MAYER • BROWN

VOLUME 01, ISSUE 05 | August 14, 2018

REVERSE inquiries

Structured and market-linked product news for inquiring minds.

Regulation Best Interest: Can Structured Products Conflicts Be Resolved?

Of the three new obligations included in proposed Regulation Best Interest (the "Regulation"), perhaps the most challenging for brokers and dealers of structured products will be the conflict of interest obligation.[1] With respect to that obligation, the Regulation states that a broker or dealer's best interest obligation will be satisfied if the broker or dealer establishes, maintains and enforces written policies and procedures reasonably designed to:

- identify and at a minimum disclose, or eliminate, all material conflicts of interest associated with making recommendations of any securities transaction or investment strategy involving securities to a retail customer; and

- identify and disclose *and mitigate*, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations. (Emphasis added.)

In This Issue

Material conflicts of interest arising from financial incentives are treated differently under the Regulation, as those conflicts must be mitigated or eliminated, whereas other material conflicts of interest may be resolved with disclosure only.

[1] This article discusses only the conflict of interest obligations of a broker or dealer. It does not address the disclosure and care obligations as proposed by the Regulation.

A "material conflict of interest" is defined as a "conflict of interest that a reasonable person would expect might incline a broker-dealer – consciously or unconsciously – to make a recommendation that is not disinterested."[2] "Financial incentives" associated with a recommendation include, but are not limited to:

- compensation practices established by the broker-dealer, including fees and other charges for the services provided and products sold;
- employee compensation or employment initiatives;
- compensation practices involving third parties, including both sales compensation and compensation that does not result from sales activity, such as compensation for services provided to third parties;
- receipt of commissions or sales charges, or other fees or financial incentives, or differential or variable compensation, whether paid by the retail customer or a third party;
- sales of proprietary products or services, or products of affiliates; and
- transactions that would be effected by the broker-dealer (or an affiliate thereof) in a principal capacity.[3]

Some of these financial incentives are less prevalent in recommendations of an equity security or a fixed-rate debt security. Structured notes, however, are complex securities, and distributions of structured products may often involve certain of these financial incentives.

For example, let's imagine a structured note issued by BankHoldCo, as issuer ("BHC"). The structured note's payoff is linked to a proprietary index created by BHC's affiliated broker-dealer, BankHoldCo Junior ("BHCJ"). BHC pays a licensing fee to BHCJ for BHC's use of the proprietary index as a reference asset for the note. The determination of whether a market disruption event exists and whether other payoff events are triggered (such as whether a contingent coupon will be paid if an autocall occurs or if a barrier is breached on the final valuation date) will be made by the calculation agent, which happens to be an affiliate of BHC. BHCJ recommends this structured note to certain financially sophisticated retail investors. All of these features are fully disclosed in the offering document for the structured note, including associated risk factors. BHCJ's associated persons receive slightly higher compensation for selling the BHC structured note, as opposed to selling an equivalent security (or securities) of another issuer.[4]

Regulators have focused on the types of conflicts of interest that arise in selling structured products. In its Report on Conflicts of Interest (Oct. 2013) (the "FINRA Report"), the Financial Industry Regulatory Authority, Inc. ("FINRA") identified a number of potential "embedded" conflicts of interest that may exist in the context

[2] Exchange Act Release No. 34-83062 (Apr. 18, 2018) (the "Release") at II.D.3.a (page 169). The Release is available at: goo.gl/GcYM6k.

[3] *Id.*

[4] *See* Release at n.303, p. 177: "Conflicts of interest may arise from compensation other than sales compensation" using an example of a mutual fund for which the member firm provides various administrative services. The compensation received by the member firm for these services is an incentive to not offer a fund or other products for which it does not receive compensation.

of offerings of structured products. These embedded conflicts usually exist when issuers or their affiliates play multiple roles in determining a structured product's economic outcome and also may make critical and potentially subjective decisions that affect the value of the structured product.[5] These decisions are usually made by the calculation agent or index calculation agent, each of which may be an affiliate of the issuer (and possibly the member firm):

- an index calculation agent's discretion in determining an index closing level;
- an index calculation agent's discretion to adjust an index methodology;
- a calculation agent's various valuation functions;
- a calculation agent's ability to cause the issuer to call the note if there is a hedging disruption event (an event that makes it difficult for the issuer or its affiliates to initiate, unwind or maintain hedges relating to the structured product);
- the use of a proprietary index, particularly one created and maintained by the issuer or its affiliates;
- the fees associated with proprietary indices, which may be difficult to assess; and
- a call provision in an exchange traded note whereby the issuer has the ability to call the note when it is significantly undervalued.[6]

The FINRA Report also highlighted potential conflicts of interest that may arise when a member firm distributes proprietary products for which that firm receives revenue sharing payments. The FINRA Report noted that proprietary products may involve significant financial incentives for firms to favor these products over others.[7] An additional conflict may arise if, in response to a reverse inquiry, a member firm solicits and/or works with only one issuer in creating the structured product, as opposed to bidding the request out among multiple issuers. If the former, there is an incentive for the member firm, as a "co-manufacturer," to build in or incorporate high selling concessions or potentially higher returns at the cost of a riskier product structure.[8]

Returning to our note, how would a broker-dealer's policies and procedures address the conflict of interest obligation's requirements to identify and at a minimum disclose, or eliminate, all material conflicts of interest, and disclose and mitigate, or eliminate, conflicts of interest arising from financial incentives, in each case associated with making recommendations of any securities transaction or investment strategy involving the note to a retail customer?

[5] The FINRA Report on Conflicts of Interest (Oct. 2013) can be found at: goo.gl/76Fpdx.

[6] *See* FINRA Report at 21-23.

[7] *Id*. at 24.

[8] *Id*. at 25.

The note checks the box on financial incentives, such as sales of products and services of affiliates and the receipt of differential compensation, in addition to raising many of the embedded conflicts of interest identified in the FINRA Report.

Disclosure alone is not the answer if there are material conflicts of interest arising from financial incentives. No matter how clearly the conflicts of interest could be disclosed to a retail customer, the Regulation requires that material conflicts of interest arising from financial incentives must be mitigated (or eliminated). In this case, according to the Securities and Exchange Commission (the "Commission"), retail investors need the enhanced protections not provided by disclosure alone.[9] This is interesting given that this is a higher standard than the standard currently imposed on registered investment advisers by statute.

There may be material conflicts of interest other than those arising from financial incentives that may have to be eliminated, in addition to being disclosed. The Regulation would require that a member firm's policies and procedures be reasonably designed to "at a minimum disclose, or eliminate," all material conflicts. In a situation where the member firm determines that disclosure does not reasonably address the conflict, or the disclosure cannot be made in a clear manner or is not helpful to the retail customer's understanding of the conflict or the customer's capacity for informed decision making, the member firm would have to establish policies and procedures reasonably designed to either eliminate or both disclose and mitigate the conflict. This issue could also arise if it becomes difficult for the member firm to determine that it is not putting its own interests ahead of the retail customer's.[10]

How does a member firm mitigate conflicts of interest arising from financial incentives? The Commission asserts that the Regulation does not mandate the absolute elimination of any particular conflicts, absent another requirement to do so, noting that it is not the Commission's intent to cause a broker-dealer not to receive compensation for its services. However, in the next sentence, the Commission gave three examples of how to eliminate a material conflict of interest:

- removing incentives associated with a particular product or practice;
- not offering products with special incentives; or
- negating the effect of the conflict by crediting, for example, mutual fund advisory fees against other broker-dealer charges.[11]

The Release does acknowledge the difficulty of eliminating conflicts of interest, or mitigating conflicts arising from financial incentives, in certain situations. Differential compensation, used as an example by the Commission, "may appropriately recognize the time and expertise necessary to understand an investment, and in doing so promote investor choice and access to a range of products …."[12] Accordingly, the Release states that elimination of that conflict may not be appropriate or desirable.

[9] *See* Release at p. 168.

[10] *See id*. at p. 175-176.

[11] *See id*. at p. 175.

[12] *Id.* at p. 177-178.

The Regulation does not require a fixed approach or specific mitigation measures; rather, it uses a principles-based approach, providing broker-dealers with the flexibility to develop reasonably designed policies and procedures that include conflict mitigation measures, based on each firm's circumstances.[13] Conflict mitigation measures may vary based on factors relating to the broker-dealer's business model, including the firm's size, retail customer base, the nature and significance of the compensation conflict and the complexity of the product. Heightened mitigation measures, including enhanced supervision, may be appropriate for less sophisticated retail customers in instances in which the compensation is less transparent (e.g., fees received from third parties), or depending on the complexity of the product.[14] The Release also states that "more or less demanding mitigation measures" may be included in reasonably designed policies and procedures depending on a member firm's assessment of these factors as a whole.[15]

Here, the Release points to the Regulation's "Care Obligation," which keys off of the existing FINRA suitability requirements expressed in FINRA Rule 2111. In discharging FINRA's suitability requirements, a member firm would necessarily have to satisfy itself that the retail customer had sufficient knowledge to understand the recommendation. The Release also cites FINRA's recommendation to member firms that they employ certain heightened procedures in connection with making recommendations of complex products, including making those recommendations contingent upon specific limitations or conditions, and prohibiting sales to certain retail investors, citing FINRA Regulatory Notice 12-03, Heightened Supervision of Complex Products (Jan. 2012).[16]

At this point in the Release, the Commission seems to refer to existing FINRA rules and guidance as a starting point for reasonably designed policies and procedures that could, depending on the broker-dealer's business model, be sufficient to mitigate a material conflict of interest arising from financial incentives for sales to at least some retail investors. It would seem that a broker-dealer that has expertise in selling complex products similar to the proprietary note could satisfy the mitigation requirement of the conflicts of interest obligation in recommending that product to at least some financially sophisticated retail investors. The broker-dealer would have to satisfy its suitability requirements under FINRA Rule 2111, have in place and enforce the necessary policies and procedures and use supervised sales personnel sufficiently trained to understand and clearly explain the note. Given the Regulation's focus on this area, it is a good idea for the broker-dealer to document its efforts at mitigation when recommending complex products. This may include having financially sophisticated customers sign representation letters acknowledging that they are fully aware of any financial incentives relating to the complex product.

How would a broker-dealer resolve the material conflict of interest arising from an increased sales fee paid to personnel who recommend particular structured products, such as those of an affiliated issuer? This goes to the heart of the vague definition of "material conflict of interest." A reasonable person would expect that an increased sales fee would influence a broker-dealer to make a recommendation that is not disinterested.

---

[13] *See id.* at p. 179.

[14] *See id.* at p. 179-180.

[15] *Id* at p. 179.

[16] *See id.* at n.313, p. 180. FINRA Regulatory Notice 12-03 is available at: goo.gl/Gd2sLC.

As mentioned above, differential compensation may be appropriate. For complex products, time and effort is spent structuring the products and creating the appropriate hedge, among other tasks, and the Commission recognizes that it is not unreasonable for the broker-dealer to be compensated for those efforts. It would be a reasonable approach to mitigation if a broker-dealer offered a customer a choice between an equivalent structured product of a non-affiliated issuer, without an increased sales fee, and a note similar to that which we have described with a fully disclosed increased sales fee. If an informed, sophisticated retail investor chose the proprietary note instead of the competitor's equivalent note in that situation, the broker-dealer should document that.

The same broker-dealer may also determine that, at least for less sophisticated retail investors, the material conflicts of interest arising from the financial incentives in the proprietary note could not be mitigated and, accordingly, the proprietary note should not be recommended to those investors.[17] This decision may be made despite good disclosure, strong policies and procedures and an educated sales force.

The Commission enumerated a non-inclusive list of potential practices that, if incorporated into written policies and procedures, may reasonably mitigate conflicts of interest arising from financial incentives, including the following:

- minimizing compensation incentives for employees to favor one type of product over another, such as a proprietary or preferred provider product (firms should consider establishing differential compensation based on neutral factors, such as time and complexity of work involved);

- implementing supervisory procedures to monitor recommendations that involve higher compensating products or proprietary products; and

- limiting the types of retail customers to whom a product, transaction or strategy may be recommended (e.g., certain products that give rise to conflicts of interest associated with complex compensation structures).

The Commission noted that whether a recommended securities transaction or investment strategy complies with the Regulation will turn on the facts and circumstances of the particular recommendation and the particular retail customer and whether the broker-dealer has complied with the Regulation's Disclosure and Care Obligations.[18]

CONCLUSION

If adopted, the Regulation will enhance scrutiny of a broker-dealer's recommendation of complex products, such as structured notes, that may involve material conflicts of interest arising from financial incentives. In any event, broker-dealers should review their policies and procedures to ensure that, to the extent possible, they are disclosing or eliminating material conflicts of interest and also disclosing and mitigating, or eliminating, material conflicts of interest arising from financial incentives. Broker-dealers that onsell complex

[17] *See* the Release at p. 181.

[18] *See id.* at pp. 181-183 and n.317.

products downstream should review their know-your-dealer policies to ensure that the downstream dealers have in place the necessary policies and procedures. Maintaining documentation of a broker-dealer's analysis of how and why a material conflict of interest was disclosed, mitigated or eliminated will be helpful in protecting against regulatory scrutiny in the future.

Investor Bulletin on Nontraditional Index Funds Covers Issues Familiar to Structured Products Investors

The Commission recently published a new Investor Bulletin educating investors about features and potential risks of nontraditional index funds.[19] Nontraditional index funds are index funds that track custom-built indices that are developed based on criteria commonly used by actively managed funds. By combining the benefits of passive investing and the advantages of active investing strategies, nontraditional index funds may seek to outperform the market or achieve alternative investment objectives. The Commission cited examples including smart beta funds, which use factors such as value, dividends or quality in selecting investments; quant funds, which use numerical methods; and environmental, social and governance (ESG) funds, which use environmental, social and governance factors.

Many of the issues related to these nontraditional custom indices are familiar to those who are aware of the regulatory attention paid to complex products over the years. The Investor Bulletin listed some of the risks related to these types of indices:

- Less market correlation;
- Seeking to outperform the market, but with no guarantee of success;
- Complexity;
- Cost – many of these indices have higher expenses than traditional indices; and
- Limited performance histories – these funds tend to be newly created, and it may not be clear to investors how these funds will perform under different market conditions.

With respect to the last bullet point, offering documents for structured products linked to new proprietary indices tend to include hypothetical historical performance data, or "pre-inception performance" ("PIP") data, which, if used, must be carefully explained, clearly segregated from historical performance data and have associated risk factors explaining how the PIP data was created and if there are any differences from a pure application of the methodology to historical data of the index components.

[19] Investor Bulletin: Smart Beta, Quant Funds and other Non-Traditional Index Funds can be found at: goo.gl/9e8fGp.

Dividend Equivalent Regulations Still in Limbo for Transactions after 2018

The future of Section 871(m) of the Internal Revenue Code of 1986 (the "Code") continues to be a question mark for transaction planners after 2018. Section 871(m) generally treats "dividend equivalent" payments as U.S. source dividends potentially subject to 30% withholding. Final regulations under Section 871(m) were published in September 2015 and went into effect in 2017, but with a delayed effective date of January 1, 2018 for instruments that were not "delta one." The IRS subsequently extended the effective date for instruments that were not delta one to January 1, 2019. Whether the IRS will again delay the effective date for these types of instruments remains to be seen.

A BRIEF HISTORY

The basic effect of Section 871(m), which was enacted as part of the Hiring Incentives to Restore Employment Act of 2010, is that "dividend equivalent" payments are sourced in the United States for withholding tax purposes. Therefore, Section 871(m) directly overrides alternative sourcing rules that would source payments to the residence of the payee. As a result, payments to non-U.S. persons that are caught by Section 871(m) are generally subject to withholding tax at the 30 percent rate applicable to dividends (or lower rate if a treaty so provides).

Although the statutory provision of Section 871(m) applies to securities lending, sale-repurchase and certain notional principal contracts, the statute also empowers the Treasury Department to identify other transactions that may be within the scope of Section 871(m). In 2012, the Treasury Department issued proposed regulations that would have expanded the scope of Section 871(m) to notional principal contracts that met one of seven tests. The Treasury Department withdrew these regulations in 2013 and instead proposed a "delta" approach that would bring notional principal contracts and equity-linked instruments within scope if the "delta" of the instrument is high enough, indicating an economic equivalence to direct ownership of the underlying. These proposed regulations were finalized, with some modifications, in September 2015 and have been amended in part through additional regulations and IRS notices.

CURRENT 871(M) REGULATIONS

The critical question under Section 871(m) is whether a payment is a "dividend equivalent," in which case the payment is potentially subject to a 30% United States withholding tax. Under the regulations currently in effect, a dividend equivalent is any payment that references a dividend from a U.S. corporation pursuant to (1) a securities lending or sale-repurchase transaction, (2) a specified notional principal contract ("Specified NPC"), or (3) a specified equity-linked instrument ("Specified ELI").

Whether an NPC or ELI is a Specified NPC[20] or Specified ELI is first determined by whether the contract is "simple" or "complex." A simple contract is generally one that references a fixed number of shares that is

[20] NPCs issued before January 1, 2017, are Specified NPCs if either (i) in connection with entering into the contract, any long party to the contract transfers the underlying security to any short party to the contract; (ii) in connection with the termination of the contract, any short party to the contract transfers the underlying security to any long party to the contract; (iii) the underlying security is not readily tradable on an established securities market; or (iv) in connection with entering into the contract, the underlying security is posted as collateral by any short party to the contract with any long party to the contract.

ascertainable when the contract is priced and that has a single maturity date. A complex contract is one that is not simple.

Simple ELIs or NPCs are Specified ELIs or Specified NPCs if they have a “delta” that is 0.8 or greater. The delta of an ELI or NPC is the ratio in the change of the fair market value of the ELI or NPC to a small change in the fair market value of the underlying security. The delta is generally determined when the contract is priced or issued (whichever is earlier), but if the contract is priced more than 14 days before it is issued, the delta is determined at issuance.

Complex ELIs or NPCs are Specified ELIs or Specified NPCs if they meet a “substantial equivalent test,” which generally compares how sensitive the complex contract is to variations in the price of the underlying security to how sensitive a “simple contract benchmark” is to variations in the price of the underlying security.

NPCs or ELIs that reference a “qualified index” are not treated as referencing U.S. corporations and, thus, are generally not subject to Section 871(m). A qualified index is one that (i) references 25 or more component securities, (ii) references only long positions in component securities, (iii) references no component underlying security that represents more than 15 percent of the weighting of the component securities in the index, (iv) references no five or fewer component underlying securities that together represent more than 40 percent of the weighting of the component securities in the index, (v) is modified or rebalanced only according to publicly stated, predefined criteria, (vi) did not provide an annual dividend yield in the immediately preceding calendar year from component underlying securities that is greater than 1.5 times the annual dividend yield of the S&P 500 Index as reported for the immediately preceding calendar year, and (vii) is traded through futures contracts or option contracts on a national securities exchange or a foreign exchange or board of trade that is a “qualified board or exchange.”

EFFECTIVE DATE (FOR NOW)

In December 2016, the IRS issued a notice that provided that transactions entered into in 2017 would not be Specified ELIs or Specified NPCs unless the contract had a delta of one. Then, in August 2017, the IRS further extended this treatment so that transactions entered into in 2018 would not be Specified ELIs or Specified NPCs unless they were delta-one. It is not clear whether the IRS will again push back the effective date for non-delta-one instruments or whether withholding on a broader range of ELIs and NPCs will come into effect January 1, 2019. In the meantime, practitioners may be left wondering and hoping for the best but planning for the worst.

Responsibilities When Outsourcing to Third-Party Service Providers

Discussions on regulatory requirements generally focus on substance. Less often highlighted is how the nuts and bolts of compliance and daily operations are actually carried out—often by third-party service providers. FINRA recognizes the role third-party service providers play and even hosts the Compliance Vendor Directory. We discuss FINRA’s guidelines for the use of third-party service providers below using examples relating to technology governance, cybersecurity and anti-money laundering ("AML") programs. These topics were included in the FINRA 2018 Regulatory and Examination Priorities Letter and were chosen to highlight the role of outsourcing across various focus areas.

Third-party service providers are commonly used for a range of activities including compliance, operations, administration and information technology services, but there is a limit to what third parties may do. Any activity that requires qualification and registration cannot be outsourced. Any person performing such an activity will be deemed to be an associated person of the applicable member even if such person is not registered with the member (though there is a limited exception for registered broker-dealers providing certain specified services, such as clearing). FINRA's analysis regarding the appropriateness of delegation is impact-focused; members should consider the financial, reputational, operational, legal or other potential effects of a third party's failure to perform before delegating any task. In the cybersecurity context, for example, members are responsible for understanding a vendor's cybersecurity systems and standards, and FINRA has described a sliding scale of diligence procedures from vendor questionnaires to on-site security reviews based on the level of potential vendor risk.

Once the determination that an activity is appropriate for outsourcing is made, there is still work to be done. The member firm must create a supervisory system including written procedures appropriately tailored to its business and the outsourced activities and conduct initial and ongoing due diligence reviews of all third-party service providers. For example, FINRA has chastised firms for failure to appropriately tailor "off-the-shelf" vendor AML systems based on individual risks. Firms must also supervise and monitor any third-party service provider for ongoing fitness, compliance with both the terms of service agreement and applicable laws and the accessibility of the third-party service provider's work product. All third-party work product must be accessible both to the member and to all applicable regulators to the same extent as if the work had been performed by such member. In December 2016, 12 firms were fined a total of $14.4 million for recordkeeping violations related to vendor failures to preserve records in write once read many (commonly referred to as "WORM") format. The disciplinary records discuss the firm's liability on both the basis of procedural and supervisory failures with respect to the third-party service provider and as a result of the firm's ultimate liability for regulatory compliance.

As evidenced by the December 2016 disciplinary actions, delegation of a particular task or function by a firm does not correspond to a delegation of responsibility. In addition to the ongoing responsibility to oversee the third party's activities, the member retains ultimate responsibility for legal and regulatory compliance. Outsourcing an activity neither absolves a member of liability nor lessens a member's responsibility for either the performance of the task or the resulting work product's compliance with applicable laws and regulations.

Because outsourcing is the means through which a firm's many operations and compliance obligations are performed, it is essential to regularly revisit existing outsourcing arrangements and to properly review new ones to ensure that the expectations of all parties, including the regulators, continue to be met.

FINRA's outsourcing guidance should be considered as structured products market participants look to electronic platforms. To the extent that electronic platforms provide educational materials and training materials, member firms should consider how they will use or rely on these materials. Will the member firm provide its own educational and training materials? Will it rely on the platform's materials? If so, has it made a determination regarding the sufficiency and adequacy of the platform's materials? Does the platform's materials use terminology that's consistent with the member firm's own terminology in the context of its offering materials? Is the educational and training material offered by the platform fair and balanced? Readers may recall that the Commission's Division of Enforcement took action against a broker-dealer whose training materials were inconsistent with the offering materials for the same products. Setting aside educational materials, for transactions that take place over a platform, who owns the trade tickets and all the transaction records? These are just a few of the questions that should be asked.

Make Sure That Your CDs Remain CDs

Offering documents for structured certificates of deposit make clear that the dealers selling the CDs will not make a market in the CDs. 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 Plastic* promised to, and did, maintain a secondary market in the CDs).[21]

In addition to avoiding market-making in CDs, banks should clearly disclose that depositors should always receive back at least the principal amount of their structured CDs, including upon an early redemption. There is authority that, if the term of the CD does not provide that it pays at least principal at maturity, the FDIC may take the view that it is not a deposit. The general view is that the depositor should not lose any principal with a deposit, so therefore the CD must be a security if the depositor could lose principal. Consequently, any type of fee charged against the depositor upon an early redemption should be characterized as a penalty instead of a reduction in principal amount. The disclosure should be fashioned such that, in this early redemption example, investors would receive back their principal amount, but will be charged a fee for the early redemption. Although the end result is the same as the depositor receiving a reduced principal amount, banks should not imply, in their offering documents, that investors will receive anything less than their full principal amount.

Quantitative Suitability: A Changing Standard?

At a time when the Commission has solicited comment on the proposed Regulation Best Interest, which would introduce a new and heightened standard of conduct for broker-dealers, FINRA chose to release Regulatory Notice 18-13. This Regulatory Notice solicits comments on proposed amendments to the quantitative suitability standard, which, according to the notice, are intended to align with the standard articulated in the

[21] The Commission recently took the view that certain structured CDs would be treated as securities due to, it seems, excessive churning. See REVERSEinquiries, Volume 1, Issue 4 (July 13, 2018), available at: goo.gl/oAYzBP.

Commission's proposed rule. It is likely that the Commission's proposed Regulation Best Interest will be the subject of intense comment. The Commission's proposal follows on the heels of several years of debate and litigation relating to the Department of Labor's fiduciary rule, which was recently revoked. The timing of the proposed FINRA amendments is unusual when considered against this backdrop. It would be reasonable to have waited for the best interest standard to take shape and be formalized before proceeding with changes (to the extent any were warranted) to FINRA's suitability obligation.

See the full article in *NSCP Currents*, available at: goo.gl/GwLhE5.

FINRA Announces New Department of Enforcement Structure and Senior Leadership Team

Last month's announcement by FINRA marks the completion of the consolidation of FINRA's enforcement functions under the leadership of Susan Schroeder. One of the key outcomes of FINRA360, the new structure is designed to ensure a more consistent enforcement program. Schroeder noted, "The consolidation of our enforcement function enables us to better target developing issues that can harm investors and market integrity, and ensure a uniform approach to charging and sanctions." Under the new structure, the Department of Enforcement contains two new centralized units, Investigations and the Office of the Counsel to the Head of Enforcement, and three specialized teams, Main Enforcement, Sales Practice Enforcement and Market Regulation Enforcement. The groups will be headed by Terrence Bohan, Lara Thyagarajan, Jessica Hopper, Christopher Kelly and Elizabeth Hogan, respectively. See the full announcement at: goo.gl/aL8Jwy.

NYSE Proposes Change to the Definition of "Membership Organization" under Rule 2

The New York Stock Exchange LLC ("NYSE") proposes to amend Rule 2 to remove the FINRA or other national securities exchange membership requirement for member organizations. Rule 2 was previously amended in 2007 to require FINRA membership as part of the transition plan for the consolidation of NYSE Regulation, Inc. and the National Association of Securities Dealers ("NASD"). During this transition period, FINRA provided regulatory surveillance and enforcement services to NYSE, including with respect to NYSE rules, while the harmonization of NYSE and NASD rules was completed. The proposed rule change reflects the end of the transition period and related regulatory outsourcing as NYSE resumed direct performance of certain previously outsourced regulatory functions on January 1, 2016. Going forward, common members will continue to be regulated pursuant to the current allocation plan between FINRA and NYSE, and FINRA will continue to perform certain regulatory services under the oversight of NYSE's regulatory unit pursuant to the existing Regulatory Services Agreement. The full notice may be found at goo.gl/aXgVYa and the full text of the proposed revisions may be found at goo.gl/UiMxTX.

Announcements

SPA
Structured Products Association

Legal, Regulatory & Compliance for Structured Investments Summit 2018

THE ONE AND ONLY LEGAL, REGULATORY AND COMPLIANCE CONFERENCE IN 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:

- Proposed Regulation Best Interest, 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.

For more information, or to register, please visit the event website: goo.gl/g4C4Ni.

CLE credit for this program is pending.

LinkedIn Group. Stay up to date on structured and market-linked product 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.

Contacts

Bradley Berman
New York
T: (212) 506-2321
E: bberman@mayerbrown.com

David Goett
New York
T: (212) 506-2683
E: dgoett@mayerbrown.com

Marla Matusic
New York
T: (212) 506-2437
E: mmatusic@mayerbrown.com

Anna Pinedo
New York
T: (212) 506-2275
E: apinedo@mayerbrown.com

Remmelt Reigersman
Palo Alto
T: (650) 331-2059
E: rreigersman@mayerbrown.com

Mingli Wu
New York
T: (212) 506-2270
E: mwu@mayerbrown.com

The Free Writings & Perspectives, or FW&Ps, blog provides news and views on securities regulation and capital formation. The blog provides up to the minute information regarding securities law developments, particularly those related to capital formation. FW&Ps also offers commentary regarding developments affecting private placements, mezzanine or "late stage" private placements, PIPE transactions, IPOs and the IPO market, new financial products and any other securities related topics that pique our and our readers' interest. Our blog is available at: www.freewritings.law.