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REVERSE inquiries

Structured and market-linked product news for inquiring minds.

In This Issue

LIBOR: Just Say No

The Alternative Reference Rates Committee ("ARRC") held a roundtable on June 3, 2019. The ARRC hosted a number of industry participants, and the program was introduced with a speech by Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System.[1]

Chair Quarles emphasized that issuers should be transitioning to using the new fallbacks for U.S. dollar LIBOR floating rate notes ("FRNs") published by the ARRC on April 25, 2019 as a matter of prudent risk management.[2] However, simply issuing U.S. dollar LIBOR FRNs, even with the new fallback language, is not a path that the regulators unreservedly support. Chair Quarles and Tom Wipf, Chair of the ARRC, both said that there is still a risk of value transfer at the time that a LIBOR FRN transitions over to the replacement rate, even with the ARRC final fallback language included. Chair Wipf referred to the ARRC fallbacks as a "safety belt," and Chair Quarles noted that relying on the fallback language brings operational and economic risks. Both speakers indicated that decisions to issue LIBOR FRNs may be questioned in hindsight.

Chair Quarles also went one step farther, stating that "[t]here is, however, also another and easier path, which is to simply stop using LIBOR." It's clear that bank regulators are very focused on limiting risk to bank issuers from LIBOR issuances, and will be asking questions of banks that continue to issue U.S. dollar LIBOR FRNs.

It was emphasized that Term SOFR may not be ready by the time LIBOR is expected to cease in 2021, so market participants were encouraged not to wait for it. Term SOFR would be a forward-looking term rate, much like LIBOR is now, and is also the first choice in the waterfall of replacement rates in the ARRC fallbacks. There was also strong encouragement to the private market to consider more SOFR issuances, using compounded average SOFR. The rationale behind this is that the more SOFR issuances there are, the deeper the derivatives market will be, thus providing data to create a viable IOSCO-compliant Term SOFR in the future.

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[1] Chair Quarles's speech is available at: http://bit.ly/2XzzDqr.

[2] Our Legal Update on the ARRC's Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Floating Rate Notes is available at: http://bit.ly/2ZMviO8.

For legacy LIBOR FRNs that mature after LIBOR is expected to cease and have the existing fallbacks from the 2006 ISDA Definitions, which will cause these notes to become fixed rate notes when LIBOR ceases, a potential legislative solution is being investigated, but no definite approach has been finalized as of yet.

Regulation Best Interest

On June 5, 2019, the Securities and Exchange Commission (SEC) adopted Regulation Best Interest (Rule 15l-1 under the Securities Exchange Act of 1934 (Exchange Act)), which requires broker-dealers and their associated persons who are natural persons to act in the best interest of their retail customers when making a recommendation. The SEC also adopted Form CRS Relationship Summary, which requires registered investment advisers (RIAs) and broker-dealers to deliver to retail investors a succinct, plain English summary about the relationship and services provided by the firm and the required standard of conduct associated with the relationship and services (Rule 17a-14 and Form CRS under the Exchange Act). Regulation Best Interest, Form CRS and the related rule will become effective 60 days after their publication in the Federal Register. The compliance date for both rules is June 30, 2020.

See our Legal Update regarding Regulation Best Interest and the Form CRS.

Components of Regulation Best Interest

As we mention above, the SEC adopted Regulation Best Interest. The final regulation includes obligations relating to disclosure, care, conflicts of interest and compliance, which are each specific components of the general obligation established by the Regulation.

Our chart summarizes the components of Regulation Best Interest.

SEC Publishes Final Interpretation of Investment Adviser Standard of Conduct

On June 5, 2019, the SEC also published an interpretation of the standard of conduct for RIAs under the Investment Advisers Act of 1940 (Advisers Act). The objective of the Proposed and Final Interpretations was to reaffirm and clarify certain aspects of an RIA's fiduciary duty under Section 206 of the Advisers Act. In the SEC's view, the Final Interpretation does not create new obligations.

This Legal Update describes the SEC's interpretation of an RIA's standard of care and, where important or interesting, compares points made in the Proposed Interpretation and those in the Final Interpretation.

Potential Regulation of Algorithmic Trading

Developments in artificial technology have altered the way that individuals interact with the market and regulators are starting to take note. In May, the House of Representatives announced the creation of a Task Force on Financial Technology and a Task Force on Artificial Intelligence. Congresswoman Maxine Waters (D-CA), Chairwoman of the House Committee on Financial Services, announced the creation of these task forces, stating "[a]s new technologies emerge and the financial services industry puts those technologies to use, Congress must make sure that responsible innovation is encouraged, and that regulators and the law are adapting to the changing landscape to best protect consumers, investors and small businesses."[3] Algorithmic trading, a form of automated trading that is heavily reliant on complex mathematical formulas and high speed technology, is a likely candidate for heightened regulatory focus.

Algorithmic trading makes up a significant percentage of the overall trade volume in markets today. Because of its volume, frequency, and automated nature, there are concerns that algorithmic trading magnifies upward and downward market trends, resulting in artificially inflated market volatility. In the European Union, regulators have attempted to address this concern through the Markets in Financial Instruments Directive,[4] which requires algorithmic traders to perform stress-tests on their algorithms and to maintain kill switch functionality in case of malfunction.

The power to automatically execute a large volume of trades also raises concerns about market manipulation. There have been several regulatory responses to these concerns. In 2016, the SEC approved a rule proposed by the Financial Industry Regulatory Authority, Inc. (FINRA) that requires algorithmic trading developers to register as securities traders.[5] In 2016, the Commodity Futures Trading Commission proposed a supplement to Regulation AT, which would have required, among other things, that the proprietary source code behind trading algorithms be made available to the CFTC and the Department of Justice.[6] The attention that algorithmic trading has received from various regulatory bodies indicates that new regulations are a real possibility in the near future. It is difficult to predict the exact form that such regulation will take, but examining proposals and regulations adopted in other jurisdictions provides useful insight into what we can expect.

Senior Safe Act Fact Sheet

On May 23, 2019, the one-year anniversary of the Senior Safe Act's (the "Act") enactment, the SEC, the North American Securities Administrators Association (NASAA), and FINRA issued a fact sheet to provide information on the immunity and training provisions of the Act, as well as additional resources from the SEC, NASAA, and FINRA.

Pursuant to the Act, "covered financial institutions," which include RIAs, broker-dealers, and transfer agents, and their eligible employees, can make reports on exploitation of senior citizens (defined as not younger than 65 years) without liability in any civil or administrative proceeding. Employees who are eligible for such immunity

[3] See press release at http://bit.ly/2ZQ5X68.

[4] See http://bit.ly/2FAIzl9.

[5] See http://bit.ly/2LlyNXN.

[6] See http://bit.ly/2FwSgBm.

should either be an employee who serves as a supervisor or in a compliance or legal function (including as a Bank Secrecy Act officer) for a covered financial institution; or, a registered representative, investment adviser representative or insurance producer affiliated or associated with a covered financial institution. In addition, reports of suspected exploitation must be made "in good faith" and "with reasonable care."

To receive the immunity provided by the Act, training must include instructions on how to identify and report the suspected exploitation of a senior citizen. A covered institution could receive institutional immunity when an eligible employee makes a disclosure to a covered agency and all employees have received the necessary training.

2019 GlobalCapital Americas Derivatives Awards

For the second year in a row, Mayer Brown has been named Americas Law Firm of the Year (Overall) at *GlobalCapital*'s Americas Derivatives Awards.

Many thanks to *GlobalCapital* magazine for this recognition and to our clients for their trust in us and continued support.

Events

Swap Dealer Conduct Risk
PLI Webinar

July 17, 2019
1:00 PM – 2:00 PM EDT

For more information, or to register, visit PLI's event page.

Partners Matthew F. Kluchenek and Curtis A. Doty will provide an overview of the principal external and internal business conduct obligations imposed on swap dealers. They will focus in detail on best practices with respect to policies and procedures designed to comply with these requirements and mitigate risk, including a review recent relevant enforcement actions, relating to the following areas:

- Obligations to furnish risk disclosure; scope of standardized risk disclosures and when they may need to be supplemented;
- Identifying and disclosing material conflicts and incentives, including the pre-trade mid-market mark;
- Pre-hedging practices and other uses of confidential information;
- Hedging pitfalls: anti-manipulation and disruptive trading practices;
- New product approvals process;
- Documentation and legal risks, and the role of legal opinions; and
- Prime brokerage and multi-participant transaction structures.

The ***REVERSEinquiries* Workshop Series** will be back in the fall with webinars on New Product Governance and Post-Sale Reviews, ETNs and Daily Redeemable Notes, and Platforms and Securities Law and Commercial Considerations. For more information, or to be added to our mailing list, e-mail REVERSEinquiries@mayerbrown.com.

ANNOUNCEMENTS

Capital Markets Tax Quarterly. Mayer Brown's Capital Markets Tax Quarterly, provides capital markets-related US federal tax news and insights.

In our latest issue we look at Q1 2019.

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.

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.

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