

REVERSE inquiries

Structured and market-linked product news for inquiring minds.

The World's Most Important Number: The IRS Addresses the Replacement of LIBOR

The London Interbank Offer Rate (LIBOR) was considered the most banal reference point in modern finance until 2012 when it was discovered that the rate was unreliable. And when \$350 trillion of securities use the same index to determine payments, even the smallest tweak can (and did) result in extreme discontinuities in the financial markets. LIBOR has been

so engrained in the worldwide financial system that notwithstanding these challenges, financial regulators will not discontinue publishing LIBOR until 2022. The resulting change in the reference rate on bonds and derivatives could have substantial unanticipated US federal income tax consequences.

On October 8, 2019, the US Internal Revenue Service (the IRS) released proposed regulations (the "Proposed Regulations") addressing certain US federal tax consequences of replacing an interbank offered rate with a successor rate.¹ As discussed in more detail below, the Proposed Regulations generally provide (a) circumstances in which the replacement of an IBOR, such as LIBOR, with a fallback rate, or an addition of a fallback mechanic to an existing instrument, will not result in a deemed taxable exchange of the instrument under section 1001 of the Internal Revenue Code of 1986, as amended (the "Code"), (b) the source and character of any one-time payment associated with a replacement of an IBOR rate, (c) relief under the rules for real estate mortgage investment conduits (REMICs), and (d) some relief pursuant to specific tests under existing regulations governing variable rate debt instruments (VRDIs).

Please [click here](#) for the full article.

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¹ The Proposed Regulations are available at <http://bit.ly/2Ntsyk3>.

SEC Adopts Security-Based Swaps Recordkeeping and Reporting Rules; *Compliance Countdown Begins Soon*

On September 19, 2019, the US Securities and Exchange Commission (SEC) took another significant step toward completing its requirements for the security-based swap and swap activities by finalizing its recordkeeping and reporting rules for security-based swap dealers (SBSDs), major security-based swap participants (MSBSPs) and broker-dealers.² With compliance dates approaching, we provide a summary of the key recordkeeping and reporting rules adopted.

The SEC's new recordkeeping and reporting rules will impact US banks, US broker-dealers and many non-US banks engaging in security-based swap activities. Addressing seven key areas, the SEC adopted rules that:

- establish record making requirements for SBSDs and MSBSPs and amend the existing record making requirements for broker-dealers to account for their security-based swap activities; establish record making requirements for SBSDs and MSBSPs and amend the existing record making requirements for broker-dealers to account for their security-based swap activities;
- establish record preservation requirements for SBSDs and MSBSPs and amend the existing record preservation requirements for broker-dealers to address records relating to their security-based swap activities;
- establish periodic reporting and annual audit requirements for SBSDs and MSBSPs and amend the existing reporting requirements for broker-dealers to account for their security-based swap activities;
- establish early warning notification requirements for SBSDs and MSBSPs;
- establish security count requirements for SBSDs that are not registered as broker-dealers and do not have a prudential regulator³ (stand-alone SBSDs);
- provide a mechanism to request "substituted compliance" with respect to the recordkeeping and reporting requirements for SBSDs and MSBSPs; and
- permit certain SBSDs that are registered as swap dealers and predominantly engage in a swaps business to comply with CFTC requirements in lieu of SEC requirements.

Additionally, the SEC adopted substituted compliance in connection with certain recordkeeping and reporting requirements. The recordkeeping and reporting rulemaking is the penultimate rule set necessary to trigger the SEC's registration and compliance requirements for the SBSD and MSBSP regime under Title VII of the Dodd-Frank Act.⁴ Only the cross-border final rules remain.⁵

Please [click here](#) for full article.

² Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers (Sept. 19, 2019) ("Adopting Release"), available at: <http://bit.ly/353074x>.

³ "Prudential regulator" is defined in Section 1a(39) of the Commodity Exchange Act, 7 U.S.C. 1a(39), and that definition is incorporated by reference in Section 3(a)(74) of the Exchange Act, 15 U.S.C. 78c(a)(74). Pursuant to the definition, the Board of Governors of the Federal Reserve System (Federal Reserve Board), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, or the Federal Housing Finance Agency is the "prudential regulator" of an SBSD, MSBSP, swap dealer, or major swap participant if the entity is directly supervised by that agency.

⁴ SEC Adopts New Rules and Amendments under Title VII of Dodd-Frank, Press Release (Sept. 19, 2019), available at: <http://bit.ly/2AGI4TI>.

⁵ See Proposed Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements, 84 Fed. Reg. 24206 (July 23, 2019), available at <http://bit.ly/2OjLgwF>.

SEC Roundtable on Elder Investment Fraud

On October 3, 2019, the SEC Retail Task Force held a roundtable on combating elder investor fraud. The roundtable examined the multiple dimensions of elder investment fraud, including the social, physiological and economic factors that contribute to elder financial exploitation. The roundtable also discussed the preventative and remedial measures that regulators, broker-dealers, investment advisors, and others can take to identify and combat elder investor fraud. In his [keynote remarks](#), Chairman Jay Clayton noted the SEC's ongoing commitment to combating elder investment fraud as an essential part of the SEC's mission to educate and empower investors so they can plan for a financially secure future. Chair Clayton noted that the National Council on Aging found that elder financial abuse costs Americans \$36.5 billion annually.

The roundtable's first panel examined contributing factors to elder exploitation, such as cognitive decline, capacity issues, social isolation, and institutional vulnerabilities that create entry points for fraudsters and other unscrupulous actors. Lisa Bleier, Managing Director and Associate General Counsel at the Securities Industry Financial Markets Association (SIFMA) advises firms to focus on noticing changes in the behavior of their clients. Bleier highlighted how social isolation can play a role in exploitation, as well as cognitive indicators such as an inability to make basic mathematical calculation, frequent account password resets, or repeatedly asking for the same trade. Commissioner Elad Roisman stated, "Investor protection is fundamental to the SEC's mission and rests at the core of the decisions I make as a commissioner." He further noted that "elder financial fraud is by no means limited to brokerage and retirement accounts. Opportunities for fraud exist in deposit accounts and other areas where assets are held."

Jeanette Wingler, Associate General Counsel of the Financial Industry Regulatory Authority, Inc. (FINRA) highlighted various tools that FINRA has put into place to help address elder investor fraud, including a senior helpline, educational resources for training purposes and FINRA Rules 2165 and 4512. Rule 2165 allows a securities firm to place a temporary hold on disbursement of funds or securities from the account of a specified adult if the firm has a reasonable belief that a questionable request has been made regarding financial exploitation of a customer. Rule 4512 requires firms to make reasonable efforts to implement a "trusted contact" system into their customer accounts. Ms. Wingler noted that FINRA recently launched a retrospective rule review to solicit comments about these rules.

Judith Shaw, Securities Administrator at the Maine Office of Securities, highlighted additional developments targeted to combat elderly investor fraud, such as the North American Securities Administrators Association's ["Model Legislation to Protect Vulnerable Adults from Financial Exploitation"](#) that essentially codifies FINRA Rules 2165 and 4512 at the state level for broker-dealers and investment advisors. Additionally, the [Senior Safe Act](#) provided immunity from liability in any civil or administrative proceeding for reporting potential exploitation of a senior citizen.

FINRA Publishes 2019 Report on Examination Findings and Observations

On October 16, 2019, FINRA released its 2019 Report on FINRA Examination Findings and Observations (the "Report").⁶ The Report documents key issues from the examination of FINRA member firms, including "findings", based on a firm's violation of SEC, FINRA, or other relevant rules, and "observations", suggestions as to how a firm can address perceived weaknesses that may elevate risk but may not rise to the level of a rule violation. The Report addresses findings and observations relating to the following categories: (1) Sales Practice and Supervision, (2) Firm Operations, (3) Market Integrity, and (4) Financial Management. Each of the four categories is split into sub-issues where FINRA details its findings and observations.

Please [click here](#) for the full article.

IOSCO Releases Final Report on its Thematic Review on Sustainability Requirements with respect to the Distribution of Complex Financial Products

On September 26, 2019, the International Organization of Securities Commissions (IOSCO) released its report (the "Report") setting out the findings of its review on the consistency of implementation by 29 IOSCO members in 28 jurisdictions of the nine suitability principles (the "Principles") aimed at preventing the mis-selling of complex financial products under IOSCO's *Suitability Requirements With Respect to the Distribution of Complex Financial Products* report, which was published in 2013 (the "2013 Report").

For purposes of the review, "complex financial products" refers to financial products with terms, features and risks that are not reasonably likely to be understood by a retail customer because of their complex structure, and which may be difficult to value.

Section 4 of the Report includes a table providing IOSCO's ratings for each participating jurisdiction with respect to their consistency of implementation of the Principles. Although only five jurisdictions earned ratings of "Fully Consistent" across all nine Principles, IOSCO determined that the majority of the jurisdictions implemented the Principles in manners generally consistent with the Principles.

Other key findings and observations in the Report include:

- 19 out of 28 jurisdictions require intermediaries to distinguish between complex and non-complex products, including by defining the products and product attributes that are complex, defining specific products that are non-complex, and providing guidance on product complexity in lieu of codified standards. Definitions used by developing jurisdictions varied the most from the 2013 Report, which IOSCO posited may be a reflection of the current state of market development and investor sophistication in those jurisdictions. Definitions of complexity appear to correlate to levels of market

⁶The Report is available at: <http://bit.ly/33QGuvi>.

development, which, in turn, appear to correlate to robustness of suitability frameworks in those jurisdictions.

- The majority of jurisdictions were either “fully consistent” or “broadly consistent” in implementing the Principles to distinguish retail customers from non-retail based on their ability to understand the risks associated with financial products and to make independent investment decisions, and in implementing an overarching duty of care with respect to intermediaries’ conduct towards customers. However, the practices of most jurisdictions did not consider the complexity and riskiness of different products, which is inherent to the Principles.
- All but two of the jurisdictions have specific product disclosure regimes prescribing the basic level of disclosure needed for customers to make an informed decision regarding a financial product, such as the features, risks and costs (rather than just merely providing access to such information).
- Jurisdictions operating under European regimes and complying with the Markets In Financial Instruments Directive (“MiFID II”) especially had strong approaches to compliance and suitability assessments in line with certain Principles.
- FinTech development with respect to digital advisors and online platforms has created new suitability-related challenges.

The full report is available [here](#).

FINRA Provides New Reg. BI and Form CRS Resource

On October 8, 2019, FINRA published a new resource to assist its member firms in their efforts to comply with the SEC’s Regulation Best Interest (Reg. BI) and Form CRS by the June 30, 2020 compliance date.⁷ FINRA’s Reg. BI and Form CRS Firm Checklist⁸ (the “Checklist”) provides a Q&A outlining the major requirements of the recent rulemaking package and explains some key differences between FINRA rules and the SEC’s Reg. BI and Form CRS to help member firms assess their obligations under each.

Please [click here](#) for the full article.

⁷Other available resources include the SEC’s Regulation Best Interest, A Small Entity Compliance Guide, available at <http://bit.ly/2NgBNlb> and Form CRS Relationship Summary; Amendments to Form ADV, A Small Entity Compliance Guide, available at <http://bit.ly/36mPZEn>.

⁸The Checklist is available at <http://bit.ly/36lv44M>.

Webinar: *REVERSEinquiries* Workshop Series: Platforms and Securities Law and Commercial Considerations

Thursday, November 14, 2019

1:00pm – 2:15pm ET

To register or for more information, please visit our [event site](#).

With the rise of new structured products and fixed income related internet-based platforms, issuers and their affiliated broker-dealers as well as distributors must consider a number of securities law and regulatory considerations. Among other things, we will discuss:

- Broker-dealer and investment adviser registration requirements;
- Section 11 and Section 12 liability under the Securities Act;
- Electronic media guidance;
- FINRA communications rule and social media guidance; and
- Documenting the commercial arrangements.



Mayer Brown has been named **Global Law Firm of the Year (Overall)** at *GlobalCapital's* 2019 Global Derivatives Awards.

Earlier this year, Mayer Brown was 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.

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 Q3 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.

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.

Contacts

Bradley Berman

New York

T: +1 212 506 2321

E: bberman@mayerbrown.com**Steven Garden**

Chicago

T: +1 312 701 7830

E: sgarden@mayerbornw.com**Thomas Humphreys**

New York

T: +1 212 506 2450

E: thumphreys@mayerbrown.com**Matthew F. Kluchenek**

New York

T: +1 312 701 8700

E: mkluchenek@mayerbrown.com**Mark Leeds**

New York

T: +1 212 506 2499

E: mleeds@mayerbrown.com**Marla L. Matusic**

New York

T: +1 212 506 2437

E: mmatusic@mayerbrown.com**Stephanie Monaco**

Washington, DC

T: +1 202 263 3379

E: smonaco@mayerbrown.com**Russel Nance**

New York

T: +1 212 506 2434

E: rnance@mayerbrown.com**Marlon Paz**

Washington, DC

T: +1 202 263 3044

E: mpaz@mayerbrown.com**Ali Perry**

New York

T: +1 212 506 2608

E: akperry@mayerbrown.com**Anna Pinedo**

New York

T: +1 212 506 2275

E: apinedo@mayerbrown.com**Ansley H. Schrimpf**

Chicago

T: +1 212 701 8646

E: aschrimpf@mayerbrown.com**Kyle Swan**

New York

T: +1 202 263 3072

E: kswan@mayerbrown.com**Brennan Young**

New York

T: +1 212 506 2691

E: byoung@mayerbrown.com