COVID-19 WEBINAR SERIES

July 8, 2020

A New Normal in Broker-Dealer Regulation, Examination and Enforcement

SIDLEY

Disclaimer

This presentation has been prepared by Sidley Austin LLP and Affiliated Partnerships (the Firm) for informational purposes and is not legal advice. This information is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. All views and opinions expressed in this presentation are our own and you should not act upon this information without seeking advice from a lawyer licensed in your own jurisdiction. The Firm is not responsible for any errors or omissions in the content of this presentation or for damages arising from the use or performance of this presentation under any circumstances.

Do not send us confidential information until you speak with one of our lawyers and receive our authorization to send that information to us. Providing information to the Firm will not create an attorney-client relationship in the absence of an express agreement by the Firm to create such a relationship, and will not prevent the Firm from representing someone else in connection with the matter in question or a related matter. The Firm makes no warranties, representations or claims of any kind concerning the information presented on or through this presentation.

Attorney Advertising – For purposes of compliance with New York State Bar rules, our headquarters are Sidley Austin LLP, 787 Seventh Avenue, New York, NY 10019, +1 212 839 5300; One South Dearborn, Chicago, IL 60603, +1 312 853 7000; and 1501 K Street, N.W., Washington, D.C. 20005, +1 202 736 8000. Prior results do not guarantee a similar outcome. Some images on this presentation are of actors and not of clients or Firm personnel.

COVID-19 WEBINAR SERIES

July 8, 2020

A New Normal in Broker-Dealer Regulation, Examination and Enforcement

James Brigagliano, Partner, Washington, D.C.
W. Hardy Callcott, Partner, San Francisco
Kevin J. Campion, Partner, Washington, D.C.
Susan L. Merrill, Partner, New York

SIDLEY

Agenda

1. Enforcement Process
2. SEC Exams
3. FINRA Exams
4. SEC Enforcement Priorities
5. FINRA Enforcement Priorities
6. SEC Regulatory Priorities
7. FINRA Regulatory Priorities

Enforcement Process

Enforcement Process – The New Normal

- **Document Production**
  - Document production to the SEC and FINRA has moved almost entirely online
  - For SEC productions one uploads documents via the Kiteworks/Accellion system
  - Production letters and production passwords are emailed to the ENF-CPU and the relevant staff attorneys
  - FOIA confidential treatment requests are emailed to the SEC FOIA office
  - Paper documents can be mailed to an ENF-CPU mail drop in Alexandria VA but delays occur in processing these documents
  - SEC staff in most cases has become more forgiving about deadlines, but expect requests for tolling agreements earlier in the case

Enforcement Process – The New Normal

- FINRA staff can provide a hyperlink to FINRA DocShare (a/k/a Kiteworks/Accellion) for large productions
- FINRA will also accept documents produced via FTP/SFT
- Smaller productions can be sent as attachments to emails in a password protected file
- Firm productions can be made through the Gateway
- Letters can be sent via email with electronic signatures

Enforcement Process – The New Normal

Witness Interviews and Testimony

- SEC and FINRA have usually (but not always) been understanding that it takes longer to prepare a witness in a virtual environment
- Staff is sometimes now willing to conduct informal telephone interviews, not on-the-record, in place of sworn testimony – a trend that was evident before the pandemic
  - Benefit to the staff is no transcript that may have to be produced in contested litigation – staff's notes of the interviews are attorney work-product
  - Downside is potential need for a second session, on-the-record, if the staff's needs change
- Staff is sometimes now willing to accept attorney proffers in situations where it previously would have insisted in talking to the witness
- $64 question is whether staff will continue to be as flexible in the fall and winter when offices partially reopen, but travel remains difficult and vulnerable witnesses wish to remain socially distanced

Enforcement Process – The New Normal

Witness Interviews and Testimony

- The SEC staff have become comfortable with interviews and testimony by remote access
- Most significant issue is access to documents
  - Sometimes the staff will give advance access to all the documents about which it plans to question the witness
  - But often the staff will not give advance access to all documents, especially those produced by third parties
  - During testimony/interview, staff will allow the witness to review the document online, but the staff controls what part of the document the witness can see
  - This process can work for short documents, but is difficult for long documents
- It is preferable, but not always possible, to be present with the witness during the interview
  - If you are not present, you need to arrange a way to communicate with the witness during the testimony and breaks
  - It may be necessary to be more active in interjecting and objecting during remote testimony

Enforcement Process – The New Normal

Witness Interviews and Testimony

- FINRA has stated that witnesses do not have a right to have counsel physically present for OTRs
- FINRA has taken over 160 remote OTRs since March 2020
- Zoom is FINRA's preferred vendor, despite recent security issues
- Staff will conduct a walk through with counsel in advance to test technology
- Staff will sometimes provide documents in advance, but not always
- Push-back on requests for OTRs have had some success, particularly for non-target witnesses
- Informal telephone interviews and written interrogatories have been successfully used

Enforcement Process – The New Normal

- Some SEC investigations are proceeding at normal speed, notably cases involving COVID-19 frauds and other ongoing offering frauds
- SEC has been aggressive in seeking trading halts against companies it believes are involved in COVID-19-related frauds
- In cases where the SEC staff faces a statute of limitations issue under *Kokesh*, and where your client is a witness (and thus offering to toll the statute is ineffective), the staff may still need to move quickly despite pandemic issues
- FINRA has adopted a 3-week return policy for 8210 requests, rather than the usual 2-week period
- Staff is generally understanding of need for extensions, as long as rolling productions are made

SEC Exams

SEC Exams – The New Normal

- At the beginning of the Clayton administration, the SEC shifted OCIE resources away from broker-dealers towards investment advisers, and decided to rely more heavily on FINRA
  - In FY 2019, OCIE conducted 2180 exams of investment advisers, about 15% of the registered IA population (compared to around 10%/year prior to the shift in priorities)
  - In FY 2019, OCIE conducted 350 exams of broker-dealers – and 160 exams of FINRA and 110 exams of securities exchanges, in significant part to review their oversight of broker-dealers
  - But exams of investment advisers affiliated with broker-dealers, or dual-registrants, can seek lots of information from the BD side of the business, especially if it custodies IA-side assets
  - OCIE's National Exam Analytics Tool (NEAT) allows it to analyze years' of trading data and fees to discover patterns and identify unusual activity much more effectively than it could before the financial crisis
  - For broker-dealers, OCIE primarily engages in sweep exams or where it is concerned about specific issues at a specific firm – there is no longer an OCIE "cycle" for broker-dealer exams

SEC Exams – The New Normal

- The pandemic has shifted OCIE priorities somewhat
  - Some OCIE resources have been shifted from exams to market monitoring (e.g. to determine if various markets are functioning normally)
  - Some shift in oversight focus from retail-oriented firms to larger, more systemically significant firms
  - All existing exams and some new exams review how firms' BCP plans have operated during the pandemic – with a continued focus (in the new operating environments) on cyber-security and protection of customer information
  - While some new exams have started, OCIE has been slower to close out existing exams
  - Overall total number of exams completed likely to be lower than 2019

SEC Exams – The New Normal

- Pre-pandemic, OCIE and FINRA was examining firms' preparedness for Regulation Best Interest and Form CRS – OCIE issued reports on both rules on April 7, 2020
- OCIE and FINRA both expect to examine the implementation of Regulation Best Interest and Form CRS after implementation on June 30, 2020
  - Stated policy is to look for "good faith efforts" to comply, with guidance to firms that made what the examiners view to have made good faith but incomplete or mistaken steps to comply
  - Initially, stated policy is to reserve enforcement referrals for firms that did little or nothing to adopt or maintain Regulation Best Interest and Form CRS policies
  - But of course, good faith is in the eye of the beholder
- OCIE also has been examining LIBOR transition preparedness, and completed a report on June 18, 2020 – this will remain a priority as well

FINRA Exams

FINRA Exams – The New Normal

- On December 12, 2019, FINRA announced that its exam functions would be consolidated into a single, unified program. This was the culmination of the process that began in October 2018 as part of the FINRA360 initiative.
- Under the new consolidated program, exams will be tailored to the specific business models of FINRA's member firms. Each of the member firms will be grouped into one of the five following business models, rather than geographically:
  - **Retail**
  - **Capital Markets**
  - **Carrying and Clearing**
  - **Trading and Execution**
  - **Diversified**
- The exam program is led by Bari Havlik. The leadership team includes a number of FINRA and industry veterans. Most recently, Greg Ruppert was appointed EVP of National Cause and Financial Crimes Detection Programs. Mr. Ruppert has 18 years experience as a FBI agent and 6 years at Schwab as an AML officer.

FINRA Exams – The New Normal

- Prior to the pandemic, FINRA had recognized that it needed to be more flexible with how member firms received and responded to requests for information. For example, it enhanced the Request Manager tool to allow for it to be the medium through which all exam requests are issued.
- It also allowed member firms to provide requested information in the format in which it retained it, as opposed to having to conform to FINRA-specific format requests.
- Not surprisingly, the COVID-19 pandemic has caused FINRA to reconsider how it carries out broker-dealer and registered representative examinations.
- In March 2020, FINRA temporarily stopped issuing new requests for information. This was done to allow member firms to adjust to the "new normal" imposed by the pandemic.
- The issuance of those inquiries, including those associated with cycle examinations, has since resumed.
- Nevertheless, FINRA has made clear that it will work with member firms and will take into account, where appropriate, circumstances at individual firms that might prevent a firm from complying completely and timely with an information request.
- If you are unable to respond to a FINRA exam request, be sure to communicate the reasons to your examiner promptly.

FINRA 2020 Exam Priorities Letter

- **Old and Ongoing**
  - Complex Products, VAs, Private Placements, FI Markup Disclosures, Vulnerable Adults & Seniors

- **New and Emerging**
  - Reg BI - procedures and training,
  - Communications with the public – private placements, digital channels
  - Cash Management & Bank Sweep accounts – focus on disclosures
  - Sales of IPO shares – Flipping, retail demand, allocation method
  - Trading Authorization - Trading of same security in unrelated accounts within short timeframe
  - Cybersecurity - Protect customer records under Reg S-P Rule 30
  - Technology Governance - Changes to BCP

SEC Enforcement Priorities

SEC Enforcement Priorities – Where We Were Before the Pandemic

- Clayton SEC has been characterized by more continuity than change – all of the major enforcement program areas the SEC historically has pursued have continued to get substantial resources
- To the extent that there was any change, the Clayton SEC has emphasized cases involving “Main Street” investors, especially senior and other vulnerable investors
  - Thus, in some cases, the SEC brought cases involving single-rep fraud or embezzlement that it might have referred to FINRA in the past
  - Single most notable initiative in FY 2019 was approximately 100 cases involving Rule 12b-1 fees in the mutual fund Share Class Selection Disclosure (SCSD) initiative, which resulted in the highest-ever number of cases against investment advisers (many of which were dual-registrant firms), and those investigations have continued and expanded to revenue-sharing and bank sweep revenues

SEC Enforcement Priorities – Disgorgement

- Supreme Court decision in *Liu v. SEC* changes the enforcement landscape
- Court held that SEC may continue to seek disgorgement as a type of equitable relief under Exchange Act Section 21(d)(5)
- However, Supreme Court suggested three major limits on existing SEC practice
  - Disgorgement must be "for the benefit of investors" so simply depriving defendants of their profits, in situations where no victim was harmed, and paying that money to the U.S. Treasury, is inappropriate
  - Disgorgement should be individual to the wrongdoing of the specific defendant, so joint and several disgorgement is inappropriate
  - Disgorgement should only deprive the defendant of their profits, so should be based on the defendant's net profits, not gross revenues
- Court left open whether there are exceptions to these general principles
- Very likely but not absolutely certain that same limits would apply to disgorgement in administrative proceedings, and under other federal securities laws

SEC Enforcement Priorities – Disgorgement

- Liu has interesting implications in many types of cases
  - FCPA cases typically involve significant profits by the corporation, but little if any identifiable harm to third parties – is disgorgement still appropriate?
  - In insider trading cases, the SEC typically has sought joint-and-several disgorgement among tippers and tippees, even remote tippees of whom the original tipper was unaware – is that still appropriate?
  - In regulated industry cases, the SEC typically has sought gross revenues as the measure of disgorgement, without any offset for the firm's costs (e.g. compensation to its representatives or costs of facilities) – is net profits now the proper measure?
- Where there is uncertainty about the correct legal result, there is a greater likelihood of litigation
- Will the SEC look for the best test cases to establish the post-Liu law, or will it litigate disgorgement claims across the board

SEC Enforcement Priorities – New Priorities During the Pandemic

- **COVID-19**. SEC has been aggressive in investigating and bringing cases involving companies that exaggerate their role in COVID-19 treatments or vaccines, or other pandemic-related needs (e.g. companies claiming to produce PPEs and ventilators)
  - For broker-dealers, extra due diligence needed for securities offerings by such companies
  - Beware of possible pump-and-dump schemes customers conduct through firm's accounts
- **MNPI.** SEC has expressed heightened concern about MNPI – it allowed public companies to delay periodic reports, and encouraged companies to provide forward-looking information about liquidity and revenue expectations – and it expressed concern that many more people than usual at those companies may have access to MNPI
  - For regulated firms, concerns include the firm itself trading while in possession of MNPI
  - Note recent *Ares Capital* case about adequacy, tailoring, enforcement and documentation of MNPI/information barrier policies and procedures
  - Broader concern is detecting and reporting suspicious customer trading

SEC Enforcement Priorities – New Priorities During the Pandemic

- **Municipal securities.** SEC has expressed concern that pandemic has had a substantial effect on state and local government budgets, thereby increasing the risk of municipal bond defaults and making continuing event disclosure more important
  - Because the SEC's jurisdiction over municipal issuers themselves is limited, expect a focus on municipal securities underwriters and dealers, both concerning underwriting of new municipal issuances, and disclosure in connection with secondary trading
- **Foreign securities issuers.** The SEC has warned investors about the securities of issuers listed on U.S. securities markets, but organized and headquartered in foreign jurisdictions (notably including but not limited to China) that do not cooperate with the U.S. audit regulators or the U.S. securities enforcement process
  - Expect SEC scrutiny of broker-dealers that underwrite and trade the securities of such companies, or that recommend those securities, especially to retail investors

SEC Enforcement Priorities – New Priorities During the Pandemic

- It is expected that the SEC will be aggressive in investigating broker-dealers for compliance with existing U.S. short sale restrictions under Regulation SHO, including the following:
  - Marking Requirement: Sell orders in equity securities are required to be properly marked as "long" or "short" – orders can only be marked "long" if the seller has a net long position and intends to deliver the security being sold.
  - Locate Requirement: Prior to effecting a short sale, a broker-dealer must have reasonable grounds to believe that the security can be borrowed.
  - Alternative Uptick Rule: Applies to securities that have a price decrease of at least 10% from the prior day's close, and prevents short sales from being effected at a price at or below the National Best Bid (NBB) for the remainder of the day and the following day.
- The SEC will likely also continue to be aggressive with respect to other short sale restrictions, such as:
  - Rule 105 of Regulation M: Generally prevents purchasing in a SEC-registered offering if short sales were effected during a "restricted period" which is generally 1-5 business days prior to pricing.
  - Partial Tender Offers: Rule 14e-4 states that a person may tender shares into a partial tender offer only if both at the time of the tender and at the end of the proration period the person has a "net long position" in the security that is the subject of the tender offer.

SEC Enforcement Priorities – New Priorities During the Pandemic

- Just last week, the SEC entered into a $250,000 settlement with BNP Paribas Securities Corp. ("BNPP") for violating Rule 203(a)(1) of Regulation SHO, which generally prohibits lending shares to settle sell orders marked as "long."
  - The sell orders were all executed by a hedge fund away from BNPP at another executing broker, and subsequently were submitted as "long" sales to BNPP for clearance as prime broker. Such long sales were in connection with common stock of issuers obtained pursuant to convertible or exchange agreements.
  - At the start of the settlement date for each of these "long" sales, the hedge fund did not hold sufficient shares in its account at BNPP to settle the trades. BNPP's system identified those trades as an "oversell" and triggered an alert, whereby BNPP Ops employees sought and received confirmation from the hedge fund stating that the order at issue was properly marked "long."
  - BNPP's middle office personnel then overrode the trade break alert and permitted the trade to proceed as a "long" sale. BNPP's "loan" to the hedge fund customer occurred in connection with BNPP borrowing shares to meet its net delivery obligations. BNPP was thus aware of certain "red flags" that the hedge fund client was repeatedly failing to deliver on sell orders marked "long."
- This could be a signal that the regulators may be becoming more aggressive with respect to Regulation SHO, including utilizing Rule 203(a), which has not been the basis for many prior enforcement actions.

CLE Code

FINRA Enforcement Priorities

FINRA Enforcement Priorities – Leadership Changes

- Jessica Hopper became Head of Enforcement in January, 2020
- Christopher Kelly became Deputy Head of Enforcement and Head of Sales Practice Enforcement
- Lara Thyagarajan became Head of Market Regulation Enforcement
- Terrence Bohan became Head of Investigations
- **Four Priorities**
  - Obtaining restitution for customers
  - Ridding industry of bad brokers
  - Focus on senior and vulnerable investors
  - Ensuring integrity of markets
- **Predictable, Consistent and Transparent Outcomes**
  - Credit for cooperation - Reg Notice 19-23
  - Sanctions Considerations in AWC

FINRA Enforcement Priorities – Where We Were Before the Pandemic

- **Best execution in both Equities and Fixed Income**
  - Targeted Exam Letters focused on firms with Zero Commission business model
  - Looking for conflicts of interest between duty of best ex and generating revenue in a zero commission model
  - Changes in order flow to venues with payment for order flow and rebates
- **REG BI**
  - Eliminating need to prove broker controlled the account will mean more churning/excessive trading cases
  - Will also focus on recommendation of account type, advisory fee vs. commissions, reverse churn cases
- **529 Plan Initiative**
  - Voluntary participation through self report
  - Promise of no penalty

FINRA Enforcement Priorities – Where We Were Before the Pandemic

- **Complex Products sold to retail without proper training and supervision**
  - Non-traded ETFs, UITs, Structured Notes
  - Disclosure, Concentration, Suitability

- **Broker's recommend to trade on Margin**
  - 12% margin loan to buy a product with 4% return

- **Cross-Product Switching**
  - Preferred → CEF → UIT → Preferred
  - Commissions effect yield
  - Surveillance needed across product lines

FINRA Enforcement Priorities Post COVID-19

- **COVID -19 TASK FORCE**
  - Coordinating with SEC and CFTC
  - Microcap issuers promising vaccines, treatments, testing, PPE
  - Phishing attempts related to COVID-19
  - Trend for more sophisticated hacking — firms need to have robust systems to prevent identity theft & account intrusions

- **VOLATILE MARKETS**
  - Some cross-market surveillance alerts up 6% to 167%
  - Best Execution alerts in Fixed Income products up 10%
  - Collapse in Real Estate and Oil & Gas sector and products tied to those sectors
  - Volatility ETFs and ETPs sold to retail and held longer than a day

SEC Regulatory Priorities

SEC Regulatory Priorities – Proposed Amendments to Accredited Investor Definition

Current Rule: The "accredited investor" definition uses income and net worth thresholds to identify natural persons as accredited investors eligible to participate in certain private offerings. Certain entities – such as banks, savings and loan associations, registered broker-dealers (BDs), insurance companies and investment companies qualify as accredited investors based on their status alone. Other entities may qualify as accredited investors based on a combination of their status and the amount of their total assets.

*Key Cha*nges:

- The proposed amendments to the accredited investor definition would add new categories of natural persons based on professional knowledge, experience or certifications, as well as a "catch-all" category for any entity owning in excess of US$5 million in investments.
- Among the new categories would be:
  - natural persons based on certain professional certifications and designations
  - for investments in a private fund, "knowledgeable employees" of the fund
  - any entity owning "investments" in excess of $5 million and that was not formed for the specific purpose of investing in the securities offered
  - "family offices" with at least $5 million in assets under management
- SEC also would amend the definition of "qualified institutional buyer" in Rule 144A that would expand the list of entities that qualify as QIBs.
- *Compliance Note for BDs*: Assuming these amendments are adopted, BDs will have additional sources of investors but will need to have polices and procedures to make sure that the expanded pools of investors are qualified under the new standards.

SEC Regulatory Priorities – Proposed Amendments to Harmonize and Simplify Exempt Offering Rules

- Facilitate the ability of issuers to move from one exemption to another and ultimately to a registered offering
- Increase the offering limits for Regulation A, Regulation Crowdfunding and Rule 504 offerings, and revise certain individual investment limits based on the SEC's experience with the rules, marketplace practices, capital raising trends and comments received

For Regulation A:

- Raise the maximum offering amount under Tier 2 of Regulation A from US$50 million to US$75 million
- Raise the maximum offering amount for secondary sales under Tier 2 from US$15 million to US$22.5 million

For Regulation Crowdfunding:

- Raise the offering limit in Regulation Crowdfunding to US$5 million
  - remove investment limits for accredited investors
  - allow non-accredited investors to rely on the greater of their annual income or net worth when calculating the limit on how much they can invest

The SEC also proposed four non-exclusive safe harbors from integration

SEC Regulatory Priorities – Proposed Amendments to Harmonize and Simplify Exempt Offering Rules (cont'd)

For Rule 504 of Regulation D:

- Raise the maximum offering amount from US$5 million to US$10 million
- Permit certain "demo day" activity without running afoul of the prohibition on general solicitation

"Test-the-Waters" and "Demo-Day" Communications

- Permit Regulation Crowdfunding issuers to "test-the-waters"
- Provide that certain "demo-day" communications would not be deemed general solicitation or general advertising
- Align the financial information that issuers must provide to non-accredited investors in Rule 506(b) private placements with financial information that issuers must provide to investors in Regulation A offerings
- Add a new item to the non-exclusive list of verification methods in Rule 506(c)
- Simplify Regulation A offerings and make them more consistent with registered offerings
- Harmonize the bad actor disqualifications in Regulation D, Regulation A and Regulation Crowdfunding

Integration Framework

- Ease integration analysis by looking to the particular facts and circumstances of the offering, and focus the analysis on whether the issuer can establish that each offering either complies with the registration requirements of the Securities Act, or that an exemption from registration is available
- The SEC also proposed four non-exclusive safe harbors from integration

SEC Regulatory Priorities – Due Diligence by BDs and RIAs for Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles

Proposed Rule: It would enhance the use of derivatives by registered investment companies, including mutual funds, exchange-traded funds (ETFs) and closed-end funds, as well as business development companies (BDCs). Currently, the Investment Company Act limits the ability of registered funds and BDCs to obtain leverage, including by transactions that involve potential future payment obligations. The proposed rule would permit these funds to use derivatives that create such obligations, provided that they comply with certain conditions designed to protect investors.

Special Regime for Leveraged and Inverse ETFs: Certain registered investment companies that seek to provide *leveraged or inverse exposure* to an underlying index — including leveraged ETFs — would *not be* subject to the proposed limit on fund leverage risk but instead would be subject to *alternative* requirements under the SEC's proposal. These funds would have to limit the investment results they seek to 300% of the return (or inverse of the return) of their underlying index.

Sales Practice Rules: Rule 15l-2 under the Securities Exchange Act of 1934 and Rule 211(h)-1 under the Investment Advisers Act of 1940 would require that a BD or registered investment advisor (RIA) exercise *due diligence* in approving a retail customer or client's account to buy or sell shares of these funds before any investment is made. Designed to limit these products to retail investors to those capable of evaluating their characteristics and risks.

Rules are modeled after current FINRA options account approval requirements, and would require a firm to (i) approve the retail investor's account for buying and selling shares of leveraged/inverse investment vehicles after performing due diligence and obtaining certain essential facts about the retail investor, and (ii) adopt and implement written policies and procedures reasonably designed to comply with the Sales Practices Rules.

SEC Regulatory Priorities – Equity Market Structure Reform – Key Initiatives

- **Governance of NMS Plans for Consolidated Market Data** (May 6, 2020)
  - Consolidates three NMS plans governing the systematic investment plan (SIPs) into a single plan
  - Provides 1/3 voting power to non-self-regulatory organization (SRO) participants
  - Requires an independent administrator operate the SIP (i.e., not NYSE or Nasdaq)
  - Revised NMS plan due August 11 subject to legal challenge
- **Market Data Infrastructure Proposal** (February 14, 2020)
  - Expand the content of consolidated market data (e.g., 5 levels of depth of book; certain odd lots)
  - Shift from an exclusive SIP model to a competing consolidator model
  - Modifies round lot quantities for higher priced securities (i.e., those priced greater than US$50 per share)
- **Rescission of Effective Upon Filing Fee Changes for National Market System (NMS) Plans** (October 1, 2019)
  - Anticipated adoption this summer

SEC Regulatory Priorities – Proposed Amendments to Exchange Act Rule 15c2-11

Current Rule: Requires BDs to review basic issuer information before publishing quotations in a quotation medium for securities that are not listed on a national securities exchange; allows piggybacking in reliance on the initial BD's quotations after 30 days of frequent quotation activity.

Key Proposed Changes:

- Require information used by BDs to be current and ***publicly available*** including for use of the piggyback exception
- Require information be current and ***publicly available*** for a BD to rely on it to publish quotations by or on behalf of company insiders
- Limit the piggyback exception to bid and ask quotations that are published at specified prices with no more than four successive days without quotation activity
- Eliminate the piggyback exception during the first 60 calendar days after the termination of a Commission 12(k) trading suspension
- Eliminate the piggyback exception for securities of "shell companies"

Add exceptions to reduce burdens for broker-dealers:

- For securities of well-capitalized issuers whose securities are actively traded (US$100,000 ADTV and US$50 million in assets)
- If the BD publishing the quotation was named as an underwriter in the security's registration statement or offering circular
- Allow reliance on regulated third-party (IDQS) compliance with the rule's required review and determinations that the requirements of certain exceptions have been met

FINRA Regulatory Priorities

FINRA Regulatory Priorities – Rules on the Horizon

FINRA 360: In 2017, FINRA launched a retrospective review of its rules to assess their effectiveness and assess the need for modernization. The subject matter areas included: carrying agreements, outside business activities, Member Application Program processes, communications with the public, payments to market makers, capital raising and remote branch supervision, and gifts and entertainment. For the most part, FINRA has issued regulatory notices but has yet to adopt rule amendments in response to its review. Nonetheless, we may expect regulatory developments in the above areas and those discussed below.

Conformance with SEC Reg BI: FINRA has amended its suitability rule, Capital Acquisition Broker suitability rule and rules governing non-cash compensation effective June 30, 2020 to provide clarity on which standard applies and to address potential inconsistencies with the SEC's Regulation Best Interest (Reg BI).

Outside Business Activities: FINRA proposed Rule 3290 to govern the outside business activities and private securities transactions of registered persons. The proposed rule would replace both current FINRA Rule 3270 (Outside Business Activities of Registered Persons) and current FINRA Rule 3280 (Private Securities Transactions of Associated Persons), and is intended to streamline regulation in this area and focus compliance on activities most likely to create risk for investors. Key changes include: definitions of the terms "investment-related" and "business activity" and specific firm obligations for each activity category; and exclusion of activities of registered persons on behalf of firm affiliates from the scope of the proposed rule.

FINRA Regulatory Priorities (cont'd)

High-Risk Brokers: FINRA is proposing to: (1) amend FINRA Disciplinary Proceedings rules to allow a Hearing Officer to impose conditions or restrictions on the activities of a respondent member firm or respondent broker and require heightened supervisory procedures for such broker when a disciplinary matter is on appeal; (2) require member firms to adopt heightened supervisory procedures for statutorily disqualified brokers during the period a statutory disqualification eligibility request is under review by FINRA; (3) allow the disclosure through FINRA BrokerCheck of the status of a member firm as a "taping firm"; and (4) require a firm to consult the Membership Application Program (MAP) group when a natural person that has, in the prior five years, one or more "final criminal matters" or two or more "specified risk events" seeks to become an owner, control person, principal or registered person of the firm.

Proposed Procedures to Address Cheating on Qualification Examinations: FINRA will solicit comment on a new expedited proceeding rule for failures by associated persons and non-associated persons to comply with the FINRA Qualification Examinations Rules.

Proposed Amendments to FINRA Corporate Financing Rules to Require Members to File Retail Communications Concerning Specified Private Placements: FINRA will propose amendments to Rules 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities) to require firms to file retail communications concerning specified private placements.

Proposal Relating to Trade Reporting and Compliance Engine (TRACE) Reporting of Delayed Treasury Spot and Portfolio Trades: FINRA will solicit comment on proposed amendments to TRACE rules to require members to identify corporate bond trades that are priced off of a spread to a U.S. Treasury Security or that are part of a portfolio trade.

Consolidated Audit Trail - Key Developments

Compliance date for Equities file submission and data integrity was June 22, 2020.

- First day of reporting: 12.2 billion records from over 1,000 firms; rejection error rate was under 0.5%

Recent Other Milestone:

SIFMA led Settlement with SROs regarding the SRO limitation of liability in the CAT Reporter Agreement. SROs agreed to remove the offending language and to not impose limitation of liability language without going through rule proposal requiring notice and comment.

Upcoming dates:

- July 20 - Compliance date for Options file submission and data integrity
- July 27 - Compliance date for Equities intrafirm linkage
- August 24 - Compliance date for Options intrafirm linkage
- August 27 - Equities Report Card available
- September 15 - Equities and Options Report Card available

Up Next 2021 and Beyond :

- Retirement of Order Audit Trail System (OATS)
- Expansion to Fixed Income Securities

Speaker Biographies

James Brigagliano
Partner
Washington, D.C.
+1 202 736 8135
jbrigagliano@sidley.com

JAMIE BRIGAGLIANO is a partner of the Securities Enforcement and Regulatory group, which received the 2019 *Chambers USA* award for Financial Services Regulation Firm of the Year, and was named the "Law Firm of the Year" for Securities Regulation in 2020 and 2017 by *U.S. News – Best Lawyers*. Prior to joining the firm, Jamie served as the Deputy Director of the Division of Trading and Markets at the Securities and Exchange Commission, where he held senior policymaking and management responsibilities. His practice at Sidley is composed of advising broker-dealers, hedge funds and other financial services firms on a broad variety of regulatory, enforcement, compliance and transactional matters. Jamie focuses his practice in particular on SEC and SRO rules governing trading by broker-dealers and hedge funds, and broker-dealer registration and conduct rules.

Jamie's practice is recognized by *Chambers USA* since 2013 and *The Best Lawyers in America*. In the 2015 edition of *Chambers USA*, Jamie was recognized as a lawyer with "a good understanding of how the SEC operates" and "strong practical skill in trading practices." For the 2016, 2017 and 2019 rankings, *The Best Lawyers in America* list Jamie as a "Best Lawyer" in the Securities Regulation category.

W. Hardy Callcott
Partner
San Francisco
+1 415 772 7402
hcallcott@sidley.com

HARDY CALLCOTT's practice concentrates on enforcement defense and regulatory counseling concerning securities market and regulatory issues for broker-dealers, investment advisers, mutual funds and others in the financial services industry. He provides securities enforcement defense before the SEC, Department of Justice, FINRA and other SRO and state regulators for members of financial services industry, public companies and officers and directors. He also conducts internal investigations.

Hardy is a member of Sidley's global Securities Enforcement and Regulatory practice, which received the 2019 *Chambers USA* Award for "Financial Services Regulation Firm of the Year" and 2020 *Chambers USA* Band 1 for Financial Services Regulation: Broker Dealer (Compliance & Enforcement). Sidley was also named the "Law Firm of the Year" for Securities Regulation in 2020 and 2017 by *U.S. News – Best Lawyers*. Hardy was ranked nationally in *Chambers USA* for Securities Financial Services Regulation 2008–2020, including the highest category, Band 1, in both Broker Dealer (Compliance) and Broker Dealer (Enforcement) in 2020. He was also included in *The Best Lawyers in America* 2007–2012 and 2014–2016 lists, chosen based on peer-reviewed surveys of U.S. lawyers. He was with Charles Schwab & Co. Inc., as senior vice president and general counsel. He served in the General Counsel's Office of the SEC as assistant general counsel for Market Regulation (now Trading and Markets), and taught in the Securities LLM program at Georgetown University Law Center. After law school, Hardy clerked for the Hon. Mariana Pfaelzer in the U.S. District Court for the Central District of California.

Speaker Biographies

Kevin J. Campion
Partner
Washington, D.C.
+1 202 736 8084
kcampion@sidley.com

KEVIN J. CAMPION advises a wide array of financial services firms including investment and commercial banks, broker-dealers and hedge funds — on a broad variety of regulatory, enforcement, compliance and transaction matters. Mr. Campion focuses his practice in particular on broker-dealer and market regulation matters, with particular emphasis upon regulations governing short sales (Regulation SHO), short interest reporting, Regulation M, research analyst conflicts, FINRA advertising rules, clearance and settlement, and broker-dealer registration and compliance issues. Mr. Campion also regularly assists advisers and hedge funds with trading questions and long and short position disclosure requirements, including the requirements of Section 13(d), 13(f) and Section 16.

Mr. Campion has been recognized annually in *Chambers USA: America's Leading Lawyers for Business* since 2011 in the area of Financial Services Regulation: Broker Dealer (Compliance; Nationwide). The 2015 edition of *Chambers USA* highlights Mr. Campion for the "strength of his compliance advice to broker-dealer clients," and market observers suggest that he is "increasingly becoming a household name" in the industry. Mr. Campion was recognized as a 2015 Rising Star by *Euromoney LMG* in the Capital Markets field. The firm also received the most first-tier national rankings, including Securities Regulation, of any U.S. law firm every year since the 2011 *U.S. News — Best Lawyers* "Best Law Firms" survey. Mr. Campion is a member of Sidley's global Securities and Derivatives Enforcement and Regulatory practice, which received the 2019 *Chambers USA* Award for Financial Services Regulation, and was named the "Law Firm of the Year" for Securities Regulation in 2020 and 2017 by *U.S. News – Best Lawyers*.

Susan L. Merrill
Partner
New York
+1 212 839 8558
smerrill@sidley.com

SUSAN MERRILL assists broker-dealers, investment advisers, financial institutions, exchanges and Fortune 500 companies across the United States in investigations before the SEC, CFTC, FINRA and state securities regulators. Susan also conducts internal investigations and advises clients on regulatory compliance matters. She is a member of Sidley's global Securities Enforcement and Regulatory practice, which received the 2019 *Chambers USA* Award for "Financial Services Regulation," and was named the "Law Firm of the Year" for Securities Regulation in 2020 and 2017 by *U.S. News – Best Lawyers*.

Susan is the former head of enforcement at FINRA, where she oversaw the establishment and development of its enforcement program. She joined FINRA from her position as enforcement chief at New York Stock Exchange Regulation when it merged with the NASD in 2007. Before she became a regulator, Susan was in private practice for 17 years and represented clients in some of the highest-profile matters on Wall Street.

Beijing

Boston

Brussels

Century City

Chicago

Dallas

Geneva

Hong Kong

Houston

London

Los Angeles

Munich

New York

Palo Alto

San Francisco

Shanghai

Singapore

Sydney

Tokyo

Washington, D.C.

sidley.com