

BROKER-DEALER

SEC Adopts Rules and Interpretations To Enhance Protections and Preserve Choice for Retail Investors

On June 5, the Securities and Exchange Commission voted to adopt a package of rules and interpretations designed to enhance the quality and transparency of retail investors' relationships with investment advisers and broker-dealers. Specifically, the SEC approved Regulation Best Interest.

Regulation Best Interest creates an enhanced standard of conduct applicable to broker-dealers at the time they recommend to a retail customer a securities transaction or investment strategy involving securities. When making a recommendation, a broker-dealer must act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests.

The enhanced standard of conduct includes the following obligations:

Disclosure Obligation: Before or at the time of the recommendation, a broker-dealer must disclose, in writing, material facts about the scope and terms of its relationship with the customer.

Care Obligation: A broker-dealer must exercise reasonable diligence, care and skill when making a recommendation to a retail customer.

Conflict of Interest Obligation: Policies and procedures must be reasonably designed:

- To mitigate conflicts of interests that create an incentive for an associated person of the broker-dealer to place its interests or the interest of the firm ahead of the retail customer's interest;
- When a broker-dealer places material limitations on recommendations that may be made to a retail customer (e.g., offering only proprietary or other limited range of products), to disclose the limitations and associated conflicts, and to prevent the limitations from causing the associated person or broker-dealer from placing the associated person's or broker-dealer's interests ahead of the customer's interest; and
- To identify and eliminate sales contests, sales quotas, bonuses and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time.

Regulation Best Interest will become effective 60 days after it is published in the *Federal Register*, and will include a transition period until June 30, 2020 to give firms sufficient time to come into compliance.

A Katten client advisory describing Regulation Best Interest will be forthcoming.

The SEC's press release is available [here](#).

SEC Approves Amendments to FINRA's Codes of Arbitration Procedure for Customer and Industry Disputes

On May 30, the Securities Exchange Commission approved amendments to the Financial Industry Regulatory Authority's customer and industry arbitration rules to expand the time period for non-parties to respond to arbitration subpoenas and orders of appearance of witnesses or production of documents.

FINRA's Codes of Arbitration Procedure for Customer and Industry Disputes (Codes) allow parties who seek discovery from a non-party to request that the panel issue an order of appearance of witnesses or production of documents if the non-party is subject to FINRA's jurisdiction. Arbitrators are also authorized to issue a subpoena if the non-party is not subject to FINRA's jurisdiction. If the panel decides to issue the order or subpoena, FINRA will transmit the signed order or subpoena to the moving party to serve on the non-party. If a non-party receiving an order or a subpoena objects to the scope or propriety of the order or subpoena, they may file written objections through the director of the Office of Dispute Resolution within 10 calendar days of receiving the order or subpoena.

The amendments extend the response time for non-parties to object to an order or subpoena from 10 calendar days of service to 15 calendar days of receipt of the order or subpoena. In addition, first-class mail is excluded as an option to serve documents on the non-party and as an option for the non-party to file the objection to the scope or propriety of the order or subpoena. Lastly, the amendments codify the current practice that the director send, at the same time, objections and responses to the panel after the reply date has elapsed, unless otherwise directed by the panel.

The amendments are effective for cases filed on or after July 1. FINRA's regulatory notice is available [here](#).

NASAA, SEC and FINRA Issue Senior Safe Act Fact Sheet

On May 23, the North American Securities Administrators Association (NASAA), Securities Exchange Commission and the Financial Industry Regulatory Authority issued a fact sheet on the Senior Safe Act to help raise awareness among broker-dealers, investment advisers and transfer agents.

The Senior Safe Act was included as Section 303 of the Economic Growth, Regulatory Relief and Consumer Protection Act, which was signed into law on May 24, 2018. The Act addresses barriers financial professionals face in reporting suspected senior financial exploitation or abuse to authorities. Specifically, the Act protects "covered financial institutions"—which include investment advisers, broker-dealers and transfer agents—and their eligible employees, affiliated persons and associated persons from liability in any civil or administrative proceeding for reporting a case of potential exploitation of a senior citizen to a covered agency.

The immunity established by the Act is provided on the condition that employees receive training on how to identify and report exploitative activity against seniors before making a report. In addition, reports of suspected exploitation must be made in good faith and with reasonable care. This immunity applies to individuals and firms.

The Senior Safe Act Fact Sheet is available [here](#).

DERIVATIVES

ISDA Publishes Initial Margin Implementation Guidance for Financial End Users

On May 29, the International Swaps and Derivatives Association (ISDA) issued calculation guidance for swap market participants seeking to determine if they might become subject in 2020 to mandatory initial margin requirements for swaps executed with swap dealers registered with the Commodity Futures Trading Commission. Under both the CFTC margin rules and the margin rules adopted by the prudential regulators for bank swap dealers, any "financial end user" (as defined in the margin rules) that is not already subject to mandatory initial margin for trades with swap dealers will become so on September 1, 2020, if it has "material swaps exposure." An entity will have "material swaps exposure" for 2020 if the entity and its margin affiliates have a daily average aggregate notional amount (DAANA) of uncleared swaps, uncleared security-based swaps, foreign exchange forwards and foreign exchange swaps with all counterparties for June, July and August of this year that exceeds \$8 billion, where such amount is calculated only for business days.

The ISDA guidance is both a reminder that the 2019 material swaps exposure calculation period begins on June 3 and a five-step guide to the actual calculation of DAANA for a particular entity. Since the margin rules only capture swap dealer counterparties that are financial end users, no other types of entities need to do the DAANA calculation. A financial end user that does not have material swaps exposure based on its 2019 calculation must repeat the same calculation in 2020 and each subsequent year until it does exceed the \$8 billion DAANA level. When that happens, the entity will become subject to initial margin when trading with a swap dealer on January 1 of the following year (i.e., a financial end user that has material swaps exposure based on a calculation performed for June, July and August of 2020 will become in scope for initial margin on January 1, 2021).

The definition of “financial end user” is available [here](#).

The ISDA guidance is available [here](#).

CFTC Issues Margin Relief for Changes to Legacy Swaps

On June 6, the Division of Swap Dealer and Intermediary Oversight (DSIO) of the Commodity Futures Trading Commission issued no action letter 19-13 to permit swap dealers and their counterparties to make certain changes to current swaps without subjecting the swaps to the CFTC swap margin rule. The need for the relief stems from the anti-avoidance position taken by the CFTC when the swap margin rule was enacted that any change made after the margin rule compliance date applicable to swap dealer and its counterparty to an uncleared swap (a Legacy Swap) in existence on the compliance date will cause the Legacy Swap to be brought into scope for margin.

The letter, which was issued in response to a request from the International Swaps and Derivatives Association, clarifies that the margin rule will not apply to:

- (1) A Legacy Swap that is amended in a way that does not change any material terms;
- (2) A swap resulting from the exercise of a swaption that is a Legacy Swap;
- (3) A Legacy Swap that is partially terminated;
- (4) A Legacy Swap that is partially novated; and
- (5) Any new swaps resulting from a multilateral compression exercise consisting solely of Legacy Swaps.

The CFTC letter is available [here](#).

CFTC

CFTC Announces Climate-Related Agenda for June 12 Public Meeting

On June 5, the Commodity Futures Trading Commission announced the agenda for the upcoming Market Risk Advisory Committee (MRAC) public meeting that will focus on climate-related financial market risks.

Specifically, MRAC members and guests will conduct a series of panels discussing (1) potential climate change impact on the stability of the global financial system, (2) domestic and international policy initiatives and supervisory approaches to addressing climate-related risks on the financial market, (3) market participant approaches to such risks, including key risk management, governance and disclosure considerations, and (4) the related challenges ahead for regulators and market participants.

In addition, the Interest Rate Benchmark Reform Subcommittee regarding LIBOR transition will provide a status report, and Steven Maijoor, the chair of the European Securities and Markets Authority, will give a presentation on European Market Infrastructure Regulation 2.2, central counterparty stress testing and Brexit.

The MRAC meeting will be held on June 12.

More information 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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