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SEC/CORPORATE

SEC Adopts Additional Rules for Security-Based Swaps

On June 21, the Securities and Exchange Commission adopted a panoply of final rules dealing with the following aspects of the regulation of security-based swaps (SBS):

- Capital requirements for nonbank SBS Dealers (SBSDs) and Major SBS Participants (MSBSPs).
- Increased minimum net capital requirements for broker-dealers that use internal models to compute net capital (ANC broker-dealers).
- Capital requirements tailored to security-based swaps and swaps for broker-dealers that are not registered as an SBSD or MSBSP to the extent they trade those instruments.
- Margin requirements for nonbank SBSDs and MSBSPs with respect to non-cleared security-based swaps.
- Creation of a process for non-US SBSDs and MSBSPs to request substituted compliance with respect to the capital and margin requirements.
- A requirement that nonbank SBSDs establish internal risk management controls compliant with Rule 15c3-4.

These new rules will have limited impact in the short run. However, the SEC has revised the overall time frame for implementing its regulatory regime for SBS, so that the compliance date for the new rules and all other SEC rules for SBS will be 18 months after the later of (1) the effective date of final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs; or (2) the effective date of final rules addressing the cross-border application of certain security-based swap requirements.

The table below summarizes the minimum net capital requirements that will be applicable to nonbank SBSDs as of the compliance date of the rule.

Type of Registrant	Rule	Tentative Net Capital	Net Capital	
			Fixed-Dollar	Financial Ratio
Stand-alone SBSD (not using internal models)	18a-1	N/A	$20 million	2% margin factor
Stand-alone SBSD (using internal models)[1]	18a-1	$100 million	$20 million	2% margin factor
Broker-dealer SBSD (not using internal models)	15c3-1	N/A	$20 million	2% margin factor + Rule 15c3-1 ratio
Broker-dealer SBSD (using internal models)	15c3-1	$5 billion	$1 billion	2% margin factor + Rule 15c3-1 ratio

1 Includes a stand-alone SBSD that also is an OTC derivatives dealer.

The rules also establish net capital "haircuts" for SBS positions that will apply to all broker-dealers.

The margin requirements for nonbank SBSDs are closely aligned with the swap margin rules adopted by the CFTC and the prudential regulators but differ in the following significant ways:

- The requirements apply only to non-cleared, security-based swaps.
- An SBSD is not required to exchange any margin with an affiliate.
- An SBSD does not have to post initial margin and is not required to collect Initial margin from "Financial Market Intermediaries" (including other SBSDs).
- The initial margin rules apply even if a counterparty does not have "material swaps exposure."
- Broker-dealer SBSDs must use the standardized haircuts for security-based swaps referencing equity securities and indexes.

A nonbank SBSD can comply instead with the swap capital, margin and segregation requirements of the CFTC, if it is not a broker-dealer, and its SBS positions do not exceed certain dollar and percentage limits.

The text of the rules can be found here: https://www.sec.gov/rules/final/2019/34-86175.pdf

BROKER-DEALER

SEC Adopts Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Participants

On June 21, the Securities and Exchange Commission adopted a package of new rules and rule amendments to establish capital, margin and segregation requirements under Title VII of the Dodd-Frank Act.

The new rules address the following areas:

- Capital requirements for security-based swap dealers (SBSDs) and major security-based swap participants (MSBSP), for which there is not a prudential regulator (nonbank SBSDs and MSBSPs).
- Capital requirements for broker-dealers that trade security-based swaps or swaps and are not registered as an SBSD or MSBSP.
- Minimum net capital requirements for broker-dealers that use internal models to compute net capital.
- Margin requirements for nonbank SBSDs and MSBSPs with respect to non-cleared security-based swaps.
- Segregation requirements for SBSDs and stand-alone broker-dealers for cleared and non-cleared security-based swaps.

The new rules also amend the SEC's existing cross-border rule to provide a mechanism for substituted compliance with respect to the capital and margin requirements for foreign SBSDs and MSBSPs.

The SEC's press release is available here.

FINRA Files Proposed Rule Change to Public Communications and Research Reports

On June 20, the Financial Industry Regulatory Authority (FINRA) filed with the Securities and Exchange Commission proposed amendments to FINRA Rule 2210 (Communications with the Public) and FINRA Rule 2241 (Research Analysts and Research Reports) required by the Fair Access to Investment Research Act of 2017.

The proposed amendments would eliminate the "quiet period" for restrictions for publishing a research report or making a public appearance concerning a covered investment fund under Rule 2241. The amendments would also create a filing exclusion for covered investment fund research reports under Rule 2210.

A copy of the proposed amendments is available here.

DERIVATIVES

See "SEC Adopts Additional Rules for Security-Based Swaps" in SEC/Corporate section.

See "CFTC Approves LedgerX LLC as Designated Contract Market" in CFTC section.

See "CFTC Staff Issues No-Action Relief for Floor Traders Engaged in Swaps Activity" in CFTC section.

CFTC

CFTC Approves LedgerX LLC as Designated Contract Market

On June 25, 2019, the Commodity Futures Trading Commission announced that it had approved the application of LedgerX LLC (LedgerX) for designation as a contract market under Section 5 of the Commodity Exchange Act (CEA) and Part 38 of the CFTC's regulations. LedgerX has been registered with the CFTC as a swap execution facility and derivatives clearing organization (DCO) since July 2017.

LedgerX has requested that the CFTC amend LedgerX's order of registration as a DCO to allow it to clear futures listed on its DCM.

The CFTC press release is available here.

A full copy of the Order of Designation is available here.

CFTC Publishes Request for Comment on Proposed Rule Change to Cross-Border Regulatory Commitments

On June 25, 2019, the Commodity Futures Trading Commission published for comment a proposed amendment to CFTC Regulation 30.10. Part 30 of the CFTC's regulations govern the offer and sale of foreign futures and options to customers located in the United States. Among other requirements, Regulation 30.4 requires any person that solicits or accepts orders for execution on a foreign board of trade and that, in connection therewith, accepts any money or securities to margin any resulting contracts, to be registered with the CFTC as a futures commission merchant (FCM). Regulation 30.10 authorizes the CFTC to exempt from registration as an FCM any person located outside of the U.S. that the CFTC finds is subject to a comparable regulatory structure in the jurisdiction in which it is located. Requests for exemption are generally filed by a non-U.S. regulatory authority or self-regulatory organization on behalf of their registrants.

Although the CFTC reserves the right to condition, modify, suspend, terminate, withhold as to a specific firm or otherwise restrict any exemptive relief it grants under Regulation 30.10, the regulation currently does not provide a specific course of action should the CFTC determine that exemptive relief is no longer warranted. To address this issue, the proposed amendment to Regulation 30.10 would provide that the CFTC may terminate exemptive relief if, after appropriate notice and an opportunity to respond, the CFTC determines that: (i) there has been a material change or omission in the facts and circumstances pursuant to which relief was granted; (ii) the continued exemptive relief would be contrary to the public interest or inconsistent with the purposes of the exemption; and (iii) the information-sharing arrangements no longer adequately support exemptive relief.

Interestingly, in describing circumstances in which it could determine to withdraw a Regulation 30.10 exemption, the CFTC notes that it could take into account a lack of comity relating to the execution or clearing of any commodity interest subject to the CFTC's exclusive jurisdiction. This appears to be the first time that the CFTC has stated that lack of comity could be a factor in determining whether a Regulation 30.10 exemption would be appropriate.

The comment period will end 30 days after the proposal is published in the Federal Register.

A full copy of the press release is available here.

CFTC Staff Issues No-Action Relief for Floor Traders Engaged in Swaps Activity

On June 27, 2019, the Division of Swap Dealer and Intermediary Oversight (DSIO) of the Commodity Futures Trading Commission issued a no-action relief (No Action Letter) for registered floor traders from compliance with certain conditions of a CFTC regulation related to the de minimis exception to the swap dealer definition.

Under paragraph (6)(iv) of the swap dealer definition in CFTC regulation 1.3, a registered floor trader does not need to consider cleared swaps executed on or subject to the rules of a designated contract market (DCM) or swap execution facility (SEF Cleared Swaps) when determining whether it is a swap dealer, provided certain conditions are satisfied. The No Action Letter clarifies that the exemption is available even if the registered floor trader: (1) enters into swaps other than DCM and SEF Cleared Swaps; and (2) directly, or through an affiliated person, negotiates the terms of those other swaps. The No Action Letter also removes the condition that a registered floor trader must submit periodic risk reports as required by CFTC regulation 23.600(c)(2).

In an unusual dissenting statement, CFTC Commissioner Brian Quintenz agrees with the relief but argues that this no action relief is a poor substitute for an actual revision of the swap dealer definition that allows all market participants — not just proprietary trading firms — to exclude cleared swaps from calculations to determine if they have passed the de minimis swap dealer registration threshold. In a separate statement, Commissioner Dan M. Berkovitz agrees that the CFTC should amend the swap dealer definition and notes that Chairman Giancarlo has agreed to direct the CFTC staff to draft a proposed amendment to the floor trader provision that is consistent with the no action relief granted.

The No Action letter is conditioned upon the registered floor trader complying with CFTC regulations 23.201, 23.202, 23.203 and 23.600 (other than 23.600(c)(2)) with respect to each of its swaps (including swaps that are not DCM and SEF Cleared Swaps) as if it was a swap dealer.

A complete copy of the No Action Letter and Statements is available here.

EU DEVELOPMENTS

ESMA Publishes Updated I Transparency Calculations for Equity and Equity-like Instruments

On June 21, 2019, the European Securities and Markets Authority (ESMA) published a press release announcing that it has made available updated results of the annual transparency calculations for equity and equity-like instruments.

The results are published pursuant to delegated regulations under the revised Markets in Financial Instruments Directive and the Markets in Financial Instruments Regulation. The calculations include:

- Liquidity assessments.
- The determination of the most relevant market in terms of liquidity (MRM).
- The determination of the average daily turnover (ADT) relevant for the determination of the pre-trade and post-trade large in scale (LIS) thresholds.
- The determination of the average value of the transactions (AVT) and the related standard market size (SMS).
- The determination of the average daily number of transactions on the most relevant market in terms of liquidity relevant for the determination of the tick-size regime.

The full list of assessed equity and equity-like instruments is available through ESMA's financial instruments transparency system (FITRS).

The updated results apply from July 8, 2019 to March 31, 2020. The next annual transparency calculations are due to be published by March 1, 2020 and will become applicable from April 1, 2020.

ESMA's press release, including links to FITRS, 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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EU DEVELOPMENTS

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