA-regulated firms that have their head office in the United Kingdom and are not BIPRU firms (i.e., not engaged in investment activities or services under the revised Markets in Financial Instruments Directive (MiFID II)). This designation includes the majority of proprietary trading firms.

Under the transitional arrangement, firms may be allowed to incur, subject to the relevant NCAs' discretion, large exposure limits in relation to certain public sector debt of member states in the European Union, up to the following limits:

- 100 percent of the IFPRU investment firm's Tier 1 capital until December 31, 2018;
- 75 percent of the IFPRU investment firm's Tier 1 capital until December 31, 2019; and
- 50 percent of the IFPRU investment firm's Tier 1 capital until December 31, 2020.

The transitional arrangement will last three years, beginning January 1, 2018, for exposures of this type, so long as they:

- were incurred on or after December 12, 2017;
- would have been assigned a risk weight of 0% in accordance with the version of Article 495(2) (concerning the treatment of equity exposures under the internal ratings based approach) of the CRR that was in force on December 31, 2017.

The FCA's webpage on the transitional arrangement is available here.

Article 1(2) of the IFRS 9 Regulation, updating Article 493 of the CRR, is available here.

UK Government Guarantees Gibraltar Financial Services Firms' Access to UK Markets

On March 8, the UK government's Department for Exiting the European Union (DExEU) published a statement guaranteeing Gibraltar financial services firms with continued access to UK markets from now until 2020.

DExEU goes on to state that, in the meantime, the UK government will work closely with the government of Gibraltar to design a replacement framework that will last beyond 2020. It is intended that this framework will be based on common high standards of regulation and regulatory enforcement, and underpinned by modern arrangements for information-sharing, transparency and regulatory cooperation.

The statement is available here.

FCA Confirms Amendment to the LEI Validation Rule Effective March 2018

On March 2, the UK's Financial Conduct Authority (FCA) updated its webpage for firms subject to transaction reporting obligations under the revised Markets in Financial Instruments Directive.

The European Securities and Markets Authority's (ESMA) statement on December 20, 2017, regarding transition measures (for further information please see the January 5 edition of *Corporate & Financial Weekly Digest*), forced a temporary change to the FCA's legal entity identifier (LEI) validation rule in its transaction reporting system, the market data processor (MDP). Subsequently, in its response to ESMA's statement, the FCA confirmed that this change would not take place before January 3.

On its updated webpage, the FCA confirms that the change will be implemented in the MDP on March 10. Beginning March 12, firms should (re)submit any outstanding transaction reports for which the trade date precedes the LEI registration date.

The FCA's updated webpage is available here.

The FCA's response is available here.

Mark Carney Criticizes Cryptocurrencies in Speech About the Future of Money

On March 2, the governor of the Bank of England (BoE), Mark Carney, delivered a speech entitled "The Future of Money."

Mr. Carney highlighted shortcomings of cryptocurrencies and the need for authorities to isolate, regulate or integrate them, with his preference being regulation. Mr. Carney stated that "isolation risks foregoing potentially major opportunities from the development of the underlying payment technologies." He also suggested that cryptocurrencies do not pose material risks to financial stability due to their relative insignificance.

After an initial historical background regarding the nature of money, Mr. Carney credited the confidence and ease with which citizens can use sterling to the support of the BoE through:

- its real-time gross settlement (RTGS) payment system;
- the Monetary Policy Committee's oversight of monetary policy;
- the Prudential Regulation Committee's regulation of banks and building societies;
- the Financial Policy Committee's wide powers to counteract systemic risks; and
- the anti-counterfeiting measures of its durable banknotes.

Mr. Carney emphasized that current cryptocurrencies do not represent the future of money; he suggested that, in short, they are "failing" to fulfill the role of money. This was justified on the basis that cryptocurrencies are poor short-term stores of value, inefficient media of exchange and virtually non-existent units of account—i.e., they fall short on Adam Smith's criteria.

Mr. Carney preferred the term "crypto-asset" throughout the latter half of the speech to reinforce this point; however, he indicated that crypto-assets were likely to foreshadow the future of money in three ways.

Firstly, crypto-assets represent a larger shift in society to "a series of distributed peer-to-peer connections."

Secondly, the distributed ledger technology (DLT) underlying crypto-assets "is throwing down the gauntlet to the existing payment systems" by:

- increasing efficiency of managing data;
- eliminating central points of failure;
- enhancing transparency and auditability; and
- widening the use of automatic processes, such as "smart contracts," which reduce the potential for human error or ambiguity.

Thirdly, crypto-assets raise questions about whether their infrastructure could be combined with the trust inherent in existing fiat currencies to create a central bank digital currency.

The speech closed by tying the potential DLT evolution to recent innovations by the BoE, in particular, the BoE's overhaul of RTGS. Mr. Carney identified securities settlement as particularly "ripe for innovation" by the new RTGS, which could significantly reduce settlement times.

The speech is available to read and watch here.

EU/BREXIT DEVELOPMENTS

EC Publishes Notices on the Consequences of Brexit for the Financial Services Sector

On February 8, the European Commission's Directorate General for Financial Stability, Financial Services and Capital Markets (DG FISMA) published a webpage containing a number of notices to financial services stakeholders highlighting the consequences of Brexit on:

- markets in financial instruments;
- banking and payment services;
- post-trade financial services;
- asset management;
- credit rating agencies;
- insurance/reinsurance; and
- statutory audit.

The notices, which various EC Directorates General are publishing in relation to different sectors, aim to set out the consequences of the United Kingdom withdrawing from the European Union and becoming a third- country, and UK-based firms losing their EU authorization under financial services legislation, as well as outlining the necessary preparations that stakeholders should make.

Key points under the notices include the following with respect to:

- Markets in financial instruments: UK-based central counterparties (CCPs) will no longer benefit from the open and non-discriminatory access to EU trading venues and to EU benchmarks;
- Asset management: Branches of UK managers in the European Union will be treated as branches of a non-EU alternative investment fund manager as of the date of the United Kingdom's withdrawal from the European Union, and such branches will be subject to the requirements of national private placement regimes, where available;
- Post-trade financial services: Derivatives traded on a UK-regulated market will no longer fulfill the definition of exchange-traded derivatives under EU law, therefore they will be subject to the European Market Infrastructure Regulation requirements for OTC transactions;
- Banking and payment services: The prudential treatment of exposures to third parties established in the United Kingdom will be affected; for example, the assessment of the eligibility of liabilities for the minimum requirement for own funds and eligible liabilities may be affected for those liabilities issued under UK law.

More generally, the European Commission explains in each notice that, unless a ratified withdrawal agreement establishes another date, all primary and secondary EU law will cease to apply to the United Kingdom beginning March 30, 2019.

The EC's webpage with the notices is available here.

ESMA Publishes Trading Volumes and Calculations Regarding the Double Volume Cap Under MiFID II

On March 7, the European Securities and Markets Authority (ESMA) published trading volumes and calculations regarding the double volume cap (DVC) under the revised Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR).

The DVC mechanism is designed to limit the amount of "dark" trading in equities, meaning trading that relies on the reference price waiver and the negotiated transaction waiver to avoid MiFIR transparency requirements.

As explained in its January 2018 press release, ESMA delayed the implementation of the DVC until March 2018 due to problems relating to the quality and completeness of data. ESMA has since worked with national competent authorities (NCAs) and the European Union to solve these issues.

ESMA has now published the DVC calculations for January 2018 (relating to trading data from January to December 2017, totalling 18,644 instruments) and February 2018 (relating to trading data from February 2017 to

January 2018, totalling 14,158 instruments). Using the data, the two caps will limit dark trading in equity and equity-like instruments, as follows:

- 17 instruments for January 2018 and 10 for February 2018, for which their percentage of trading on a single trading venue under the waiver goes beyond 4 percent of the total volume of trading in those financial instruments across all EU trading venues over the previous 12 months; and
- 727 instruments for January 2018 and 633 for February 2018, for which their percentage of trading across all trading venues under the waivers goes beyond 8 percent of the total volume of trading in that financial instrument across all EU trading venues over the previous 12 months.

Where the caps were exceeded, the NCAs would suspend the use of waivers in those financial instruments within two working days. The use of the waivers would, therefore, be suspended for such instruments for a period of six months, beginning March 12.

ESMA intends to publish on April 9 the applicable DVC data for March 2018. This will also include any data received after the data-submission deadline of March 1.

ESMA's press release is available here.

ESMA's DVC calculations for January 2018 and for February 2018 are available here.

European Commission Publishes FinTech Action Plan

On March 8, the European Commission issued a press release unveiling a 23-step action plan on how to harness the opportunities presented by technology-enabled innovation in financial services (FinTech). The European Commission identifies two goals: (1) capitalizing on fast-moving progress in technology to improve the European Union's economy, and (2) incentivizing a more competitive and innovative European financial sector.

The action plan's steps fall under the three categories listed below; the most notable steps are highlighted under each category:

Enable innovative business models to reach EU scale

- Presenting a proposal for EU passporting in relation to crowdfunding;
- Considering the relevance of the current EU regulatory framework to cryptocurrencies and initial coin offerings, with a Q2 2018 roundtable and report later in 2018 as a further step;
- Establishing foundational steps for a European open banking eco-system; and
- Continuing the use of "regulatory sandboxes" (i.e., experimentation frameworks for innovative firms). As a separate step, the EC will present a blueprint with recommendations for regulatory sandboxes by the Q4 2018.

Support the uptake of technological innovation in the financial sector

- Establishing an expert group to review the EU financial services regulatory framework by Q2 2019 for the use of disruptive technologies, such as distributed ledger technologies (DLT) and artificial intelligence;
- Removing existing obstacles that hinder the greater use of outsourcing to cloud services;
- Considering increased digitization of regulated information on EU-regulated market-listed companies; and
- Hosting an EU FinTech lab where EU and national authorities can engage with technology solution providers in a neutral, non-commercial space during targeted sessions.

Enhance security and integrity of the financial sector

- The European Commission will hold a public-private workshop in the Q2 2018 and consider existing practices, with a view to increasing information sharing on cyber threats among the financial sector by addressing existing barriers; and

- Conducting a cost-benefit analysis of developing a coherent cyber threat testing framework for significant market participants and infrastructures across the EU financial sector.

The action plan is available here.

The press release is available here.

A fact-sheet summary of the action plan 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/BREXIT DEVELOPMENTS

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