

DERIVATIVES

See “European Parliament Adopts EMIR 2.1 Proposal” in the EU Developments section.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Releases Updates to Custody Rule Frequently Asked Questions

On June 5, the Securities and Exchange Commission’s Division of Investment Management staff (Staff) updated its “Staff Responses to Questions About the Custody Rule” (Custody Rule FAQs). The Custody Rule FAQs address questions regarding Rule 206(4)-2 of the Investment Advisers Act of 1940, the “Custody Rule.” The update to the Custody Rule FAQs specifically addressed concerns regarding the Staff’s February 2017 Guidance Update titled: “[Inadvertent Custody: Advisory Contract Versus Custodial Contract Authority](#)” (Guidance Update). The Guidance Update indicated that investment advisers may inadvertently have custody (Inadvertent Custody) of client assets due to provisions in a separate custodial agreement entered into between its advisory client and a qualified custodian that allow the investment adviser to instruct the custodian to disburse, or transfer, client funds or securities.

The June 2018 update to the Custody Rule FAQs clarified that if an investment adviser does not have a copy of a client’s custodial agreement, and does not know, or have reason to know whether the agreement would give the investment adviser Inadvertent Custody, the investment adviser will not need to comply with the Custody Rule with respect to such client account as long as the sole basis for custody of such account is Inadvertent Custody. In addition, the investment adviser would not need to indicate in its Form ADV that it has custody of such client’s assets. However, the Staff stated that this relief would not apply if the investment adviser recommended, requested or required a client’s custodian.

The Custody Rule FAQs are available [here](#). The revised FAQs are Question II.11 and Question 11.12.

SEC Charges 13 Private Fund Advisers for Repeated Form PF Filing Failures

On June 1, the Securities and Exchange Commission announced settlements with 13 registered investment advisers who repeatedly failed to annually file or update reports on Form PF. Form PF is a confidential reporting form required for private fund investment advisers managing \$150 million or more of assets. The SEC began requiring that applicable registered investment advisers file an annual Form PF in 2012 under Rule 204(b)-1 of the Investment Advisers Act of 1940. Form PF requests, among other things, information about private funds’: asset values, investment strategies, performance, and use of borrowed money and derivatives. The SEC uses Form PF data to monitor industry trends, inform rulemaking, identify compliance risks, and target examinations and enforcement investigations. The SEC also shares Form PF data with the Financial Stability Oversight Council (FSOC), which assists FSOC in evaluating systemic risks potentially caused by hedge funds and other private funds.

The settlement orders found that the 13 investment advisers were delinquent in their filings over multi-year periods. Without admitting or denying the SEC findings, the investment advisers each agreed to be censured,

cease and desist and pay a civil penalty of \$75,000. The investment advisers also remediated their failures by making the necessary filings during the course of the investigation.

The SEC press release, as well as links to the orders, are available [here](#).

UK DEVELOPMENTS

FCA Confirms Change of London Address

Following the UK Financial Conduct Authority's (FCA) announcement in a consultation paper it first published on March 2, its London office will relocate over summer 2018.

From July 1, the FCA's new registered address will be:

Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

References to the FCA's current addresses in Canary Wharf, London, beginning 25 The North Colonnade and 1 Canada Square, must be updated by regulated firms from July 1 in any communications with clients and in printed material as soon as reasonably practicable.

For the references which are being updated in the FCA Handbook (also effective July 1), click [here](#).

The FCA's March 2 consultation paper is available [here](#).

FCA Publishes "Dear CEO" Letter on Cryptoassets and Financial Crime

The UK Financial Conduct Authority (FCA) has published a "Dear CEO" letter dated June 11, on cryptoassets and financial crime. The purpose is to ensure that banks adequately manage the financial crime risks associated with cryptoassets. The FCA defines cryptoassets as any publicly available medium of exchange that features a distributed ledger and a decentralized system for exchanging value.

According to the FCA's letter, banks should conduct enhanced client due diligence where the (prospective) client's activities include operating cryptoasset exchanges, trading involving wealth derived from cryptoassets and any initial coin offering (ICO)-related activity.

The examples of appropriate steps set out in the letter are:

1. training staff on cryptoassets to facilitate the identification of high risks;
2. keeping financial crime frameworks up to date in light of any crypto-related activities of the firm and the speed of developments in the area;
3. engaging with clients to understand their business and any relevant risks;
4. conducting due diligence of key individuals in the client's business;
5. evaluating any cryptoasset exchange clients' own client due diligence arrangements; and
6. for clients involved in ICOs, considering the issuance's investor-base, organizers, the functionality of tokens (including intended use) and the jurisdiction of issue.

The FCA's predecessor, the Financial Services Authority (FSA), published a review on banks' defenses against investment fraud in June 2012, which the FCA's letter refers to for discussion of best practices that also can be applied to ICOs. The examples are set out at the end of each chapter of the FSA's review and are consolidated in section 11, available [here](#).

The FCA's letter is available [here](#).

UK Money Market Funds Regulations 2018 Published

On June 11, the Money Market Funds Regulations 2018 (MMFR) were published and set to go into effect on July 21. The MMFR relates to the EU Regulation on Money Market Funds (EU MMF Regulation), and ensures the UK Financial Conduct Authority (FCA) can authorize money market funds (MMFs) and enforce the MMFR from the day that the EU MMF Regulation goes into effect.

The MMFR amends the Financial Services and Markets Act 2000 (FSMA) to allow the FCA to authorize funds as MMFs, as well as to exercise regulatory powers over MMFs. It further amends FSMA to grant the FCA powers to authorize, and intervene in respect of, unit trusts and contractual schemes (both being subsets of MMFs).

The MMFR also introduces changes to the following delegated legislation:

1. Open-Ended Investment Companies Regulations 2001 to permit open-ended investment companies (OEICs) to apply to become MMFs, or those applying to be OEICs to simultaneously apply to be authorized as an MMF;
2. Alternative Investment Fund Managers Regulations 2013 to enable the FCA to prescribe the application process for an alternative investment fund (AIF) to be authorized as an MMF, the procedure for refusal of an application and the process if the FCA decides to revoke authorization of an AIF which is an MMF; and
3. Financial Services and Markets Act 2000 (Qualifying EU Provisions) Order 2013 to enable the FCA to investigate and bring enforcement action against funds directly for breach of the EU MMF Regulation.

The MMFR is available [here](#), and the explanatory memorandum can be accessed [here](#).

EU DEVELOPMENTS

ESMA Releases Latest Double Volume Cap Data Under MiFID II

On June 7, the European Securities and Markets Authority (ESMA) updated its public register with the latest set of double volume cap (DVC) data under the revised Markets in Financial Instruments Directive (MiFID II). The update follows last month's update to the DVC public register (for more information, see the May 11, 2018 edition of [Corporate & Financial Weekly Digest](#)).

New breaches total 52 equities for the 8 percent cap, which applies to all trading venues, and seven equities for the 4 percent cap, which only applies to individual trading venues. For those instruments in breach of the caps, suspensions of trading under the waivers apply from June 12 to December 12. As a result of corrected data received by ESMA for two instruments, previously identified breaches of the 8 percent and 4 percent caps are incorrect and the relevant suspensions of trading under the waivers should be lifted, according to ESMA's announcement.

As of June 7, a total of 932 instruments are suspended.

ESMA's announcement in relation to the updated DVC register is available [here](#).

The updated public register regarding the DVC mechanism is available [here](#).

European Parliament Adopts EMIR 2.1 Proposal

On June 12, the European Parliament (EP) issued a press release announcing its adoption in plenary of the proposed regulation to amend the European Market Infrastructure Regulation (EMIR) in respect of, among others, clearing, reporting and risk-mitigation techniques for over-the-counter derivatives contracts not cleared by a central counterparty (CCP).

The proposed regulation is referred to as "EMIR 2.1" to distinguish it from the proposal for amendments in respect of the authorization of CCPs and recognition of third-country CCPs, known as "EMIR 2.2" (further coverage of EMIR 2.2 is available in the [Corporate & Financial Weekly Digest](#) edition of June 1, 2018).

As a next step with respect to EMIR 2.1, the Council of the European Union, the European Commission and the EP will engage in three-way talks, which are scheduled to start in July. According to the provisional text, EMIR 2.1 will go into effect 20 days after its publication in the *Official Journal of the European Union*.

The EP's press release can be accessed [here](#).

The provisional text for EMIR 2.1, also published by the EP on June 12, 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 DEVELOPMENTS

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