

# REVERSEinquiries

*Structured and market-linked product news for inquiring minds.*

## FINRA Rule 5110 – An Amendment to the Proposed Rule Change

The Financial Industry Regulatory Authority, Inc. (“FINRA”) has again released proposed revisions to FINRA Rule 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements). FINRA originally filed, and later withdrew, a proposed rule change to amend FINRA Rule 5110 in October 2018 and then refiled its proposed rule change in April 2019 (discussed in greater detail [here](#) and [here](#)).

The most recent changes, which address industry comments to the April 2019 release, have arrived in the form of a partial amendment. As highlighted in

our [previous article](#), the updates of most interest to structured notes issuers are the revisions to the treatment of derivatives acquired in connection with public offerings, the exemptions to the FINRA filing requirements and the revised definitions, the latter two of which have been updated by the recent amendment.

The FINRA filing requirement exemptions most frequently used by structured note issuers (the experienced issuer exemption and the investment grade debt exemption) have both been modified in the proposed rule.

The experienced issuer exemption remains unchanged from the April 2019 proposal and defines an “experienced issuer” as an issuer with a 36-month reporting history and at least \$150 million aggregate market value of voting stock held by non-affiliates or, alternatively, an aggregate market value of voting stock held by non-affiliates of at least \$100 million and an annual trading volume of three million shares. The investment grade debt exemption was expanded in the April 2019 update to explicitly include “banks,” but has been modified in the recent amendment in order to clarify that the qualifying investment grade debt must be currently outstanding. The proposed definition of a “bank” has also been updated in the new amendment to include U.S. branches and agencies of foreign banks that are supervised by a federal or state banking authority, removing the requirement to seek a specific exemption from FINRA. This change more closely aligns the treatment of U.S. branches and agencies of foreign banks with their U.S. counterparts in line with broader bank regulatory policy.

While the proposed underwriting compensation and lock-up restriction provisions have also been revised in the recent amendment, the revisions do not affect the treatment of derivatives except to the extent that the

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proposed definition of “public offering” has been revised. FINRA has updated its proposed definition of “public offering” to correct the reference to offerings to accredited investors pursuant to Section 4(a)(5) of the Securities Act of 1933.

In addition to the above updates, the new amendment also: (i) modifies the requirement to file a description of any securities acquired and beneficially owned by any participating member during the review period; (ii) excepts “actively-traded” securities from the lock-up restriction; (iii) excludes reimbursed accountable expenses received in a prior offering from underwriting compensation in a revised public offering; (iv) exempts issuer self-tender offers; and (v) modifies the definition of issuer to clarify the carve out for participating members. The full text of the amendment, as well as other materials relating to the proposed changes to FINRA Rule 5110, is available [here](#) and the ongoing developments related to the proposed rule may be tracked using FINRA’s Rule Filing Status Report.

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## Volcker Rule Revisions Adopted by Agencies

The Federal Deposit Insurance Corporation (“FDIC”), Office of the Comptroller of the Currency (“OCC”), Board of Governors of the Federal Reserve System (“Federal Reserve”), Securities and Exchange Commission (“SEC”) and Commodity Futures Trading Commission (“CFTC”) (collectively, the “Agencies”) have finalized or shortly will finalize revisions to certain sections of the Volcker Rule (the “2019 Revisions”).<sup>1</sup> The 2019 Revisions implement changes that had been proposed by the Agencies in a May 2018 notice of proposed rulemaking (“2018 Proposal”).<sup>2</sup>

Subject to the statutory constraints, the 2019 Revisions are intended to (i) establish a more risk-based approach, (ii) make the implementation of the regulation more efficient and less burdensome by reducing its complexity, and (iii) update the existing regulations to reflect the experience of the industry and the regulators. The 2019 Revisions address many of the implementation and compliance issues raised by the proprietary trading and compliance program sections of current regulation and some of the issues related to the covered fund section; however, the 2019 Revisions do not address the comments by market participants on the covered fund section. The Agencies have indicated that they intend to issue a notice of proposed rulemaking at a later date to address additional potential changes that the Agencies are considering for the covered fund section. The 2019 Revisions will become effective on January 1, 2020 and compliance with them will be required on January 1, 2021, although there is an option for early adoption at a banking entity’s election.

A Mayer Brown Legal Update will be released shortly.

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<sup>1</sup> FDIC Approves Interagency Final Rule to Simplify and Tailor the “Volcker Rule,” (Aug. 20, 2019), available at <https://bit.ly/30iYXz6>. The Comptroller of the Currency indicated on August 20, 2019 that he had approved the 2019 Revisions on behalf of the OCC. The Federal Reserve, SEC, and CFTC are expected to approve the 2019 Revisions in the coming weeks.

<sup>2</sup> 83 Fed. Reg. 33,432 (proposed July 17, 2018). See our alert on the 2018 Proposal: <https://bit.ly/2ZuX1q4>.

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## FIMSAC Approves Recommendation for Investor Education Regarding Retail Notes

In a meeting held on July 29, 2019, the SEC's Fixed Income Market Structure Advisory Committee ("FIMSAC") unanimously approved its Corporate Bond Transparency Subcommittee's ("Subcommittee") preliminary recommendation regarding investor education concerning secondary market liquidity in the corporate bond market for retail notes ("Recommendation"). Mihir Worah, the Subcommittee chair, identified some characteristics that make retail notes attractive to retail investors, including the regular weekly issuances priced at par, yield enhancement features with embedded calls, and the survivor's option. However, he also pointed out the significantly higher turnover and transaction costs as concerns. The now-approved Recommendation underscores the significance of investor education regarding the liquidity, risks, rewards and objectives of fixed income products.

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## FINRA Reminds Firms to Engage with the SEC on Regulation Best Interest

On August 7, 2019, FINRA issued Regulatory Notice 19-26, which reminded member firms that Regulation Best Interest (Regulation BI) and the related Form CRS relationship summary were each adopted by the SEC on June 5, 2019, and also provided a number of helpful tools for those firms.<sup>3</sup> The Notice provides links to the adopting releases for Regulation BI and Form CRS, the Form CRS instructions, and two SEC interpretations on a registered investment adviser's standard of conduct under the Investment Advisers Act of 1940 ("Advisers Act") and the "solely incidental" prong of the exclusion for broker-dealers from the Advisers Act. The Notice also provides a SEC web address for questions by member firms about the new rules and releases.

FINRA has also established a webpage for Regulation BI with links to the various adopting releases and interpretations and a list of FINRA staff contacts.<sup>4</sup> The Notice seems to signal that FINRA will be working with its member firms to provide guidance or at least make resources available relating to Regulation BI.

Additional information, including the full notices, is available here: <https://bit.ly/2LQ4Rnl>.

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## Update on Proposed NAIC Amendments Affecting Insurance Company Buyers of Structured Notes

As we reported in the prior issue, the National Association of Insurance Commissioners ("NAIC") Valuation of Securities (E) Task Force ("Task Force") would be considering the recommendation from the Director of the NAIC Securities Valuation Office ("SVO") to require principal protected structured notes that are purchased by insurance companies to be submitted to the SVO for analysis. The SVO's recommendation included the text of

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<sup>3</sup> FINRA Regulatory Notice 19-26 is available at: <https://bit.ly/2KUvvdU>.

<sup>4</sup> The Regulation BI webpage is available at: <https://bit.ly/2NzoYa6>.

a proposed amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (“P&P Manual”) to clarify that the existing filing exemption does not apply to such principal protected notes. Since then, two updates have occurred:

- The comment period for the proposed amendment to the P&P Manual is now open, and will close on September 20, 2019; and
- On August 4, 2019, the Task Force adopted an amendment to the P&P Manual providing that “structured notes” are not within the filing exemption with the SVO but must be filed for review by the SVO.<sup>5</sup>

We will continue to monitor and report on these activities.

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## FINRA Seeks Comment on Senior Protection Rules

On August 9, 2019, FINRA issued Regulatory Notice 19-27 requesting comments on its rules and administrative processes that most directly apply to financial exploitation of senior investors. Comments will be assessed in conjunction with FINRA’s retroactive review of these rules and processes. Specific items of interest, among others, include:

- Rule 2165, which permits a broker-dealer to place a temporary hold on a disbursement of funds or securities from the account of a “specified adult” customer when the firm reasonably believes that financial exploitation of that adult has occurred, is occurring, has been attempted or will be attempted. FINRA is interested in whether the safe harbor should be extended to apply to transactions in securities, in addition to disbursements of funds and securities.
  - Rule 3240 (Borrowing From or Lending to Customers), which provides a regulatory framework to give member firms greater control over, and supervisory responsibility for, lending arrangements between registered persons and their customers. Lending arrangements between registered persons and customers are an area of interest for FINRA because of the potential for misconduct.
  - Rule 4512, which requires broker-dealers to make reasonable efforts to obtain the name of and contact information for a trusted contact person upon the opening of a customer’s account or when updating account information. FINRA wants to gain a better understanding of the effectiveness of the trusted contact provision.
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<sup>5</sup> The proposed amendment to the P&P Manual and the recently adopted amendment are both available at: <https://bit.ly/2U36vUo>.



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.

Mayer Brown has also been shortlisted for *GlobalCapital's* upcoming Global Derivatives Awards in the Global Law Firm of the Year (Overall), European Law Firm of the Year (Transactions), and European Law Firm of the Year (Regulatory) categories.

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

## Events

### SAVE THE DATE

#### Structured Products Association Structured Products Summit

October 8, 2019

Registration: 8:00AM – 8:30AM

Panels: 8:30AM – 5:00PM

Reception: 5:00PM – 7:00PM

Join the Structured Products Association, Bloomberg, and Mayer Brown on October 8th to hear from industry leaders on the latest developments in the structured products market and predictions for 2020 and beyond. This event will include a series of panels, keynote presentations, and opportunities to network with your peers.

Registration opens soon. For more information, please contact [bmcnelis@mayerbrown.com](mailto:bmcnelis@mayerbrown.com).

## ANNOUNCEMENTS

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In our [latest issue](#) we look at Q2 2019.

**LinkedIn Group.** Stay up to date on structured and market-linked products news by joining our LinkedIn group. To request to join, please email [REVERSEinquiries@mayerbrown.com](mailto: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](mailto:reverseinquiries@mayerbrown.com).



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