MAYER | BROWN

VOLUME 03, ISSUE 03 | March 26, 2020

REVERSE inquiries

Structured and market-linked product news for inquiring minds.

COVID-19 Resources

We are focused on helping our clients weather complex and rapidly changing business climate in light of the COVID-19 pandemic. To give you quick access to information and insights on COVID-19, we have launched three new online platforms:

Our COVID-19 web portal is a one-stop resource center that aggregates the latest Mayer Brown legal updates and insights on COVID-19 and includes links to other useful resources.

Our COVID-19 Response Blog provides timely updates, legal analysis and commentary on the latest developments surrounding the COVID-19 outbreak. The blog addresses a wide variety of topics, including those related to employment, supply chains, crisis management/risk management, corporate governance, capital markets, M&A transactions, loan financing, insurance, restructuring, dispute resolution and regulatory issues in the financial sector and other sectors.

Our Global Travel Navigator tool maps the more than 110 countries that have enacted quarantines, health checks, or other travel or visa restrictions. With updates daily, the tool indicates which travelers are affected by these fast-changing restrictions.

In This Issue

ARRC Releases its Proposed NYS Legislative Solution for Existing USD LIBOR Contracts

Included in the board minutes of the November 2019 Alternative Reference Rates Committee ("ARRC") were summary slides of a proposed legislative solution for USD LIBOR contracts governed by New York law.[1] On March 6, 2020, the ARRC published the complete "Proposed Legislative Solution to Minimize Legal Uncertainty and Adverse Economic Impact Associated with LIBOR Transition" (the "NYS Proposal").[2] The NYS Proposal governs financial contracts referencing USD LIBOR, including loans, securitizations, and floating rate notes ("FRNs"). This article focuses on the effect of the NYS Proposal on floating rate notes.

[1] The ARRC's November 2019 board minutes are available at: https://nyfed.org/2vL2Frc.

[2] The NYS Proposal is available at: https://nyfed.org/2UHn1KG.

Outstanding USD LIBOR FRNs issued prior to the use of any fallback provision to another reference rate (such as the secured overnight financing rate, or "SOFR") ("Legacy FRNs") will, without any intervention, become fixed rate notes. That is because the fallback provisions in Legacy FRNs, which follow the 2006 ISDA Definitions and involve polling banks for quotes on rates, did not contemplate a permanent LIBOR cessation. Consequently, most of these outstanding Legacy FRNs will keep resetting at the last published USD LIBOR rate, effectively converting into fixed rate notes at that last published USD LIBOR rate. Under the terms of the Legacy FRNs, the consent of 100% of the holders would be required to amend the interest rate provisions.

The NYS Proposal, if adopted, would automatically replace USD LIBOR in a typical Legacy FRN with SOFR (which is the "Recommended Benchmark Replacement").[3] Under Sections 100(1) and (2) of the NYS Proposal, on the LIBOR Replacement Date, the fallback provisions in the Legacy FRNs would automatically trigger a replacement of USD LIBOR with SOFR, and the polling provisions in the Legacy FRN would be disregarded. Under Section 100(4)(d) of the NYS Proposal, the application to any Recommended Benchmark Replacement of any cap, floor, modifier or spread adjustment to which USD LIBOR had been subject under the terms of the Legacy FRN would not be altered or impaired.[4]

The NYS Proposal also contains a number of provisions designed to rebut a claim of breach of contract by Legacy FRN holders:

- Section 200(2) provides that the application of the statute, by using a Recommended Benchmark Replacement as a Benchmark Replacement or implementing Benchmark Replacement Conforming Changes, will not constitute a breach of a contract or of the security.
- Section 200(3) protects the entity or person that determines which changes shall be made to a Legacy FRN, such as a calculation agent, issuer or trustee, from liability from damages or any action in law or equity.
- In a nod to the requirements under a typical indenture for 100% consent of the holders of any debt security (including Legacy FRNs) to any modification of or amendment to the indenture that would have a material or adverse effect on the holders, Section 200(4) provides that the use of a Recommended Benchmark Replacement or the implementation or performance of Benchmark Replacement Conforming Changes as provided in the NYS Proposal shall not be deemed to be an amendment or modification of the Legacy FRNs and shall not impair or have an adverse effect on any person's rights or obligations.

An open question is whether the NYS Proposal, if adopted, would clash with Section 316(b) of the Trust Indenture Act of 1939 (the "TIA"), which reads, in part:

> "*Prohibition of impairment of holder's right to payment*. Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment

[3] The NYS Proposal defines certain terms in the same way as the ARRC's "Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Floating Rate Notes" (the "ARRC Fallback Recommendations"), such as "LIBOR Discontinuance Event," "LIBOR Replacement Date" and "Relevant Recommending Body." A Recommended Benchmark Replacement includes any Recommended Spread Adjustment and any Benchmark Replacement Conforming Changes, which have been selected or recommended by a Relevant Recommending Body (which is defined to include the ARRC). "Benchmark Replacement Conforming Changes" closely matches the definition in the ARRC Fallback Recommendations.

[4] Most likely, any modifier or spread adjustment that had been applicable to the Legacy FRN would be adjusted under the Benchmark Replacement Conforming Changes, without liability to the entity making the determination.

> of the principal of and interest on such indenture security**,** on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder…."

Theoretically, a Legacy FRN holder could make the case that the NYS Proposal is void in that it impairs the holder's right to interest without the holder's consent, as required under Section 316(b) of the TIA. This type of litigation would most likely arise if the last USD LIBOR fixing is higher than the rate provided by the Recommended Benchmark Replacement.[5]

As of this writing, there has been no public response by the NYS Legislature to the NYS Proposal. One could assume that the NYS Legislature currently has its hands full with other pressing concerns.

Additional Guidance on Regulation Best Interest and Form CRS

Regulation Best Interest 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. A "retail customer" is defined as a natural person, or the legal representative of such natural person, who (A) receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer and (B) uses the recommendation primarily for personal, family, or household purposes.[6]

Form CRS and its related rules require investment advisers and broker-dealers registered with the Securities and Exchange Commission ("SEC") to deliver to retail investors a brief customer or client relationship summary that provides information about the firm. The relationship summaries must be filed with the SEC.[7]

On February 11, 2020, the SEC Division of Trading and Markets staff (the "Staff") provided some explanations and clarifications as additional guidance in complying with Regulation Best Interest[8] and Form CRS:[9]

1. Instances where broker-dealer's recommendation is considered "used" which satisfies the second element of the "retail customer" definition. According to the Staff, a retail customer is considered to have used the recommendation of a securities transaction or investment strategy (effectively triggering the applicability of the Regulation Best Interest) in any of these scenarios: (1) the retail customer opens a brokerage account with the broker-dealer, regardless of whether the broker-dealer receives compensation; (2) the retail customer has an existing account with the broker-dealer and receives a recommendation from the broker-dealer, regardless of whether the broker-dealer receives or will receive compensation, directly or indirectly, as a result of that recommendation; or (3) the broker-dealer receives or will receive compensation, directly or indirectly as a result of that recommendation,

[5] For a more detailed discussion of the TIA aspect, see the article available at: https://bit.ly/2vSwark.

[6] Securities Exchange Act of 1934 ("Exchange Act"), Rule 15l-1(b)(1).

[7] See: http://bit.ly/36mPZEn.

[8] Available at: https://bit.ly/2UzzaRM.

[9] Available at: https://bit.ly/2JhftJb.

even if that retail customer does not have an account at the firm. There is already "use" as long as the retail customer is in a position to accept or reject the broker-dealer's recommendation, such as if such retail customer opens or has an existing account with a broker-dealer.

2. Regulation Best Interest applies to limited-purpose broker-dealers. Regulation Best Interest applies to broker-dealers (regardless if they engage in limited activity) as long as they make recommendations of any securities transaction or investment strategy involving securities to retail customers. The Staff pointed out that Regulation Best Interest is applicable to broker-dealers that make recommendations of private offerings to accredited investors (such as high net worth natural persons and natural persons who are accredited investors).

3. Regulated financial services industry professionals are not considered as retail customers (Regulation Best Interest) or retail investors (Form CRS). Regulation Best Interest and Form CRS do not apply to legal representatives who are registered investment advisers and broker-dealers; corporate fiduciaries such as banks, trust companies and similar financial institutions; insurance companies and other regulated financial services industry professionals, including their employees and representatives. The term "legal representative" only covers non-professional trustees that represent the assets of natural persons and similar representatives such as executors, conservators, and persons holding a power of attorney for a natural person.

The relationship summary delivery requirements in the Form CRS Instructions and under Rule 204-5 under the Investment Advisers Act of 1940 (the "Advisers Act") apply only to SEC-registered investment advisers and therefore do not apply until the SEC grants registration. General Instruction 7.C.iv. of Form CRS requires an investment adviser to deliver its relationship summary to existing clients within 30 days after the date it is first required to electronically file its relationship summary with the SEC.

4. Retail customers may not waive the protections afforded under Regulation Best Interest. A broker-dealer has to comply with Regulation Best Interest. A retail customer cannot waive or agree to waive the protections afforded under Regulation Best Interest even if such retail customer or his or her legal representative certifies or represents that he or she is not relying solely on the advice of the broker-dealer.

5. Regulation Best Interest covers a recommendation to open a self-directed brokerage account. Regulation Best Interest applies to a recommendation to a retail customer to open a self-directed brokerage account even if no subsequent recommendations will be provided by the broker-dealer.

6. In satisfying the capacity disclosure obligation, the ability of a broker-dealer or its associated person to rely on the relationship summary depends on whether it is standalone or dually registered. A standalone broker-dealer (i.e., a broker-dealer that is not also registered as an investment adviser) will generally be able to satisfy this requirement to disclose its capacity by delivering the Form CRS relationship summary (containing all material facts about the scope and terms of its relationship with the retail customer) to the retail customer, in accordance with Exchange Act Rule 17a-14. Delivering the Form CRS relationship summary is not sufficient for dually registered broker-dealers, dually registered associated persons and standalone associated persons offering broker-dealer services through a dually registered firm. Such associated persons must also disclose whether they are acting (or only acting) as an associated person of a broker-dealer.

7. Forgivable loans constitute a conflict of interest under Regulation Best Interest. Under Regulation Best Interest, a conflict of interest is defined as "an interest that might incline a broker, dealer, or a natural person who is an associated person of a broker or dealer—consciously or unconsciously—to make a recommendation that is not disinterested." Forgivable loans are considered a conflict of interest under Regulation Best Interest because these are used as an incentive to induce associated persons to move from one firm to another by "forgiving" these loans upon the performance of future services by the individuals and achieving specified performance goals related to asset accumulation, revenue benchmarks, client transfer or client retention.

8. Broker-dealers are not required to build new systems of controls and compliance in order to satisfy the Compliance Obligation of Regulation Best Interest. Broker-dealers may satisfy the Compliance Obligation (requiring firms to establish, maintain and enforce written policies and procedures that are reasonably designed to achieve compliance with Regulation Best Interest) by adjusting or recalibrating their present system of supervision and compliance under federal securities laws and regulations and applicable self-regulatory organization rules.

9. A Form CRS relationship summary is required to be delivered in these instances:

    - An investment adviser is required to deliver a relationship summary before or at the time the adviser enters into an investment advisory contract with a retail investor, even if the agreement with the retail investor is oral. However, if an investment adviser (Firm A) provides investment advisory services to an unaffiliated investment adviser (Firm B) which, in turn, provides investment advisory services to retail investors (and Firm A is not providing services to, and does not have an investment advisory contract with, Firm B's retail investor clients), Firm A is not required to deliver a relationship summary to Firm B's retail investor clients.

    - Opening a new brokerage account that is different from the retail investor's existing investment advisory account triggers delivery of the relationship summary, even if the firm already provided the retail investor with a relationship summary describing both its brokerage and advisory services when the retail investor opened the account. However, if a firm amends an existing account agreement solely to add another account holder or beneficiary, it is not required to deliver a relationship summary.

    - An investment adviser may prepare a joint Form CRS with an investment adviser affiliate, and file and deliver a single relationship summary to retail investors that discusses the services provided by the adviser and its adviser affiliate. A broker-dealer may prepare a joint Form CRS with a broker-dealer affiliate, and file and deliver a single relationship summary that discusses the services provided by the broker-dealer and its broker-dealer affiliate. Firms may include multiple affiliates in a single combined relationship summary so long as they still comply with the four-page limit without compromising the relationship summary's accuracy, clarity, usability and design.

    - Where an investment adviser (Firm A) is affiliated with a broker-dealer (Firm B), both of which offer services to retail investors but neither is a dual registrant, each of Firm A and Firm B can only prepare one relationship summary summarizing all of the principal relationships and services it offers to retail investors (either a single combined relationship summary or separate

relationship summaries). If Firm A and Firm B prepare a single relationship summary, the firms would be required to deliver the combined relationship summary, whether or not all of their financial professionals are dually licensed with Firm A and Firm B.

- A firm which regularly communicates with retail investors in a language other than English may deliver a complete translation of the relationship summary in a foreign language so long as the firm also delivers a separate English relationship summary at the same time. The translated version (i) should be a complete, fair, and accurate translation of the English relationship summary, (ii) should not make any of the terms used in the relationship summary misleading, (iii) would not count towards the applicable page limit, and (iv) should not translate the term "U.S. Securities and Exchange Commission."

10. A Form CRS relationship summary is not required to be delivered in these instances:

    - A registered broker-dealer providing services solely as a "qualified custodian" pursuant to Rule 206(4)-2 under the Advisers Act for a retail investor client of a registered investment adviser is not required to prepare, file or deliver its own relationship summary when acting solely in such capacity.
    - A firm which offers advisory accounts that are managed by a subadviser does not need to deliver an amended relationship summary if aside from the replacement of the subadviser, there are no changes to the advisory agreement, services, investments, or conflicts of interest that would make the information in the adviser's relationship summary materially inaccurate.

LIBOR Transition

On February 26, 2020, at the Benchmark Strategies Forum in London, Andrew Hauser, executive director for markets of the Bank of England ("BoE"), announced two new initiatives aimed at further supporting the LIBOR transition:

- The BoE will start publishing a compounded SONIA index starting in July 2020.
- Starting in October 2020, the BoE will begin increasing haircuts progressively on LIBOR-linked collateral against which the BoE lends.

For more information, see our Legal Update here: https://bit.ly/2Jee0TW.

Proposed Changes to Volcker Rule Covered Funds Provisions

On January 30, 2020, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the SEC and the Commodity Futures Trading Commission (the "CFTC") (collectively, the "Agencies") proposed revisions to the covered funds provisions of the Volcker Rule (the "Proposal"). The Proposal is intended to address the prohibitions and restrictions regarding covered fund activities in the same way that the Agencies' August 2019 rulemaking primarily focused on the Volcker Rule's restrictions on proprietary trading.

For more information, see our Legal Update at: http://bit.ly/2UHsnXH.

Swaptions Referencing USD LIBOR

In a consultation issued on February 7, 2020, the ARRC seeks views on whether it should recommend a compensation methodology for swaptions referencing USD LIBOR that could be affected by the change, from the effective federal funds rate to SOFR, in the interest rate used for discounting and price alignment interest that is currently expected to occur for cleared derivatives at two central counterparty clearinghouses on October 16, 2020.

For more information, see our Legal Update at: http://bit.ly/2UHsnXH.

OCIE Report on Cybersecurity and Resiliency Practices

On January 27, 2020, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a 13-page report of observations from its examinations of market participants' cybersecurity and operational resiliency practices.

The report outlines practices for managing cybersecurity risk and enhancing operational resiliency that OCIE observed over "thousands of examinations of broker-dealers, investment advisers, clearing agencies, national securities exchanges, and other SEC registrants" and groups these practices into seven broad categories. While OCIE describes the report as a collection of practical observations and recognizes that there is no "one-size fits all" prescription, OCIE "felt it was critical to share these observations in order to allow organizations to reflect on their own cybersecurity practices."

For more information, see our Legal Update at: http://bit.ly/3a28QWr.

The "Names" Rule

Shakespeare wrote: "What's in a name? That which we call a rose by any other name would smell as sweet." Apparently, the SEC isn't so sure. On March 2, 2020, the SEC published a request for comment on Rule 35d-1 under the Investment Company Act of 1940 (the "Rule"). As a general matter, the Rule requires a fund to invest at least 80% of its assets in the manner suggested by its name. However, the SEC and the industry have identified certain challenges in applying the Rule. The Rule has come more into play recently, particularly with respect to unit investment trusts with a structured note type payoff, which tend to invest in assets with names that do not smell as sweet as a rose (e.g., options and other derivatives).

For more information, see our Legal Update at: https://bit.ly/2Jalrv9.

Additional COVID-19 Resources

All COVID-19 related alerts and events can be found on our COVID-19 web portal.

Selected COVID-19-related Webinars

- **COVID-19 Implications for SEC and CFTC Registrants** (PLI Webinar)
  April 6, 2020 | 3:00 p.m. – 4:00 p.m. ET | *Register here:* https://bit.ly/3afdpgy.
  In an attempt to adapt to the major impact of COVID-19 on the global financial markets, regulatory bodies such as the SEC, the CFTC, and other regulators have announced a number or recent measures that could have far reaching implications. This presentation provides an overview of the most recent regulatory responses to COVID-19 by the SEC, the CFTC, and others and discusses their potential ramifications. Specific topics Matthew F. Kluchenek and Marlon Paz of Mayer Brown LLP will discuss include: regulatory relief; topics of interest during time of stress in the financial markets; operational changes; and "Essential" businesses under shelter orders.

Selected COVID-19-related Legal Updates (titles are hyperlinked)

- COVID-19: FINRA Addresses U.S. Broker-Dealer Preparedness and Regulatory Relief in Regulatory Notice 20-08
- COVID-19 Business Continuity Updates for Commodity Futures Trading Commission Registrants and National Futures Association Members
- CFTC Issues Additional COVID-19 Relief for Remote Derivatives Trading
- NYDFS Instructs Insurers to Provide COVID-19 "Explanation of Benefits" for All Business Interruption Coverage and Report to NYDFS on Operational and Financial Preparedness
- COVID-19: US SEC Staff Offers Relief for RIAs and Funds
- COVID-19: Material Adverse Change Clauses in US Contracts
- COVID-19: US SEC Provides Temporary, Conditional Relief to Funds and Advisers
- Initial US Federal and State Tax Relief Developments Relating to COVID-19
- COVID-19 UK Emergency Legislation
- COVID-19 Contractual performance – Force Majeure clauses and other options: a global perspective
- Stimulus Measures of the US Federal Government to Address COVID-19
- COVID-19: Recent SEC Responses applicable to Investment Advisers and Funds
- COVID-19: Compliance and Operational Risks for Financial Institutions: EU Financial Authorities Provide Initial Guidance

Upcoming Events

- **Considerations for Broker-Dealers under Rule 15a-6** (Mayer Brown Webinar)
  April 14, 2020 | 1:00 p.m. – 2:00 p.m. ET | *Register here:* https://bit.ly/3bnOHL6.
  During this webcast, we will cover issues pertaining to Rule 15a-6 under the Exchange Act, which provides foreign broker-dealers with exemptions from U.S. broker-dealer registration. Among other topics, we will discuss: the origin and meaning of Rule 15a-6; implications of Rule 15a-6 for foreign

investment growth; proposed amendments and additional matters raised in SEC comment letters; and recent market trends and their impact on regulatory developments.

- **Securities Law Concerns in Equity Derivatives Transactions** (PLI Webinar)
  April 16, 2020 | 1:00 p.m. – 2:00 p.m. ET | *Register here:* https://bit.ly/2JdQir1.
  During this session we will address the principal securities and U.S. federal income tax considerations arising in connection with structuring and negotiating: accelerated share repurchases and related issuer repurchase transactions; call spreads and warrants entered into in connection with convert offerings; forward purchase agreements; and other issuer derivatives.
- ***REVERSEinquiries* Workshop: US Taxation of Structured Notes** (Mayer Brown Webinar)
  April 28, 2020 | 1:00 p.m. – 2:00 p.m. ET | *Registration opening soon.*
  This presentation will address US tax developments regarding structured products, including the rules addressing "dividend equivalent" transaction and the IRS "basket option" notices. In addition, the presentation will touch on possible legislative proposals affecting the taxation of structured products.

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 Q4 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.

Mayer Brown is pleased to be shortlisted once again for Americas Law Firm of the Year for *GlobalCapital*'s Americas Derivatives Awards 2020.

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

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

Gonzalo Go
New York
T: +1 212 506 2390
E: ggo@mayerbrown.com

Anna Pinedo
New York
T: +1 212 506 2275
E: apinedo@mayerbrown.com