SECURITIES OPERATIONS

A Publication of mediant

REGULATORY UPDATE

July 1, 2019

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SEC ADOPTS REGULATION BEST INTEREST, RELATED RULES AND INTERPRETATIONS

On June 5, 2019, the SEC voted to adopt a package of rulemakings and interpretations designed to enhance the quality and transparency of retail investors' relationships with investment advisers and broker-dealers. Specifically, these actions include the new Regulation Best Interest, the new Form CRS Relationship Summary, and two separate interpretations under the Investment Advisers Act of 1940. Under Regulation Best Interest, broker-dealers will be required to act in the best interest of the customer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. Regulation Best Interest will enhance the broker-dealer standard of conduct beyond the existing suitability standard. The Form CRS Relationship Summary will require registered investment advisers and broker-dealers to provide retail investors with simple, easy-to-understand information about the nature of their relationship with their financial professional. The SEC also published interpretations related to an investment adviser's fiduciary duty and the broker-dealer exclusion rule of the 1940 Act. Regulation Best Interest and Form CRS will become effective 60 days after they are published in the Federal Register, and will include a transition period until June 30, 2020 to give firms sufficient time to come into compliance. The SEC's interpretations under the Advisers Act will become effective upon publication in the Federal Register.

Final Rule – Reg Best Interest: https://www.sec.gov/rules/final/2019/34-86031.pdf
Final Rule – CRS Relationship Summary: https://www.sec.gov/rules/final/2019/34-86032.pdf
SEC Interpretation – Fiduciary Duty: https://www.sec.gov/rules/interp/2019/ia-5248.pdf
SEC Interpretation – BD Exclusion: https://www.sec.gov/rules/interp/2019/ia-5249.pdf

SEC ADOPTS CAPITAL, MARGIN AND SEGREGATION REQUIREMENTS RULES FOR SECURITY-BASED SWAPS

On June 21, 2019, the SEC announced that it had adopted a package of rules and rule amendments under Title VII of the Dodd-Frank Act designed to enhance the risk mitigation practices of firms that stand at the center of the security-based swap market. The rules address four key areas: 1) they establish or raise minimum capital requirements for security-based swap dealers, participants and broker-dealers under certain circumstances; 2) they establish margin requirements for nonbank dealers or participants with respect to non-cleared security-based swaps; 3) they establish segregation requirements for cleared and non-cleared security-based swaps; and 4) they amend the SEC's existing cross-border rule to provide a means to request substituted compliance with respect to the capital and margin requirements for foreign dealers and participants, and provide guidance as to how the SEC will evaluate such requests. The rules will become effective 60 days after publication in the Federal Register, and the compliance date will be announced at a future point in time.

Final Rule: https://www.sec.gov/rules/final/2019/34-86175.pdf

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SEC APPROVES FINRA RULE FOR REPORTING CERTAIN TRANSACTIONS IN U.S. TREASURY SECURITIES TO TRACE

On June 21, 2019, the SEC issued an order approving a Financial Industry Regulatory Authority ("FINRA") proposed rule change to FINRA Rule 6730. Under current FINRA Rule 6730, a trade report for a transaction in a U.S. Treasury Security executed by 5:00 p.m. ET is due on trade date by the close of the Trade Reporting and Compliance Engine ("TRACE") system hours, whereas a primary market transaction trade report is due on the next business day by the close of TRACE system hours. In order to address operational challenges for its members, FINRA has proposed to amend FINRA Rule 6730 to provide that a transaction in a U.S. Treasury Security executed to hedge a primary market transaction must be reported no later than the next business day during TRACE system hours and, if reported on the next business day, designated "as/of" with the date of execution included. The proposal was initially filed with the SEC by FINRA on April 16, 2019 and, on June 13, 2019, the SEC designated a longer period of time for SEC action. FINRA has stated that it will announce the effective date of the rule change in a Regulatory Notice to be published no later than 90 days following SEC approval.

Approval Order: https://www.sec.gov/rules/sro/finra/2019/34-86178.pdf

SEC CHAIRMAN CLAYTON HIGHLIGHTS NEW MEMBERS OF EXECUTIVE STAFF

On June 26, 2019, the SEC released a full roster of the executive staff of Chairman Jay Clayton, including several individuals who have recently joined the Commission. Among other changes to the staff, Lucas Moskowitz will be replaced by Sean Memon as Chief of Staff, and Bryan Wood will serve as Deputy Chief of Staff. Chairman Clayton's executive staff is responsible for advising him on all matters before the SEC, working closely with SEC staff, and helping the Chairman perform all day-to-day operations needed to fulfill the SEC's mission. The SEC included professional biographies of each staff member in its press release.

Press Release: https://www.sec.gov/news/press-release/2019-112

SEC NAMES KEVIN ZERRUSEN AS SENIOR ADVISOR FOR CYBERSECURITY POLICY

On June 3, 2019, the SEC announced that Kevin A. Zerrusen will serve as SEC Chairman Clayton's Senior Advisor for Cybersecurity Policy. In this role, Zerrusen will coordinate efforts across the agency to address cybersecurity policy, engage with external stakeholders, and help enhance the SEC's mechanisms for assessing cyber-related risks. Zerrusen currently serves as Chair of the Intelligence National Security Alliance's Cyber Council and is a 30-year veteran of the Central Intelligence Agency, where his responsibilities included running the Agency's cyber center, which is responsible for analyzing, evaluating, and countering foreign cyber threats. For the past five years, he has worked as Managing Director at Goldman Sachs, where he led initiatives to strengthen technology risk governance, incident management, and insider threat programs.

Press Release: https://www.sec.gov/news/press-release/2019-82

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SEC NAMES DAVID PEAVLER AS DIRECTOR OF FORT WORTH REGIONAL OFFICE

On June 6, 2019, the SEC named David Peavler as Director of its Fort Worth Regional Office. Peavler previously served for nearly 15 years in senior SEC Division of Enforcement roles in the Fort Worth Regional Office, most recently as an Associate Director. Prior to rejoining the SEC, Peavler had served as General Counsel at HD Vest Inc. since 2017. Peavler joined the SEC's Division of Enforcement as a staff attorney in April 2000 and, prior to that, he was a partner in the trial section of Locke Liddell, now Locke Lord, where he primarily represented major accounting firms in securities class actions and auditing malpractice. Peavler received his law degree from the University of Texas and his undergraduate degree in accounting and economics from Baylor University.

Press Release: https://www.sec.gov/news/press-release/2019-91

FINRA TO EXTEND IMPLEMENTATION OF CDS MARGIN REQUIREMENT RULE

On May 31, 2019, the SEC published for comment a FINRA proposal to extend the implementation of FINRA Rule 4240. The SEC had previously approved FINRA Rule 4240 on May 22, 2009 and thereafter had approved a FINRA proposal extending the implementation of FINRA Rule 4240 to July 18, 2019. The Rule implements an interim pilot program with respect to margin requirements for certain transactions in credit default swaps ("CDS") that are security-based swaps. FINRA has proposed to extend the implementation period to July 20, 2020 in light of the continuing development of the CDS business and ongoing regulatory developments.

Comments Due: June 27, 2019
Notice Release: https://www.sec.gov/rules/sro/finra/2019/34-85981.pdf

FINRA TO AMEND RULES REGARDING COMMUNICATIONS WITH THE PUBLIC, RESEARCH REPORTS

On June 20, 2019, FINRA filed proposed amendments to FINRA Rule 2210 and FINRA Rule 2241. FINRA Rule 2241 governs the publication of research reports concerning equity securities and the analysts that produce such research. FINRA Rule 2210 requires FINRA members to file within 10 business days of first use or publication retail communications that promote or recommend a specific registered investment company or family of registered investment companies, as well as retail communications that concern any other registered security that is derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance or a foreign currency. The proposed rule changes would eliminate the "quiet period" restrictions in FINRA Rule 2241 on publishing a research report or making a public appearance concerning a covered investment fund and would create a filing exclusion under FINRA Rule 2210 for covered investment fund research reports.

Comments Due: 21 days after publication in the Federal Register
Proposed Rule: http://www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2019-017.pdf

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NASDAQ TO ESTABLISH NEW ORDER TYPE

On June 11, 2019, the SEC published for comment a proposal by The Nasdaq Stock Market LLC ("Nasdaq") to amend Nasdaq Rule 4702 to establish as a new order type, the Midpoint Extended Life Order Continuous Book (or "MELOCB") order. Nasdaq has also proposed to amend Nasdaq Rule 4703(n) to permit midpoint orders on the continuous book to execute against MELOCBs under certain conditions. The SEC's action follows its March 7, 2018 approval of a prior Nasdaq proposal to add a Midpoint Extended Life Order (or "MELO") order type. A MELO is a non-displayed order that is available to all members but interacts only with other MELOs. It is priced at the midpoint between the national best bid and offer and it does not become eligible for execution until it completes a one-half second holding period. A MELOCB is a variation on the MELO concept in that it has all of the characteristics and attributes of a regular MELO, except that, in addition to executing against other MELOCBs and MELOs, it also may access additional sources of liquidity on Nasdaq's continuous book.

Comments Due: July 8, 2019
Notice Release: https://www.sec.gov/rules/sro/nasdaq/2019/34-86083.pdf

NASDAQ TO DELAY IMPLEMENTATION OF THE MIDP ROUTING OPTION

On June 11, 2019, the SEC published for comment a Nasdaq proposal to delay implementation of the MIDP routing option until the third quarter of 2019. MIDP is a new order routing option under Nasdaq Rule 4758(a)(1)(A), which would allow members to seek midpoint liquidity on Nasdaq and other markets on the Nasdaq system routing table. On May 20, 2019, the SEC approved MIDP and noted that Nasdaq planned to implement the new routing option in the second quarter of 2019. Nasdaq has proposed to delay MIDP's implementation in order to better prepare its systems for two significant market events expected to occur on June 21, 2019.

Comments Due: July 8, 2019
Notice Release: https://www.sec.gov/rules/sro/nasdaq/2019/34-86087.pdf

NASDAQ TO EXTEND ITS PENNY PILOT PROGRAM FOR OPTIONS CLASSES IN CERTAIN ISSUES

On June 19, 2019, the SEC published for comment a Nasdaq proposal to amend Chapter VI, Section 5 of the rules of The Nasdaq Options Market ("NOM") to extend through December 31, 2019, or the date of permanent approval if earlier, the penny pilot program for options classes in certain issues (the "NOM Penny Pilot"). Under the NOM Penny Pilot, the minimum price variation for all participating options classes is $0.01 for all quotations in options series that are quoted at less than $3 per contract and $0.05 for all quotations in options series that are quoted at $3 per contract or greater. The NOM Penny Pilot is currently scheduled to expire on June 30, 2019. Nasdaq has proposed to extend the time period of the NOM Penny Pilot to allow for further analysis of its structure.

Comments Due: 21 days after publication in the Federal Register
Notice Release: https://www.sec.gov/rules/sro/nasdaq/2019/34-86153.pdf

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NYSE TO ADD NEW AND MODIFY EXISTING ORDER TYPES

On June 20, 2019, the SEC granted accelerated approval and published for comment a proposal by the New York Stock Exchange LLC ("NYSE"), as modified by Amendment No. 2, to amend NYSE Rule 7.31 to add the Capital Commitment Order, a new order type that will only be available to Designated Market Makers ("DMMs"). The NYSE has also proposed to modify the Rule to specify that market orders and the last sale peg modifiers are not available to DMMs, and to make conforming changes to other related rules. The NYSE has proposed the changes to accommodate DMMs in the transition of NYSE-listed securities to the NYSE's Pillar trading platform.

Comments Due: 21 days after publication in the Federal Register
Notice Release: https://www.sec.gov/rules/sro/nyse/2019/34-86167.pdf

NYSE TO MANDATE COMMUNICATIONS BETWEEN A DMM AND SENIOR PERSONNEL OF LISTED ISSUER

On June 20, 2019, the SEC granted accelerated approval and published for comment an NYSE proposal to amend NYSE Rules 104 and 36 to require and facilitate routine DMM communications with designated representatives of listed issuers. Specifically, the NYSE has proposed to amend NYSE Rule 104 to require DMMs to communicate at least quarterly with one or more senior individuals at each issuer of listed securities in whose securities DMMs associated with the DMM unit are registered and would describe how the communication requirement can be met. In addition, the NYSE has proposed to amend NYSE Rule 36 to facilitate written electronic communications with issuers from the floor of the exchange pursuant to proposed Rule 104(l) during specified time periods and subject to certain restrictions.

Comments Due: 21 days after publication in the Federal Register
Notice Release: https://www.sec.gov/rules/sro/nyse/2019/34-86163.pdf

NYSE AMERICAN TO EXTEND PENNY PILOT IN OPTIONS CLASSES IN CERTAIN ISSUES

On June 7, 2019, the SEC published for comment a proposal by the NYSE American LLC ("NYSE American") to amend Rule 960NY in order to extend its penny pilot for options classes in certain issues (the "NYSE American Pilot Program") through December 31, 2019. The NYSE American Pilot Program is currently scheduled to expire on June 30, 2019. The NYSE is not proposing any substantive changes to the NYSE American Pilot Program; all classes currently participating will remain the same and all minimum increments will remain unchanged. The NYSE American has proposed to extend the NYSE American Penny Pilot to allow for further analysis of its structure.

Comments Due: July 5, 2019
Notice Release: https://www.sec.gov/rules/sro/nyseamer/2019/34-86061.pdf

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NYSE AMERICAN NO LONGER SEEKING CASH SETTLEMENT OF CERTAIN FLEXIBLE EXCHANGE EQUITY OPTIONS

As previously reported, the SEC on October 4, 2018 published for comment a proposal by NYSE American to amend certain rules related to Flexible Exchange ("FLEX") Options. FLEX Options are customized equity or index contracts that allow investors to tailor contract terms for exchange-listed equity and index options. Per the NYSE American's proposal, FLEX Equity Options where the underlying security is an Exchange-Traded Fund ("ETF") that is included in the NYSE American Penny Pilot would be settled by physical delivery of the underlying ETF or by delivery in cash. Under current NYSE American rules, all such options are settled by physical delivery of the underlying security. On June 14, 2019, the SEC published a notice that on May 31, 2019, the NYSE American had withdrawn its proposed rule change.

Notice Release: https://www.sec.gov/rules/sro/nyseamer/2019/34-86111.pdf

OCC TO INTRODUCE A NEW LIQUIDATION COST MODEL IN ITS MARGIN METHODOLOGY

On June 13, 2019, the SEC published a notice of no objection to an April 18, 2019 Options Clearing Corporation ("OCC") advance notice filing. The OCC made the filing in order to propose certain modifications to its margin methodology and to introduce a new model to estimate the liquidation cost for all options and futures, as well as the securities in margin collateral. Specifically, the purpose of the OCC proposal is to collect additional financial resources to guard against potential shortfalls in margin requirements that may arise due to the costs of liquidating the portfolio of a defaulted OCC clearing member. The proposed model would estimate the cost to liquidate a portfolio based on the mid-points of the bid-ask spreads for the financial instruments within the portfolio, and would scale up such liquidation costs for large or concentrated positions that would likely be more expensive to close out.

Notice Release: https://www.sec.gov/rules/sro/occ-an/2019/34-86103.pdf

MSRB OFFERS FREE COURSE ON STRUCTURING A FIXED-RATE MUNICIPAL BOND TRANSACTION

On June 20, 2019, the Municipal Securities Rulemaking Board ("MSRB") announced the release of a free online course specifically designed for understanding the process of structuring fixed-rate municipal bond transactions. Specifically, the course entitled *Municipal Bond Math Basics* provides practice scenarios for confirming the accuracy of cash flows associated with fixed-rate transactions. "We are excited to provide a course to municipal market participants that really dives into the quantitative procedures of structuring these transactions," said MSRB President and Chief Executive Officer Lynnette Kelly.

Press Release: http://msrb.org/News-and-Events/Press-Releases/2019/MSRB-Offers-Free-Course-On-Structuring-A-Fixed-Rate-Transaction.aspx

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Notable Enforcement Action

This month's SRO enforcement actions continue a recent trend of relatively modest penalties for sales practice and trade reporting violations, however, firms should review practices around pre-release of American Depositary Receipts in light of the SEC's continuing focus on this area.

A firm was censured, fined $105,000 and required to implement reasonably designed controls and procedures for failing to include a code that reflected its reliance on an information barrier when appropriate in its submissions to the Order Audit Trail System ("OATS"). The firm's Order Management System ("OMS") was designed to report the required information barrier identifier only for activity between different aggregation units at the firm. However, because the firm's broker-dealer desk and market making desk operated within the same aggregation unit, the necessary information barrier identifier was not included in those OATS submissions. The firm also failed to submit execution reports, which are Reportable Order Events ("ROEs"), to OATS. In certain instances when a firm trader combined multiple orders from the same client before routing that combined order to the trading desk, instead of reporting the required riskless principal leg of a trade, the firm's OMS reported the principal execution, which is an optional submission to OATS. The firm failed to establish and maintain a system that was reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules, including OATS reporting requirements. The firm's failure to identify this issue was caused, at least in part, because its OATS review did not include a component designed to determine whether the information barrier identification was being properly reported. The firm also violated Rule 611(c) of Regulation NMS by routing an intermarket sweep order ("ISO") to a covered exchange priced outside of at least one protected quotation without simultaneously routing additional limit orders to execute against the full displayed size of any protected bid. The firm did not have a reasonable supervisory system to achieve compliance with Rule 611(c) of Regulation NMS and as a result, it was not aware that it was not routing secondary ISOs. (**FINRA Case #2015046800201**)
http://www.finra.org/sites/default/files/fda_documents/2015046800201%20Cantor%20Fitzgerald%20%26%20Co.%20CRD%20134%20AWC%20va.pdf

A firm was censured and fined $32,500 for failing to establish, maintain and enforce a supervisory system, including written supervisory procedures ("WSPs"), reasonably designed to review email correspondence for indications of potential violations of federal securities laws or FINRA rules. The findings state that the firm lacked any pertinent WSPs, and its methods for reviewing email messages were ineffective and unreasonable given its business, size, structure and customers. The firm's WSPs did not include procedures describing how it would conduct its supervisory review of electronic communications sent or received by its registered individuals. In addition, the emails selected randomly by the firm's email vendor did not constitute a reasonable amount of the firm's overall electronic communications, and the search terms that would flag an email for principal review were not comprehensive enough to yield a meaningful sample of flagged communications. (**FINRA Case #2014042949704**)
http://www.finra.org/sites/default/files/fda_documents/2014042949704%20Wilson-Davis%20%26%20Co.%2C%20Inc.%20CRD%203777%20AWC%20va.pdf

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A firm was censured and required to provide remediation for disadvantaging certain retirement plan and charitable organization customers that were eligible to purchase Class A shares in certain mutual funds without a front-end sales charge. These eligible customers qualified for, but did not receive, applicable mutual fund sales charge waivers. Instead, they were sold Class A shares with a front-end sales charge or Class B or C shares with back-end sales charges and higher ongoing fees and expenses, causing the customers to pay higher fees than they were actually required to pay. The firm failed to reasonably supervise the application of sales charge waivers to eligible mutual fund sales by relying on its financial advisors to determine the applicability of sales charge waivers. The firm failed to maintain WSPs reasonably designed to assist financial advisors in making this determination. In addition, the firm failed to adequately notify and train its financial advisors regarding the availability of mutual fund sales charge waivers for eligible customers. The firm failed to adopt adequate controls to detect instances in which they did not provide sales charge waivers to eligible customers in connection with their mutual fund purchases. As a result of the firm's failure to apply available sales charge waivers, the firm estimates that eligible customers were overcharged by $104,044 for mutual fund purchases made since January 1, 2009. The firm agreed to pay restitution to eligible customers, which is estimated to total $125,982, which is the amount eligible customers were overcharged, with interest. (**FINRA Case #2016050231901**)
http://www.finra.org/sites/default/files/fda_documents/2016050231901%20Voya%20Financial%20Advisors%2C%20Inc.%20CRD%202882%20AWC%20va.pdf

In two separate actions, the SEC settled charges against firms for improper handling of "pre-released" American Depositary Receipts ("ADRs"), bringing to 14 the number of actions against banks or broker-dealers resulting from the SEC's ongoing investigation into abusive ADR pre-release practices, which, thus far, has resulted in monetary settlements exceeding $422 million. U.S. securities that represent foreign shares of a foreign company require a corresponding number of foreign shares to be held in custody at a depositary bank. The practice of "pre-release" allows ADRs to be issued without the deposit of foreign shares, provided brokers receiving them have an agreement with a depositary bank and the broker or its customer owns the number of foreign shares that correspond to the number of shares the ADRs represent. In both cases, the respondents improperly obtained pre-released ADRs from depositary banks when they should have known that neither the firm nor its customers owned the foreign shares needed to support those ADRs. Such practices resulted in inflating the total number of a foreign issuer's tradeable securities, which, in turn, resulted in abusive practices such as inappropriate short selling and dividend arbitrage.

https://www.sec.gov/litigation/admin/2019/33-10650.pdf
https://www.sec.gov/litigation/admin/2019/33-10647.pdf

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