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SEC/CORPORATE

SEC Division of Corporation Finance Issues C&DIs on Omission of Third Year From MD&A

As previously discussed in the April 12, 2019 edition of *Corporate & Financial Weekly Digest*, the Securities and Exchange Commission adopted final rules on March 20, 2019, that allow registrants to omit a discussion and analysis of the earliest of the three years of required financial statements from the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section of their annual reports. Omitting that section from the annual reports filing with the SEC is permissible so long as the discussion of such year is already included in an earlier SEC filing and the registrant includes a statement identifying the location of such discussion in the prior filing. On January 24, the staff of the SEC's Division of Corporation Finance (the Staff) issued three Compliance and Disclosure Interpretations (C&DIs) to address questions related to the final rule.

C&DI 110.02. The Staff clarified that a statement in a registrant's filing identifying the location of where the omitted information can be found in a prior filing, in reliance on the rule amendment, does not have the effect of incorporating such prior disclosure by reference, unless the registrant's current filing expressly provides that the information is incorporated by reference.

C&DI 110.04. The Staff further clarifies, that, when a company updates an effective registration statement by filing a Form 10-K in which the discussion of the earliest of the three years is omitted and there is a statement identifying the location of the discussion in a prior filing, the prior discussion would not be incorporated into the updated registration statement, unless the registrant's current Form 10-K filing expressly provides that the information with respect to such omitted year is specifically incorporated by reference.

C&DI 110.03. This provides that a registrant may not omit a discussion of the earliest of the three years of financial statements in a filing, in reliance on the rule amendment, if the registrant believes that such discussion would otherwise be required in order to understand the registrant's financial condition, changes in financial condition and results of operations. In such case, the registrant must either expressly incorporate the discussion by reference from a previous filing or include the discussion in the current filing.

The new C&DIs are available here.

BROKER-DEALER

SEC Designates Decision Deadline for Proposed Off-Floor Position Transfer Rule Changes

On January 21, the Securities and Exchange Commission published in the *Federal Register* a release (Release) regarding Cboe Exchange, Inc. rule changes. The Release indicates that SEC must approve or disapprove Cboe rule changes regarding off-floor position transfers (Proposed Rule) by March 19. The SEC moved the original January 19 deadline to March 19 in order to further consider, among other items, issues raised during the comment period and related SEC proceedings (Proceedings). (For additional information regarding the Proceedings, please refer to the November 1, 2019 edition of *Corporate & Financial Weekly Digest*.)

The Release is available here.

OCIE Provides Observations on Cybersecurity and Operational Resiliency Best Practices

On January 27, the Office of Compliance Inspections and Examinations (OCIE) of the Securities and Exchange Commission issued a statement summarizing its observations of cybersecurity and operational resiliency practices of broker-dealers, investment advisers, clearing agencies, national securities exchanges and other SEC registrants (the Observations). In its introduction to the Observations, the OCIE staff notes that cybersecurity is a key priority for OCIE. Therefore, although the OCIE staff acknowledges that there is not a "one-size fits all" approach to addressing cybersecurity, it recommends that SEC registrants assess their cybersecurity practices in light of the Observations.

The recommendations of the Observations include the following:

- **Governance and Risk Management.** OCIE observed that the key elements of effective governance and risk management programs include: 1) senior level engagement in setting the strategy and overseeing the cybersecurity and resiliency program; 2) developing and conducting risk assessments to identify and mitigate risks; 3) adopting and implementing comprehensive policies and procedures addressing cybersecurity; 4) establishing comprehensive testing and monitoring of cybersecurity policies and procedures; 5) responding promptly to testing and monitoring results; and 6) establishing internal and external communication policies and procedures to provide timely information to the appropriate parties.
- **Access Rights and Controls.** OCIE observed that strategies for determining appropriate users for firm systems include: 1) understanding access needs; 2) managing and restricting users as appropriate; and 3) preventing, monitoring and investigating unauthorized access.
- **Data Loss Prevention.** OCIE observed the use of the following data loss prevention measures: 1) establishing a vulnerability management program; 2) establishing perimeter security and monitoring network traffic; 3) implementing systems that provide detective security; 4) establishing a patch management program; 5) inventorying hardware and software; 6) securing data through encryption software and network segmentation; 7) creating an insider threat program to identify suspicious behaviors; and 8) decommissioning and disposing hardware and software in a manner that does not create vulnerabilities.
- **Mobile Security.** OCIE observed that vulnerabilities related to the use of mobile devices and mobile applications may be mitigated by: 1) establishing policies and procedures for the use of mobile devices; 2) using a mobile device management application to manage a firm's mobile device applications; 3) implementing security measures, which may include preventing printing, copying or saving information to personally owned devices and remotely clearing data and content from devices; and 4) training employees on policies and practices to protect mobile devices.
- **Incident Response and Resiliency.** OCIE observed that incident response plans tend to include the following: 1) developing a risk-assessed incident response plan for various scenarios and maintaining procedures on appropriate notification, escalation and communication of cybersecurity incidents; 2) addressing how to meet applicable reporting requirements; 3) assigning staff to execute specific areas of the plan; and 4) testing the plan and recovery times. In addition, OCIE observed that addressing resiliency includes: 1) identifying and prioritizing core business services; 2) determining which systems can be substituted during disruption; 3) implementing geographic separation of back-up data; 4) considering the effects of business disruptions; and 5) potentially purchasing cybersecurity insurance.
- **Vendor Management.** OCIE observed that proper vendor management includes: 1) conducting due diligence of vendors; 2) understanding vendor relationships and contract terms, along with the risks related to vendor outsourcing; and 3) monitoring vendor relationships to ensure that the vendor continues to meet security requirements and to be aware of changes to the vendor's services or personnel.
- **Training and Awareness.** OCIE observed that sound training practices include: 1) training staff to implement the firm's policies and procedures and building a culture of cybersecurity readiness and operational resiliency; 2) providing cybersecurity examples and exercises, including phishing exercises and training on how to identify and respond to breaches and suspicious client behavior; and 3) monitoring training attendance and continuously updating trainings based on cyber-threat intelligence.

The Observations further encourage SEC registrants to: 1) monitor the SEC's Cybersecurity Spotlight page; 2) sign up for alerts from the Cyber Infrastructure Security Agency; 3) participate in information-sharing groups such as the Financial Services Information Sharing and Analysis Center; and 4) consult the National Institute of Standards and Technology Cybersecurity Framework.

The Observations are available here.

DERIVATIVES

See "CFTC Proposes Revised Rules Establishing Position Limits on Derivatives Contracts that Provide for Physical Delivery" and "NFA's Swaps Proficiency Requirements Effective and Available Online" in the CFTC section.

CFTC

CFTC Proposes Revised Rules Establishing Position Limits on Derivatives Contracts That Provide for Physical Delivery

On January 30, the Commodity Futures Trading Commission (CFTC) voted to publish for comment revised rules establishing position limits on derivatives contracts that provide for physical delivery. The vote was 3-2, with Commissioners Behnam and Berkovitz dissenting.

As explained by CFTC staff, the proposed rules would establish position limits with respect to 25 "core referenced futures contracts," identified as the most liquid, physically settled exchange-traded futures contracts. The 25 contracts include the nine "legacy" agricultural futures contracts that are currently subject to CFTC position limits, seven additional agricultural futures contracts, five metals futures contracts and four energy futures contracts. With certain exceptions, cash-settled futures contracts that are directly or indirectly linked to the to the price of the physically settled contract or the underlying commodity and economically equivalent swaps, as defined, also would be subject to the proposed position limits.

With the exception of the nine legacy agricultural contracts, the CFTC's position limits would apply only in the spot month. These limits would generally be set at 25 percent of the deliverable supply, but may be higher or lower for certain contracts. With respect to the non-legacy contracts, the rule would require the relevant exchange on which the contracts are traded to adopt either position limits or position accountability levels.

The proposed rules also would expand the current list of enumerated *bona fide* hedges to include, for example, hedges of anticipated merchandizing. To provide market participants with greater flexibility on managing their business risks, the proposal also provides guidance on whether and when market participants are permitted to measure risk on a gross basis rather than a net basis. However, firms will be required to measure risk on a consistent basis. Enumerated hedges are self-effectuating. That is, no prior approval would be required from the CFTC, although a market participant would be required to obtain approval from the relevant exchange. Self-effectuating hedge exemptions also would be available for other transactions such as spreads and pass-through swaps as approved by exchanges. With respect to non-enumerated hedge exemptions, a market participant would be required to file a request to exceed the position limit with the relevant exchange. If the exchange grants the request for a non-enumerated hedge exemption, the exchange will forward its decision to the CFTC for review. The exemption will be deemed granted provided the CFTC does not intervene during a 10-day review period. The market participant would not be permitted to exceed the applicable position limit until the 10-day review period lapses. Importantly, the CFTC may act solely through its commissioners and not through staff.

In terms of process changes, the CFTC is proposing to eliminate Form 204 cash positions report and the cash information reported under Form 304.

Comments on the proposed rule must be submitted no later than 90 days after approval of the proposal by the CFTC (i.e., April 29). The CFTC does not intend to extend the comment period.

The proposal is available here.

CFTC Adopts NIST Framework for Data Privacy Protection

On January 28, the Commodity Futures Trading Commission (CFTC) announced that it will adopt the National Institute of Standards and Technology (NIST) Privacy Framework for data privacy protection. The NIST Privacy Framework is a voluntary tool developed in collaboration with stakeholders (e.g., service providers, customers, partners) intended to help organizations identify and manage privacy risk to build innovative products and services while protecting individuals' privacy. The Privacy Framework will be used to better manage and communicate privacy risk throughout the agency. The CFTC is the first federal agency to adopt the Privacy Framework.

More information is available here.

Registration Opens for Agricultural Commodity Futures Conference 2020

On January 28, the Commodity Futures Trading Commission and the Center for Risk Management Education and Research at Kansas State University announced that registration is open for the third annual Agricultural Commodity Futures Conference (AgCon2020).

A full AgCon2020 agenda will be available in March.

Registration information is available here.

NFA's Swaps Proficiency Requirements Effective and Available Online

On January 27, the National Futures Association (NFA) issued a notice to members as a reminder that the effective date for NFA's Swaps Proficiency Requirements (Requirements) is January 31, and that the Requirements must be completed by applicable individuals by the January 31, 2021 compliance date. The Requirements are now available online here.

Each individual who is an approved swap associated person (AP) at a futures commission merchant (FCM), introducing broker (IB), commodity pool operator (CPO) or commodity trading advisor (CTA) member firm, or is acting as an AP at a swap dealer (SD) on January 31, 2021, must satisfy the Requirements to remain approved as a swap AP or continue acting as an AP at an SD after this date. Subsequent to January 31, 2021, any individual who wants to engage in swaps activity will need to satisfy the Requirements prior to being approved as a swap AP at an FCM, IB, CPO or CTA member or acting as an AP at an SD.

For complete details regarding who must fulfill the Requirements, see Notice I-19-09.

Notice I-20-03 is available here.

BANKING

Federal Reserve Adopts Revamped Standards for Determinations of Bank Control

On January 30, the Board of Governors of the Federal Reserve System (the Board) adopted a final rule to simplify and increase the transparency of determinations of when a company has the ability to exercise a controlling influence over another company for purposes of the Bank Holding Company Act or the Home Owners' Loan Act. The rule takes the form of amendments to Regulation Y. The highlight of the rule is a tiered framework that substantially revises and clarifies the Board's existing regulatory presumptions of control. The framework, which is summarized in a single chart, has four tiers, each identified by the threshold percentage level of voting stock held by a potential controlling party. At each level, the framework incorporates the other major factors that the Board has historically viewed as presenting control concerns, such as business relationships and officer/employee interlocks. The rule also includes a new presumption of noncontrol if a company owns less than 10 percent of the outstanding securities of each class of voting stock of another company and is not presumed to control the other company due to other factors identified in the rule.

The rule is available here.

A chart showing the four tiers of presumptions concerning control is available here.

Volcker Rule Regulators Propose Changes to Covered Fund Rules

On January 30, the five regulators responsible for Section 13 of the Bank Holding Company Act of 1956 (the "Volcker Rule") each approved a set of amendments intended to modify and clarify the covered fund provisions of the regulations implementing the Volcker Rule. (The five regulators are the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission and the Securities and Exchange Commission.) The proposal includes the following elements:

1. The proposed rule would permit bank investment in credit funds and venture capital funds.
2. The proposal would exempt the activities of certain funds that are organized outside of the United States and offered to foreign investors (qualifying foreign excluded funds).
3. The proposal would revise certain restrictions in the foreign public funds exclusion to more closely align the provision with the exclusion for similarly situated US-registered investment companies.
4. The proposed rule would permit loan securitizations excluded from the rule to hold a small amount of non-loan assets, consistent with past industry practice, and codify existing staff-level guidance regarding this exclusion.

The comment period for the proposal runs until April 1.

The proposed rule is available here.

BREXIT/UK DEVELOPMENTS

Brexit: FCA Updates UK and EU Firms on Transition Period

On January 30, the UK Financial Conduct Authority (FCA) issued a press release (the Press Release) advising UK and EU firms on the implementation period, which starts when the UK leaves the EU at 11:00 p.m. GMT (6:00 p.m. EST) ***tonight*** (i.e., January 31), and is expected to end in 11 months' time on December 31 (for more information please see the January 24 edition of *Corporate & Financial Weekly Digest*).

In the Press Release, the FCA observed that EU law will continue to apply, and therefore that there is no change for UK firms. In particular, the FCA emphasized that the passporting regimes and reporting obligations for firms, as well as consumer rights and protections derived from EU law, will all continue to apply until end of day on December 31.

In connection with the temporary permissions regime (TPR) — a transitional set of rules that would enable firms established in the European Economic Area (EEA) to continue passporting their regulated activities into the UK for a limited period after the UK leaves the EU (for more information please see the January 11 2019 edition of *Corporate & Financial Weekly Digest*) — the FCA also explained that the notification window for EEA-based firms to file with the FCA to gain access to the TPR closed on January 30. However, the window will open again later in 2020, to allow for additional notifications by those EEA-based firms that have not yet filed with the FCA to do so before the end of the implementation period. The FCA has advised that firms and fund managers who have already submitted TPR notifications to the FCA need take no further action at this stage.

The Press Release is available here.

HMT Responds to MLD5 Consultation

On January 23, HM Treasury (HMT) published its response (the Response) to the Consultation on the Transposition into UK law of the EU's Fifth Money Laundering Directive (the Consultation). The Consultation closed in June 2019.

The Fifth Money Laundering Directive (MLD5) is primarily focused on expanding the EU's anti-money laundering (AML) regime into new areas such as crypto-assets and art dealers. It became operational in the UK on January 10 (for more information, please see the January 10 edition of *Corporate & Financial Weekly Digest*).

The purpose of the Response is to address comments and issues raised by respondents to the Consultation. In general, the respondents agreed with the Government's proposals, but wanted to ensure that definitions are clear and specific, that disclosure requirements do not undermine data security, and that, as the AML regime is expanded to encompass lay trustees, art dealers and letting agents, these people are fully aware of their new responsibilities.

HMT also used the Response to emphasize the ongoing application of the obligations in MLD5 now that the UK has left the EU but for the remainder of 2020 remains subject to EU law (for more information on the 'implementation period,' please see the January 24 edition of *Corporate & Financial Weekly Digest*). While in the Response there is no discussion of what will happen after the end of the implementation period, in the Response HMT noted that:

> "As a leading and founding member of the [Financial Action Task Force], the UK will remain at the forefront of international standards and respond to new threats… The government is committed to building on the progress already made in fighting economic crime and maintaining strong protections and standards against money laundering and terrorist financing."

The Response is available here.

For more information on the work done by the Financial Action Task Force, or FATF, please see the July 12, 2019 edition of *Corporate & Financial Weekly Digest*.

Brexit: UK Updates TPR Start Date

On January 28, the UK Government published the Financial Services (Consequential Amendments) Regulations 2020 (the Regulations). This is in response to the passing by the UK Parliament of the Withdrawal Act on Thursday last week, and in anticipation of the UK's withdrawal from the EU (and start of the implementation period) on January 31 (for more information, please see the January 24 edition of *Corporate & Financial Weekly Digest*).

As part of its preparations for Brexit, the UK Government passed a number of regulations to create temporary permissions and transitional regimes for the financial services sector. The purpose of the Regulations is to confirm that these temporary permissions and transitional regimes will take effect from the expiration of the implementation period, which is expected to end on December 31.

In particular, the Regulations amend the following secondary UK legislation:

- the Electronic Money Regulations 2011 (please see the November 30, 2018 edition of *Corporate & Financial Weekly Digest*);
- the Alternative Investment Fund Managers (AIFM) Regulations 2013;
- the Payment Services Regulations 2017;
- the Data Reporting Services Regulations 2017;
- the EEA Passport Rights (Amendment, etc., and Transitional Provisions (EU Exit) Regulations 2018 (please see the November 9, 2018 edition of *Corporate & Financial Weekly Digest*);
- the Central Counterparties (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018 (please see the October 5, 2018 edition of *Corporate & Financial Weekly Digest*);
- the Electronic Money, Payment Services and Payment Systems (Amendment and Transitional Provisions) (EU Exit) Regulations 2018;
- the Trade Repositories (Amendment and Transitional Provision) (EU Exit) Regulations 2018 (please see the October 12, 2018 edition of *Corporate & Financial Weekly Digest*);
- the Central Securities Depositories (Amendment) (EU Exit) Regulations 2018;
- the Credit Rating Agencies (Amendments, etc.) (EU Exit) Regulations 2019;
- the Collective Investment Schemes (Amendment etc.) (EU Exit) Regulations 2019 (please see the February 22, 2019 edition of *Corporate & Financial Weekly Digest*); and
- the Financial Markets and Insolvency (Amendment and Transitional Provision) (EU Exit) Regulations 2019.

The Regulations are available here and the explanatory memorandum 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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BREXIT/UK DEVELOPMENTS

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