MAYER • BROWN

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REVERSE inquiries

Structured and market-linked product news for inquiring minds.

In This Issue

The ARRC Releases its Guiding Principles for new LIBOR Fallbacks

On July 9, 2018, the Alternative Reference Rates Committee (the "ARRC") announced voluntary guiding principles for market participants to use in developing new LIBOR fallbacks for cash products, which include USD LIBOR floating rate notes.[1]

As we discussed in an earlier article in this publication, issuers of floating rate notes have begun to adjust their LIBOR fallback mechanisms to avoid having their floating rate notes default to fixed rate notes when LIBOR ceases to be published in 2021.[2] Some of the issues we discussed in our article are covered in detail in the ARRC announcement: the need for an exact definition of what constitutes a LIBOR cessation, the use of a substitute rate, adjustments to the substitute rate to account for the various LIBOR tenors and the extent of discretion allowed to the entity that chooses the substitute rate or makes necessary adjustments to that rate.

We summarize the points in the ARRC announcement below and raise a few questions.

It's time to get your head out of the sand. At this point, issuers should have some improved fallback language in place. The process will be iterative, and issuers should be willing to adjust their disclosure over time until "absolutely the most robust language possible has been identified."

The goal is uniform precision. More flexibility and discretion may be used in the beginning of the process, with a view to moving toward more specific language that removes ambiguity as to how fallbacks and adjustments will be selected. As a market consensus emerges on the key items (i.e., specific triggers, the successor rate, the spread adjustment mechanism, and the term structure), then disclosures should become more uniform and eliminate unnecessary variations. Limited discretion minimizes opportunities for dispute.

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[1] The ARRC Guiding Principles can be found at: https://goo.gl/eppZRt.

[2] Our earlier article on replacing LIBOR fallback mechanisms can be found at: https://goo.gl/XYuESX.

No mavericks. Draftspersons should keep an eye out for what is developing in other asset classes; for example, loans and derivatives. Revised fallback mechanisms for LIBOR floating rate notes should not be drafted in a vacuum.

Yes, SOFR is the new rate. The secured overnight financing rate ("SOFR") or a benchmark based on SOFR should be the replacement rate for LIBOR where appropriate and practicable.

No more polls. Stating the obvious, the ARRC discourages market participants from relying on the existing LIBOR fallbacks, which create the illusory situation of calculation agents calling up banks to get quotes for rates in a situation where a rate based on quotes was not published.

Where's the beef? The ARRC release states that "[m]echanics for determining successor rates, spread adjustments and term structures should be feasible from an operational perspective."

Agreed. The adjustment to move from a forward-looking term rate (LIBOR) to a backward-looking secured rate (SOFR) is the missing piece of the LIBOR replacement puzzle. According to published reports, this adjustment will not be fully determined until late 2021, just in time for LIBOR cessation. The ARRC release notes that market participants should understand "how any successor rate may behave relative to LIBOR in different stages of the economic cycle and in different economic conditions."

The ARRC release does not address the complexity of building an adjustment mechanism that will allow SOFR to behave like LIBOR in normal and stressed environments. Although SOFR with an adjustment may track a LIBOR tenor in a normal market, there may be a divergence in stressed economic conditions. That raises the question of how will "stress" be defined and how will a spread be triggered? Who will determine the parameters?

The ARRC release does state that the fallback language "should explicitly allow for a spread adjustment to minimize valuation changes" and that the calculation agent or similar entity making the adjustment should be adequately protected in making any determinations.

Future failure. The ARRC release recommends that draftspersons make the new fallbacks "future proof"; *i.e.*, address a potential cessation of the replacement rate.

The rate formerly known as LIBOR. Assuming that SOFR has a successful run over the next few years and quants have come up with a workable risk spread adjustment and term structure, by 2021 the market will have a new "risk-free" rate that walks and talks like LIBOR, but will operate under an assumed identity.

Coordination with global regulatory push to eliminate LIBOR. While the ARRC release focuses on the details, both UK and U.S. officials are trying to drive LIBOR out of the picture. The UK Financial Conduct Authority Chief Executive Andrew Bailey characterized the current pace of the switch from LIBOR to a replacement rate as "not yet fast enough." Mr. Bailey noted in a recent speech that new LIBOR-based swaps contracts are still being written and introduced. In the same vein, David Bowman, a senior official at the Federal Reserve Bank, said that the stock of LIBOR-based contracts needed to be reduced.[3]

[3] *See* "Global Regulators Push for Faster Transition Away From LIBOR," *Wall Street Journal* (July 12, 2018).

Broker-Dealer Sanctioned for Encouraging Early Resales of Structured Notes

On June 25, 2018, the Securities and Exchange Commission, or the SEC, announced that a broker-dealer settled charges relating to recommended resales of structured notes and certificates of deposit to retail investors between January 2009 and June 2013. According to the SEC's order (the "Order"),[4] the SEC found that the broker-dealer generated substantial fees by improperly encouraging retail customers to trade structured notes prior to their maturity dates, even though the structured notes were intended to be held to maturity. Representatives of the broker-dealer recommended that customers sell their outstanding notes before maturity and invest the proceeds in new notes, generating fees for the broker-dealer and reducing the customers' returns.[5]

The SEC determined that the broker-dealer's representatives did not reasonably investigate or understand the significant costs of their recommendations and that their supervisors routinely approved these transactions despite internal policies prohibiting short-term trading of the notes. The Order recognizes that the broker-dealer took remedial steps to address the allegedly improper sales practices.

MARK-UPS AND MARK-DOWNS LIMITING RETURNS

Structured notes are priced with embedded costs, or "mark-ups," including selling commissions and structuring and hedging costs. These costs, disclosed in each offering document, result in the estimated initial value of each note being less than its purchase price on the pricing date. There are also costs associated with redeeming notes prior to maturity. Prior to September 2011, the broker-dealer's representatives could charge a sales commission on early redemptions, with supervisor approval. Furthermore, the price at which the broker-dealer was willing to buy back the notes was typically lower than the current value of the note. This "mark-down" was typically between 2% and 3%. The mark-downs on sales of outstanding notes prior to maturity coupled with the mark-ups on purchasing new notes ate away at the customer's potential gains.

OTHER OBSERVATIONS

Churning. For the last several years, the SEC's Enforcement Division has been focused on churning, (i.e., multiple transactions switching between products within a short period of time), and the potential costs to investors. In many of the cases described in the Order, a substantial number of the broker-dealer's exchanges involved notes linked to similar or identical referenced assets. For example, a note linked to the S&P 500® was resold and the proceeds were used to purchase a note linked to the Dow Jones Industrial Average®.

Offering Documents versus Recommendations. According to the offering documents, these notes were not suitable for short-term trading due to their limited liquidity. The disclosure stated that these products were "buy-and-hold" products and should be held until maturity. This stated strategy was inconsistent with recommendations by the broker-dealer's representatives.

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[4] The Order may be found at https://goo.gl/tKmvWv.

[5] The Order relates to activities relating to sales of structured notes and certificates of deposit ("CDs"), but for the sake of brevity, we only refer to structured notes in this article.

"Locking in Gains." Certain representatives justified the exchanges by claiming that that customers were "locking in gains" on their original notes, capturing gains rather than risking a decline in the performance of the reference asset. In many instances, there was limited value in locking in gains. Due to principal protection and the note's appreciation, the only amount reasonably at risk in the original note was the gain to date. In addition, due to mark-downs on early redemptions, the customer had to sacrifice a significant portion of the gain. Further, because principal protection only applied if the note was held to maturity, a new note would only be expected to outperform the original note if held to maturity.

Supervision. The Order points out that a certain representative's supervisors and regional compliance managers approved these transaction without understanding the economics of the transaction and strategy. The broker-dealer's compliance personnel were aware of the representative's recommendations, but failed to limit the practice. The representative never received any guidance from supervisors or compliance personnel regarding the practice of soliciting customers to exchange their notes.

Two-in-a-million? The SEC focused its Order on the practices of two individual representatives of the broker-dealer and noted that most of the broker-dealer's representatives only infrequently engaged in soliciting these exchanges.

Changes in Procedure. The trades in question occurred prior to June 2013, demonstrating the broker-dealer's efforts to prevent these types of trades. Generally, broker-dealers have been working over the past several years to improve their compliance and supervision procedures.

Bad behavior results in CDs being treated as securities? CDs are generally treated as bank deposits that are not subject to the securities laws under *Marine Bank v. Weaver,* 102 S.Ct. 1220 (1982). However, at least one court has characterized CDs as securities subject to the requirements of the federal securities laws due to the particular facts of that case, which resulted in the instruments being considered "investment contracts." In *Gary Plastic Packaging Corporation v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 756 F.2d 230 (2d Cir. 1985), the CDs in question were determined to be investment contracts due to the fact that their value largely depended upon the efforts of others (i.e., the court considered that the dealer in *Gary Plastics* promised to, and did, maintain a secondary market in the CDs). In footnote 4 to the Order, which was placed at the end of a sentence noting that the representatives "engaged in a systematic practice of soliciting customers to engage in [structured notes and CDs] exchanges on hundreds of occasions," the SEC appears to reference *Gary Plastics* in stating that the CDs described in the Order were "investment contracts, and therefore securities." The SEC explained that the activities of the representatives, working with the dealer, constituted making and maintaining a market for the CDs, resulting, under a *Gary Plastics* analysis, in the CDs being treated as investment contracts, which are securities. This would be an unusual outcome, and it is not clear whether the footnote resulted from a thorough analysis of the circumstances.

CONCLUSION

The Order serves as a reminder to broker-dealers to review existing policies and practices regarding early redemption of structured products. Policies should indicate the circumstances under which trades prior to maturity may be appropriate and representatives should be trained accordingly. Compliance personnel should also be trained and review whether these transactions are appropriate under the circumstances.

Broker-dealers should ensure that their oversight and surveillance procedures track the occurrence of these transactions and the incidence of such transactions with respect to individual representatives.

Commissioner Stein on Complex Products

On June 7, 2018, SEC Commissioner Kara Stein spoke at a conference and once again focused on complex products. Commissioner Stein noted the trend toward more complex products being sold to individuals. See the full text of the Commissioner's remarks here.

Chair Clayton's Congressional Testimony

In his most recent testimony before Congress, SEC Chair Jay Clayton focused on Main Street investors. Addressing standards of conduct for broker-dealers and investment advisers, Chair Clayton noted that the rulemaking package issued in April this year would enhance retail investor protection and understanding while preserving retail investor access. He commented that the proposed broker-dealer best interest obligation addresses conflicts of interest and establishes a relationship standard that reflects reasonable retail investor expectations. He also noted that the rulemaking package would help retail investors understand who they are dealing with, what relevant questions to ask and what matters the most. In addressing the priorities, Chair Clayton noted that the Office of Compliance Inspections and Examinations will focus its attention on the SEC's commitment to protecting retail investors, and also, areas that present heightened risks. The full text of the prepared testimony may be found here.

Fifth Circuit Vacates Fiduciary Rule

On June 21, 2018, in a 2-1 decision, the U.S. Court of Appeals for the Fifth Circuit issued its mandate formally vacating the U.S. Department of Labor's ("DOL") conflict of interest rule and its related exemptions (the "Fiduciary Rule"). The Fiduciary Rule, which became effective in June 2017, broadened the definition of "investment advice fiduciary," which, in turn, expanded the universe of broker-dealers and other financial advisers subject to the fiduciary standards under the Employee Retirement Income Security Act ("ERISA") and the Internal Revenue Code, as applicable to retirement plans, IRAs and other tax-qualified savings vehicles.

In its original judgment vacating the Fiduciary Rule (*U.S. Chamber of Commerce v. U.S. Department of Labor,* No. 17-10238, 2018 WL 1325019 (5th Cir. Mar. 15, 2018)), the Court examined (1) whether the new definition of "investment advice fiduciary" comported with the ERISA Titles I and II and (2) whether the new definition was "reasonable" under *Chevron U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984) and not violative of the Administrative Procedures Act ("APA"), 5 U.S.C. § 706(2)(A) (2016).

The Court held that the DOL lacked statutory authority to promulgate the Fiduciary Rule with its overreaching definition of "investment advice fiduciary," and that the definition was unreasonable, as well as an arbitrary and capricious exercise of administrative power. A copy of the Court's opinion is available here.

Moving Forward

Financial advisers should revisit changes made to their policies and procedures in order to comply with the Fiduciary Rule. Some commentators believe that the ERISA rules for determining whether a person is an "investment advice fiduciary" that were in effect prior to the Fiduciary Rule (the "five-part test") will once again apply.[6] Other commentators have noted that the DOL's Field Assistance Bulletin No. 2018-02 is still in effect.[7] That bulletin set out a temporary enforcement policy by the DOL, under which the DOL would not pursue prohibited transaction claims against investment advice fiduciaries who work diligently and in good faith to comply with the impartial conduct standards for transactions that would have been exempted under the Fiduciary Rule's best interest contract and principal transactions exemptions. The bulletin also said that investment advice fiduciaries could rely on other applicable exemptions after the Court's decision. That would seem to encompass the five-part test.

Additionally, financial advisers and institutions should continue to monitor Regulation Best Interest, which was proposed by the SEC on April 18, 2018. Information on the components of Regulation Best Interest is available here.

SEC Hosts 2018 Meeting of the Elder Justice Coordinating Council

On June 5, 2016, the SEC hosted the spring 2018 meeting of the Elder Justice Coordinating Council (the "Council"). The meeting focused on elder abuse. Chair Clayton's opening remarks reinforced the SEC's continued commitment and concern about the financial exploitation of seniors. Chair Clayton explained how the SEC is very concerned about financial exploitation and does what it can to protect elderly investors while ensuring they have quality investment opportunities. Chair Clayton warned, when it comes to investment scams that prey on the elderly, "our Enforcement Division is on the lookout." Backing up his claim, Chair Clayton first highlighted how the SEC established the Retail Strategy Task Force, the focus of which is to identify, punish, and deter misconduct that affects everyday investors. Additionally, the SEC's Division of Investment Management provided no-action relief to permit mutual funds to temporarily delay the disbursement of redemption proceeds when there is a reasonable belief of financial exploitation of a senior or impaired adult. Chair Clayton also noted that President Trump and Congress enacted bipartisan legislation

[6] Under the DOL's five-part test, a person is a fiduciary if he or she (i) renders advice to the plan as to the value of securities or other property or the advisability of investing in, buying or selling securities or other property, (2) on a regular basis, (3) pursuant to a mutual agreement or understanding, written or otherwise, with the plan, (4) that the advice will serve as a primary basis for investment decisions and that (5) the advice will be individualized to the plan based on the particular needs of the plan regarding such matters as investment policies or strategy, overall portfolio composition and diversification.

[7] Field Assistance Bulletin No. 2018-02 is available at: https://goo.gl/DhNDnL.

which will strengthen the ability of financial institutions and their employees to identify and report instances of financial exploitation of seniors to the appropriate authorities. Chair Clayton expressed how the SEC is eager to work with other regulators in order to protect vulnerable seniors from financial exploitation and fraud.

A Sample Form CRS for Structured Products

In April 2018, the SEC released its proposed rules on Form CRS Relationship Summary[8] ("Form CRS"), which would assist retail investors in choosing investment firms, professionals and account types, and provide clarity on the nature of retail investors' relationships with investment professionals. Each investment professional registered as an investment adviser, a broker-dealer or both is required to deliver its Form CRS to any retail investor regardless of the latter's net worth. An investment adviser has to deliver its Form CRS on or before it enters into an investment advisory agreement with the retail investor; for a broker-dealer, on or before the retail investor engages its services. A dually registered investment adviser and broker-dealer has to deliver its Form CRS at the earlier of (i) entering into an investment advisory agreement with the retail investor or (ii) a retail investor engaging its services.

Form CRS is an additional report that investment professionals must generate as required by Form ADV Part 3 and Rule 204-5 of the Advisers Act for investment advisers, and by Form CRS and Rule 17a-14 of the Exchange Act for broker-dealers. It has a four-page limit and must contain a mix of tabular and narrative information in short sentences. Investment professionals have to use plain English, active voice and everyday words; and address the retail investor, using "you," "us," or "our firm." The Form CRS is divided into the following sections:

1. introduction,
2. the relationships and services the investment professional offers to retail investors,
3. the standard of conduct applicable to those services,
4. fees and costs the retail investors will pay,
5. comparisons of brokerage and investment advisory services (for standalone broker-dealers and investment advisers),
6. conflicts of interest,
7. where to find additional information, including whether the firm and its financial professionals currently have reportable legal or disciplinary events and who to contact about complaints, and
8. key questions for retail investors to ask the firm's financial professional.

[8] Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles, SEC Proposed Rules (Release No. 34-83063, April 18, 2018), *available at* https://goo.gl/ZR19uZ.

The proposed rules on Form CRS also provide instructions[9] for preparing one, and some mock-ups for investment advisers,[10] broker-dealers,[11] and dual registrants.[12] Below, we present a sample Form CRS for structured products. Since structured product offerings involve firms registered as both investment advisers and broker-dealers, our sample is patterned after the proposed rule's dual-registrants' mock-up.

Which Type of Account is Right for You — Brokerage, Investment Advisory or Both?

There are different ways you can get help with your investments. You should carefully consider which types of accounts and services are right for you. Depending on your needs and investment objectives, we can provide you with services in a brokerage account, investment advisory account, or both at the same time. This document gives you a summary of the types of services we provide and how you pay. Please ask us for more information by calling toll-free 1-8[●]-[●] or emailing [●]@[●].com.

<table>
<tr><th>Broker-Dealer Services
Brokerage Accounts</th><th>Investment Adviser Services
Advisory Accounts</th></tr>
<tr><td colspan="2">Types of Relationships and Services. Our accounts and services fall into two categories.</td></tr>
<tr><td>• If you open a brokerage account, you will pay us a transaction-based fee, generally referred to as a commission, every time you buy or sell an investment.
• You may select investments or we may recommend investments for your account, but the ultimate investment decision for your investment strategy and the purchase or sale of investments will be yours.
• We can offer you additional services to assist you in developing and executing your investment strategy and monitoring the performance of your account but you might pay more. We will deliver account statements to you each quarter in paper or electronically.
• We offer a limited selection of investments. Other firms could offer a wider range of choices, some of which might have lower costs.</td><td>• If you open an advisory account, you will pay an on-going asset-based fee for our services, or the issuer of the structured products will pay us referral fees.
• We will offer you advice on a regular basis. We will discuss your investment goals design with you a strategy to achieve your investment goals, and regularly monitor your account. We will contact you (by phone or email) at least quarterly to discuss your portfolio.
• You can choose an account that allows us to buy and sell investments in your account without asking you in advance (a "discretionary account") or we may give you advice and you decide what investments to buy and sell (a "non-discretionary account").
• Our investment advice will cover a limited selection of investments. Other firms could provide advice on a wider range of choices, some of which might have lower costs.</td></tr>
<tr><td colspan="2">Our Obligations to You. We must abide by certain laws and regulations in our interactions with you.</td></tr>
<tr><td>• We must act in your best interest and not place our interests ahead of yours when we recommend an investment or an investment strategy involving securities. When we provide any service to you, we must treat you fairly and comply with a number of</td><td>• We are held to a fiduciary standard that covers our entire investment advisory relationship with you. For example, we are required to monitor your portfolio, investment strategy and investments on an ongoing basis.</td></tr>
</table>

[9] *Id.*, Appendix B, *available at* https://goo.gl/6DV4HE.

[10] *Id.*, Appendix E, *available at* https://goo.gl/ycDQo2.

[11] *Id.*, Appendix D, *available at* https://goo.gl/JBtX9R.

[12] *Id.*, Appendix C, *available at* https://goo.gl/ghAkXq.

Broker-Dealer Services **Brokerage Accounts**	*Investment Adviser Services* **Advisory Accounts**
specific obligations. Unless we agree otherwise, we are not required to monitor your portfolio or investments on an ongoing basis. • Our interests can conflict with your interests. When we provide recommendations, we must eliminate these conflicts or tell you about them and in some cases reduce them. • Issuers of structured products play a variety of roles in connection with the issuance of the securities, including acting as calculation agent, hedging the obligations under the securities or sponsoring an index on which the payment on the structured product is calculated. An affiliate of the issuer of the structured products may be the underwriter, dealer, placement agent, or selling agent in the offering of such products. In performing these duties, the economic interests of the calculation agent and other affiliates of the issuer[, including us,] are potentially adverse to your interests as an investor in the securities. We and they will not have any obligation to consider your interests as a holder of the securities in taking any action that might affect the value of your securities.	• Our interests can conflict with your interests. We must eliminate these conflicts or tell you about them in a way you can understand, so that you can decide whether or not to agree to them. • Issuers of structured products play a variety of roles in connection with the issuance of the securities, including acting as the calculation agent, hedging its obligations under the securities or sponsoring an index on which the payment on the structured product is calculated. An affiliate of the issuer of the structured products may be the underwriter, dealer, placement agent, or selling agent in the offering of such products. In performing these duties, the economic interests of the calculation agent and other affiliates of the issuer[, including us,] are potentially adverse to your interests as an investor in the securities. We and they will not have any obligation to consider your interests as a holder of the securities in taking any action that might affect the value of your securities.
Fees and Costs. *Fees and costs affect the value of your account over time. Please ask your financial professional to give you personalized information on the fees and costs that you will pay.*	
• *Transaction-based fees.* You will pay us a fee every time you buy or sell an investment. This fee, commonly referred to as a commission, is based on the specific transaction and not the value of your account. With stocks or exchange-traded funds, this fee is usually a separate commission. With other investments, such as bonds or certificates of deposit, this fee might be part of the price you pay for the investment (called a “mark-up” or “mark-down”). With mutual funds, this fee (typically called a “load”) reduces the value of your investment. • Fees associated with sales of structured products could be higher than the fees for the products discussed above. These higher fees may be an incentive for us to recommend structured products to you instead of the other products discussed above. • Some investments (such as mutual funds and variable annuities) impose additional fees that will reduce the value of your investment over time. Also, with certain investments such as variable annuities,	• *Asset-based fees.* You will pay an ongoing fee at the end of each quarter based on the value of the cash and investments in your advisory account. The amount paid to our firm and your financial professional generally does not vary based on the type of investments we select on your behalf. The asset-based fee reduces the value of your account and will be deducted from your account. For some advisory accounts, called wrap fee programs, the asset-based fee will include most transaction costs and custody services, and as a result wrap fees are typically higher than non-wrap advisory fees. • Fees associated with sales of structured products could be higher than the fees for the products discussed above. These higher fees may be an incentive for us to recommend structured products to you instead of the other products discussed above. • Some investments (such as mutual funds and variable annuities) impose additional fees that will reduce the value of your investment over time. Also, with certain

<table>
<tr><th>Broker-Dealer Services
Brokerage Accounts</th><th>Investment Adviser Services
Advisory Accounts</th></tr>
<tr><td>you may have to pay fees such as “surrender charges” to sell the investment.
Our fees vary and are negotiable. The amount you pay will depend, for example, on how much you buy or sell, what type of investment you buy or sell, and what kind of account you have with us.
We may charge you additional fees, such as custodian fees, account maintenance fees, and account inactivity fees.
The more transactions in your account, the more fees we charge you. We therefore have an incentive to encourage you to engage in transactions.
From a cost perspective, you may prefer a transaction-based fee if you do not trade often or if you plan to buy and hold investments for longer periods of time.</td><td>investments such as variable annuities, you may have to pay fees such as “surrender charges” to sell the investment.
Our fees vary and are negotiable. The amount you pay will depend, for example, on the services you receive and the amount of assets in your account.
For accounts not part of the wrap fee program, you will pay a transaction fee when we buy and sell an investment for you. You will also pay fees to a broker-dealer or bank that will hold your assets (called “custody”).
Although transaction fees are usually included in the wrap program fee, sometimes you will pay an additional transaction fee (for investments bought and sold outside the wrap fee program).
The more assets you have in the advisory account, including cash, the more you will pay us. We therefore have an incentive to increase the assets in your account in order to increase our fees. You pay our fee quarterly even if you do not buy or sell.
Paying for a wrap fee program could cost more than separately paying for advice and for transactions if there are infrequent trades in your account.
An asset-based fee may cost more than a transaction-based fee, but you may prefer an asset-based fee if you want continuing advice or want someone to make investment decisions for you. You may prefer a wrap fee program if you prefer the certainty of a quarterly fee regardless of the number of transactions you have.</td></tr>
<tr><td colspan="2">Conflicts of Interest. We benefit from the services we provide to you.</td></tr>
<tr><td>We can make extra money by selling you certain investments, such as structured products, either because they are managed by someone related to our firm or because they are offered by companies that pay our firm to offer their investments. Your financial professional also receives more money if you buy these investments.
We have an incentive to offer or recommend certain investments, such as structured products, because the manager or sponsor of those investments shares with us revenue it earns on those investments. As a result, we may not offer to you a competitor issuer’s structured products, which may have better terms.</td><td>We can make extra money by advising you to invest in certain investments, such as structured products, because they are managed by someone related to our firm. Your financial professional also receives more money if you buy these investments.
We have an incentive to advise you to invest in certain investments, such as structured products, because the manager or sponsor of those investments shares with us revenue it earns on those investments. As a result, we may not advise you to purchase a competitor issuer’s structured products, which may have better terms.
If we advise you to purchase structured products, you</td></tr>
</table>

Broker-Dealer Services **Brokerage Accounts**	*Investment Adviser Services* **Advisory Accounts**
• If we sell you structured products, you should be aware of the unique risk factors that are listed in their offering documents. For example, they are designed to be held to maturity. There is limited liquidity (if we or the issuer do not want to buy them back from you before maturity, you may not be able to sell them in the market and will have to hold them until maturity even if their value decreases). • We can buy investments from you, and sell investments to you, from our own accounts (called "*acting as principal*"). We can earn a profit on these trades, so we have an incentive to encourage you to trade with us.	should be aware of the unique risk factors that are listed in their offering documents. For example, they are designed to be held to maturity. There is limited liquidity (if we or the issuer do not want to buy them back from you before maturity, you may not be able to sell them in the market and will have to hold them until maturity even if their value decreases). • We can buy investments from you, and sell investments to you, from our own accounts (called "acting as principal"), but only with your specific approval on each transaction. We can earn a profit on these trades, so we have an incentive to encourage you to trade with us.

Additional Information. *We encourage you to seek out additional information.*

- We have legal and disciplinary events. Visit Investor.gov for a free and simple search tool to research our firm and our financial professionals.
- For additional information about our brokers and services, visit Investor.gov or BrokerCheck (BrokerCheck.Finra.org), our website (SampleFirm.com), and your account agreement. For additional information on advisory services, see our Form ADV brochure on IAPD, on Investor.gov, or on our website (SAMPLEFirm.com/FormADV) and any brochure supplement your financial professional provides.
- To report a problem to the SEC, visit Investor.gov or call the SEC's toll-free investor assistance line at (800) 732-0330. To report a problem to FINRA, [●]. If you have a problem with your investments, account or financial professional, contact us by calling toll-free 1-8[●]-[●] or emailing [●]@[●].com.

Key Questions to Ask. *Ask our financial professionals these key questions about our investment services and accounts.*

1. Given my financial situation, why should I choose an advisory account? Why should I choose a brokerage account?
2. Do the math for me. How much would I expect to pay per year for an advisory account? How much for a typical brokerage account? What would make those fees more or less? What services will I receive for those fees?
3. What additional costs should I expect in connection with my account?
4. Tell me how you and your firm make money in connection with my account. Do you or your firm receive any payments from anyone besides me in connection with my investments?
5. What are the most common conflicts of interest in your advisory and brokerage accounts? Explain how you will address those conflicts when providing services to my account.
6. How will you choose investments to recommend for my account?
7. How often will you monitor my account's performance and offer investment advice?
8. Do you or your firm have a disciplinary history? For what type of conduct?
9. What is your relevant experience, including your licenses, education, and other qualifications? Please explain what the abbreviations in your licenses are and what they mean.
10. Who is the primary contact person for my account, and is he or she a representative of an investment adviser or a broker-dealer? What can you tell me about his or her legal obligations to me? If I have concerns about how this person is treating me, who can I talk to?

FinCEN's Beneficial Ownership Requirement

Effective May 11, 2018, final rules adopted by the Financial Crimes Enforcement Network, or FinCEN, under the Bank Secrecy Act require "covered financial institutions" (e.g., federal regulated banks, federal insured credit unions, mutual funds, broker dealers, futures commission merchants) to identify and verify the identity of beneficial owners of legal entity customers (other than those that are excluded) at the time a new account is opened (other than accounts that are exempted) (the "rule"). The rule requires risk-based procedures for conducting ongoing customer due diligence, and requires an understanding of the nature and purpose of customer relationships for the purpose of developing a customer risk profile.

LEGAL ENTITY CUSTOMER

A legal entity customer means a corporation, limited liability company, or other entity that is created by the filing of a public document with a Secretary of State or similar office, a general partnership, and any similar entity formed under the laws of a foreign jurisdiction, that opens an account (including partnerships, business trusts, etc.). The definition does not include natural persons opening accounts on their own behalf.

Exclusions. Certain legal entity customers are not covered by the rule, including:

- Regulated banks.
- A department or agency of the federal or state government.
- Entities established under the laws of the U.S., any state or political subdivision of a state.
- Entities whose stock is listed on the NYSE, the NYSE American or Nasdaq.
- A U.S. entity when at least 51% of its common stock or analogous equity interest is held by a listed entity Issuers of securities registered under Section 12 of the 34 Act or that are required to file reports under Section 15(d).
- Investment companies.
- SEC registered investment advisers.
- Clearing agencies.
- Any other entity registered with the SEC under the 34 Act.
- Bank holding companies or a savings and loan holding companies.
- Insurance companies regulated by a state.
- Pooled investment vehicles operated or advised by a financial institution excluded from the definition of a legal entity customer.
- A financial market utility designated by the Financial Stability Oversight Council under Title VIII of the Dodd-Frank Wall Street Reform and Customer Protection Act of 2010.
- A foreign financial institution established in a jurisdiction where the regulator of such institution maintains beneficial ownership information regarding such institution.
- A non-U.S. governmental department, agency or political subdivision that engages only in governmental rather than commercial activities.
- Any legal entity only to the extent that it opens a private banking account subject to 31 C.F.R. § 1010.620.

ACCOUNTS

New Accounts. While the rule applies to "new accounts" it is important to note that if something like a loan renewal or rollover of a certificate of deposit involves a new aspect, the rule would be triggered. Covered financial institutions are not required to review accounts opened prior to May 11, 2018. Instead, covered financial institutions have an event-driven (and not continuous or periodic) duty to update beneficial ownership. The requirement is triggered when a covered financial institution becomes aware of information, during the course of normal monitoring relevant to assessing or reassessing the risk posed by the customer, and such information indicates a possible change of beneficial ownership.

Exemptions. Section 1010.230(h) exempts covered financial institutions from the rule with respect to opening accounts for legal entity customers for specific activities and within certain limitations. The new rule is intended to assist law enforcement in investigating and prosecuting terrorist financing, money laundering, and other financial crimes that may be perpetrated through the use of legal entities; therefore, certain transactions that do not include any payments to third parties and do not allow parties to receive a cash refund and do not create a risk for money laundering and other financial crimes, are exempted.

BENEFICIAL OWNERSHIP

Covered financial institutions must focus on the those who control accounts owned by legal entities when determining beneficial ownership. The beneficial ownership definition includes two prongs:

- The "**control**" prong covers a single individual with significant responsibility to control, manage, or direct a legal entity customer, including an executive officer, a senior manger or any other individual who regularly performs similar functions.
- The "**ownership**" prong covers each individual, if any, who directly or indirectly, through contract arrangement, understanding, relationship or otherwise, owns 25% or more of the equity interests of a legal entity customer.

Determining a trust's beneficial owner. If a trust owns directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, 25% or more of the equity interests of a legal entity customer, the beneficial ownership for purposes of the regulation shall mean the trustee, regardless of whether the trustee is a natural person or not (ownership prong) to comply with control. Where there are multiple trustees or co-trustees, financial institutions are expected to collect and verify the identify of, at a minimum, one co-trustee of a multi-trustee trust who owns 25% or more of the equity interests. A covered financial institution may choose to identify additional co-trustees as part of its customer due diligence, based on its risk assessment and the customer-risk profile and in accordance with the institution's account opening procedures.

Determining a pooled investment vehicle's beneficial owner. In general, covered institutions are not required to look through a pooled investment vehicle to identify and verify the identify of any individuals that own 25% or more of its equity interest. Because of the way in which ownership of a pooled investment vehicle fluctuates, it would be impractical for covered financial institutions to collect and verify ownership identity for this type of entity, and, therefore, there is no requirement that the covered financial institution should request the legal entity customer to look through the pooled investment vehicle to determine and report any individual's equity interest. Under the control prong, however, institutions are required to identify those with significant responsibility to control manage or direct the vehicle, such as the portfolio manager, commodity pool operator, commodity trading advisor or general partners.

CERTIFICATION REQUIREMENT

Covered financial institutions must collect each beneficial owner's (1) name, (2) date of birth, (3) address, and (4) either (a) social security number or (b) other government identification number (for non-U.S. persons). A covered financial institution is free to obtain the required information by obtaining a completed Certification Form from the legal entity customer's representative or by any other means that comply with the substantive requirements of the rule's obligations. The Certification Form sets forth general instructions, asks if any exclusions apply, requests the identification of the beneficial owner (the individual opening the account, the legal customer name, the control prong information, the ownership prong information), and requires a signature. Rather than require a heightened knowledge threshold, a covered financial institution may rely on the information provided by a legal entity customer's representative, as long as it does not have knowledge of facts that would reasonably call into question the reliability of such information.

HOW DOES THE NEW BENEFICIAL OWNERSHIP REQUIREMENT AFFECT TRANSACTIONS BETWEEN DEALERS IN STRUCTURED PRODUCTS?

We have observed that underwriters in underwritten offerings are now performing diligence under the new requirements by obtaining completed questionnaires from issuers and selling securityholders. Those questionnaires require the issuer or selling securityholder to either certify that they are within an exclusion from the definition of a legal entity customer or to provide their beneficial ownership information.

When negotiating new dealer agreements or renegotiating existing agreements, broker-dealers should consider expanding upon the standard "compliance with law" representation that exists in dealer agreements and require the legal entity customer to represent that:

- it has either provided the necessary beneficial ownership information or an exemption applies; and
- it will inform the covered financial institution if the legal entity customer's beneficial ownership changes in the future.

Due to the breadth and easy availability of the exclusions from the definition of legal entity customer, we do not believe that it is necessary to renegotiate selected dealer agreements solely to cover this point. However, if a dealer is regularly doing business with a non-U.S. dealer, the domestic dealer should consider amending or renegotiating their selected dealer agreement to ensure that it obtains the necessary beneficial ownership information from the non-U.S. dealer. Dealers negotiating distribution agreements with an unlisted issuer of structured products, such as a non-U.S. bank, should include the representations listed above in the agreement. An affiliated U.S. broker-dealer of a non-U.S. bank should include the representations above with respect to its affiliated issuer.

Additionally, if the legal entity customer is onselling the securities to other dealers, the dealer agreement should include a representation that the legal entity customer is getting the necessary beneficial ownership information, or confirming that an exemption applies, from its customers to ensure that the initial covered financial institution will not be tainted if, farther down the line, securities are sold to a legal entity customer that is engaged in financial crimes. The types of customers that may cause concern include family offices, non-U.S. broker-dealers and non-U.S. investment advisers, none of which are within the available exemptions. There is much less concern if the legal entity customer only sells securities to natural persons such as high net worth individuals or registered investment advisers, each of whom are excluded from the definition of legal entity customer.

Announcements

NEW PUBLICATION: SOCIAL MEDIA COMPLIANCE GUIDE FOR ISSUERS, BROKER-DEALERS, AND ADVISERS

The use of social media raises many securities law and compliance challenges for issuers, broker-dealers, and investment advisers. This Compliance Guide summarizes briefly some key considerations.

Read the Social Media Compliance Guide.

LINKEDIN GROUP.

Stay up to date on structured and market-linked products news by joining our new LinkedIn group. To request to join, please email reverseinquiries@mayerbrown.com.

SUGGESTIONS?

REVERSEinquiries is committed to meeting the needs of the structured and market-linked products community, so you ask and we answer. Send us questions that we will answer on our LinkedIn anonymously or topics for future issues. Please email your questions or topics to: reverseinquiries@mayerbrown.com.

SPA Structured Products Association — Legal, Regulatory & Compliance for Structured Investments Summit 2018

SAVE THE DATE: STRUCTURED PRODUCTS ASSOCIATION'S LEGAL, REGULATORY & COMPLIANCE FOR STRUCTURED INVESTMENTS SUMMIT 2018

Date & Time: **Thursday**, **September 27**, 2018; 8:00 a.m. – 3:30 p.m.

Location: Harvard Club of New York City, 35 West 44th Street, New York, NY 10036

The Summit will cover updates on the latest legal, regulatory and compliance issues and topics including:

- The Best Interest Rule, State Fiduciary Rules and Structured Products;
- Tax Developments Affecting Issuers of Structured Products;
- Regulatory Developments Affecting Structured Products, including MiFID, PRIIPs and Benchmark Regulation;
- LIBOR and Other Benchmark Indices;
- Other Regulatory Developments, including Canadian Bail-In and TLAC Requirements, Proposed Changes to the Volcker Rule; Proposed Changes to FINRA's Quantitative Suitability Rule; and
- Market Trends, Product Developments and Growth Opportunities.

CLE credit for this program is pending.

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