Regulatory Burden Relief and Reform—What to Expect

January 18, 2018

Our Agenda

- We will aim to provide an overview of and discuss:
  - Regulatory burden relief for depository institutions;
  - Consumer financial regulatory and fintech-related developments;
  - The heightened standard of care for broker-dealers;
  - Regulatory priorities and areas of focus for registered investment advisers and funds; and
  - Other SEC-related and capital markets-related developments

Depository Institutions

Regulatory Burden Relief in 2017

- We began 2017 with discussions related to the "roll back" and "repeal" of the Dodd-Frank Act, the issuance of various Presidential executive orders, changes in the leadership of the banking agencies, and re-introduced regulatory burden relief legislation (the Financial CHOICE Act)
- As we will discuss, most of the changes and most of the proposed changes have come from and are likely to continue to come from the banking agencies, acting on their own initiative
- We will provide a quick recap to set the stage for what to expect in 2018

Executive Orders

Executive Orders

- On January 30, 2017, President Trump issued an Executive Order titled *Reducing Regulation and Controlling Regulatory Costs*
  - Establishes a regulatory cap for fiscal year 2017—unless prohibited by law, whenever an executive department or agency publicly proposes for notice and comment (or otherwise promulgates a new regulation), it must identify <u>at least two</u> existing regulations to be repealed
- On February 2, 2017, the Office of Information and Regulatory Affairs issued its *Interim Guidance Implementing Section 2 of the Executive Order of January 30, 2017*
  - Explains that departments and agencies may comply with the requirements of the Executive Order "by issuing two 'deregulatory' actions for each new significant regulatory action that imposes costs"
- On February 3, 2017, President Trump signed the Executive Order titled *Core Principles for Regulating the United States Financial System*. The order outlined seven principles of regulation, or "Core Principles," that the Trump administration will follow to regulate the U.S. financial system

- On February 24, 2017, President Trump issued an Executive Order titled *Enforcing the Regulatory Reform Agenda*, which:
  - Requires regulatory reform officers and regulatory reform task forces in each agency to identify regulations that, among other things, eliminate jobs, or inhibit job creation; are outdated, unnecessary, or ineffective; and impose costs that exceed benefits;
- Perhaps more significant than any executive order is the administration's view of agency appointments (or leaving vacancies within agencies)

Executive Orders, cont'd.

U.S. Treasury Department Report on Core Principles for Regulating the U.S. Financial System

Treasury Report

- As required by the President's Executive Order 13772, the U.S. Treasury Department published a report on June 12, 2017, identifying regulations inconsistent with the seven principles articulated in the Order
- The report addressed only the depository system and covered a broad array of topics
  - ***Regulatory Structure***: report recommends that Congress take steps to reduce fragmentation, overlap, and duplication in financial regulation by broadening the FSOC's mandate and reforming the Office of Financial Research
  - ***Tailoring Bank Capital and Liquidity Requirements***: tailoring based on size and complexity, having DFAST apply to institutions with TCA of $50 bn and higher, and evaluating the threshold for the enhanced prudential standards (EPS) requirements under Dodd-Frank
  - ***Making significant requirements to CCAR***
  - ***Modifying the LCR***: narrowing the scope to G-SIBs, with a less stringent standard being applied to internationally active BHCs that are not G-SIBs; reviewing treatment of munis and the effect of HQLA on securitizations; and reviewing the net cash outflows calculation

- ***Eliminating the CCyB, reviewing the supplementary leverage ratio, raising the threshold for the living will requirement, and making various other recommendations to Basel-related measures***
- ***Re-evaluating the requirements imposed on the boards of directors of depository institutions***
- ***Reassessing the regulations applicable to foreign banks***, including the EPS and living will requirement and the requirements imposed on IHCs
- ***Making changes to the Volcker Rule***: such as exempting smaller institutions, modifying the prop trading definition and purpose tests, and modifying the covered funds provisions
- ***Reissuing the leveraged lending guidance for comment and promoting small business lending***

- Quite a number of the recommendations made in the Treasury Report already were the subject of actions undertaken by the banking agencies acting alone, without legislation

Treasury Report, cont'd.

Reforms Initiated by the Banking Agencies

Banking Agency Initiatives

- As we will summarize briefly, the banking agencies have proposed or have undertaken reforms on their own in a variety of areas, including:
  - The Volcker Rule
  - Board supervision and risk management guidance
  - Capital plan requirements, stress testing and call report requirements
- The banking agencies also, as mentioned earlier, have new leadership

Volcker Rule

Volcker Rule

- The Federal Reserve issued a release that provides temporary relief for foreign banking organizations with respect to investments in certain foreign private funds, as well as another that provides guidance on applications for extensions for the seeding period when a banking entity organizes a covered fund
- In August 2017, the OCC released a notice and request for comment ("Request for Comment") on how to modify the implementing regulations, as well as the application and administration of the Volcker Rule
- The OCC Request for Comment focuses on:
  - ***Scope of Banking Entities Subject to the Rule***: The release suggests that certain entities may not be engaged in activities that pose the risks that the rule was intended to mitigate, including small and community banks, as well as banks with limited trading activities
  - ***Foreign Funds***: The OCC requests comment on tailoring of the rule's scope to foreign funds that have a U.S. nexus
  - ***Banking Entity Definition***: The release seeks comment on the definition of "banking entity" and the exclusions from that definition

- ***Proprietary Trading Ban***: The request solicits comment regarding ways in which the exclusions and exemptions relating to proprietary trading can be simplified in order to relieve the regulatory burden. In that regard, the release notes that the "purpose test" may impose too significant a compliance burden on banking entities. The release also requests comment on the 60-day rebuttable presumption of proprietary trading
- ***Covered Fund Definition***: The release notes that the definition of "covered fund" may be too technical in its references to the 1940 Act as well as overly broad. The release requests comment on an exclusion for venture capital funds
- ***Super 23A***: The OCC requests comment on whether there ought to be additional exceptions to the restrictions on affiliated transactions and specifically references certain securitization transactions
- ***Compliance Program and Metrics***: The request seeks feedback on the compliance burden associated with the various reporting requirements

Volcker Rule, cont'd.

Boards of Directors, Supervisory Guidance and Risk Management Guidance

Fed Proposals

- In August 2017, the Federal Reserve issued two proposals, one relating to governance and one relating to a new financial institution rating system. The governance proposal outlines an approach that is intended to provide clearer guidance regarding supervisory expectations and would:
  - Outline attributes for an effective board
  - Redirect responsibilities to management
  - Limit the extent to which MRIAs and MRAs are addressed to boards

Board Effectiveness

- Proposed guidance applies to domestic BHCs and SLHCs as well as nonbank SIFIs with total consolidated assets in excess of $50 billion
- Guidance does not apply to IHCs of FBOs; however, the Fed indicates that it will provide guidance for IHC boards in the future
- Boards are effective when focused on establishing firmwide strategy and setting risk levels; the proposal identifies five attributes for an effective board:
  - Set clear, aligned, and consistent direction regarding strategy and risk tolerance

- Actively manage information flow and board discussions
- Hold senior management accountable
- Support independence and stature of independent risk management and internal audit
- Maintain a capable board and an appropriate governance structure

Streamlining Board Guidance and Addressing MRIAs and MRAs

- The proposal would revise existing supervisory expectations relating to bank boards, including 27 supervision and regulation letters
- The general objective is to return to having supervisory guidance that is less granular and removing matters that are more appropriate for bank management teams
- Most MRIAs and MRAs will be directed to management rather than to boards, with MRIAs and MRAs addressed to boards only to the extent that there are significant governance failings that are identified by banking agencies

Fed Proposals, cont'd.

Risk Management Supervisory Expectations for Large Financial Institutions

- In January 2018, the Fed proposed guidance for comment that would clarify supervisory expectations for domestic BHCs and SLHCs with TCA of $50 bn or more, and FBOs the combined U.S. operations of which have TA of $50 bn or more
- Complements the August 2017 proposed guidance for boards of directors
- Consolidates and clarifies and supersedes in part existing guidance
- Provides core principles applicable to bank senior management and business line heads and for independent risk management and controls
- The proposal addresses: effective senior management, management of business lines, roles of the chief risk officer and chief audit executive, independent risk management, internal controls, and internal audit

CCAR, DFAST, and Stress Tests

Capital Planning and Stress Testing

- The Federal Reserve has taken various actions to relieve the burdens associated with CCAR, DFAST, and stress testing requirements
- In January 2017, the Fed finalized a rule to further tailor the capital plan requirements (CCAR) for "large and noncomplex firms" and also modified the requirements for all firms subject to capital planning processes
- In June 2017, the Fed proposed, and, in December 2017, the Fed finalized, revisions to certain aspects of CCAR and DFAST
- In December 2017, the Fed proposed a package of proposals to increase CCAR and stress testing modelling transparency, sought comment on a proposed "Stress Testing Policy Statement" that would increase transparency relating to CCAR and DFAST models, and proposed modifications to its framework on annual hypothetical economic scenarios
- In January 2018, the Fed requested comments on various aspects of call report requirements, including on the utility of the reports and the burdens associated with data collection, and proposed revisions to delete or combine certain sections and reduce the reporting frequency

Legislative Efforts at Regulatory Burden Relief

Legislative Measures

- We began the year with the re-introduction of the Financial CHOICE Act, or CHOICE 2.0, which was stylized as an all-encompassing regulatory burden relief measure that, among other things, would have repealed the Volcker Rule; applied a capital election, or "off-ramp" approach, to various capital and liquidity requirements; significantly revamped the CFPB; repealed the fiduciary rule; and implemented mortgage related reforms
- It became clear that there was no consensus for the CHOICE Act's approach
- Instead, various measures have advanced on the House side that are focused on modifying the approach to systemic designation and requiring more rigorous cost-benefit analysis in connection with regulations
- On the Senate side, a regulatory burden relief bill (the Economic Growth, Regulatory Relief and Consumer Protection Act) has garnered broad Senate support, as well as support from Hoenig and Otting. The bill would:
  - Increase from $50 bn to $250 bn the SIFI threshold;
  - Modify the supplementary leverage ratio and the LCR;

- Modify the applicability of the EPS by removing banks under $100 bn and eliminating, subject to the Fed's ability to take affirmative action to include, banks between $100 bn and $250 bn in TCA; and
- Modify the stress test requirements

Legislative Measures, cont'd.

Consumer and Fintech-Focused Developments

Status of Key CFPB Rulemakings

Disapproval of the Arbitration Rule

- On October 24, 2017, the Senate passed H.J. Res. 111, providing for congressional disapproval under the Congressional Review Act ("CRA") of the CFPB's final rule on arbitration agreements
- On November 1, 2017, the President signed the resolution and it became Public Law No. 115-74

Delay of the Small-Dollar Loan Rule

- On November 17, 2017, the CFPB published its final rule on short-term loans
- On January 16, 2018, the CFPB issued a statement on the Final Rule, noting the January 16 effective date and August 19, 2019, compliance date for most provisions, and stating that "[t]he Bureau intends to engage in a rulemaking process so that the Bureau may reconsider the Payday Rule."

Delay of the Prepaid Accounts Rule

- The CFPB's November 22, 2016, Prepaid Accounts Final Rule adds "prepaid account" to the definition of "account" in Regulation E
- On June 29, 2017, the CFPB proposed amendments to certain provisions of the Rule
- On December 21, 2017, the CFPB issued the following statement:

> The Bureau expects to issue a final rule amending certain aspects of its 2016 rule governing prepaid accounts soon after the new year. As part of that process, *the Bureau expects, based on its review of the comments received, to further extend the effective date of the 2016 rule to allow additional time for implementation of the final rule*. The Bureau proposed making changes to the prepaid rule in June; the comment period on the proposal ended in August, and the record is now closed for public input.

The Fiduciary Standard

A Brief History

- Differing standards before Dodd-Frank
  - Investment advisers were fiduciaries
  - Broker-dealers were salesmen held to a suitability standard
- Dodd-Frank authorized, but did not require, the SEC to adopt a uniform fiduciary standard for retail accounts
- SEC Staff report supported a uniform fiduciary standard
  - Split on the Commission sidelined the SEC
- DOL adopted Fiduciary Rule in April 2016
  - Initially scheduled to become applicable in April 2017
  - Became partially applicable on June 9, 2017
  - Balance of the Rule deferred until July 1, 2019
- Both the DOL and the SEC are currently evaluating the future of a fiduciary standard for retail accounts

Fiduciary Rule Basics

- The DOL Fiduciary Rule expands the scope of who might be deemed a fiduciary to anyone who provides investment advice when dealing with retail retirement accounts
  - Exceptions for educational communications, “hire me” communications, and advice provided to institutional retirement customers
- A fiduciary must act in the best interest of the client
- A fiduciary must avoid conflicts of interest or obtain written consent on a transaction-by-transaction basis
  - DOL takes the position that transactions generating commissions and other forms of variable compensation constitute a prohibited transaction because of the inherent conflict
  - Principal transactions (firm commitment underwriting; selling from inventory) would generally be prohibited

New Prohibited Transaction Exemptions

- The Best Interest Contract Exemption (BIC)
  - Available for transactions effected on an agency or riskless principal basis
  - Available for all classes of securities
  - May be used for the sale of proprietary products
  - Permits fiduciary to charge a commission on an agency or riskless principal trade
  - Requires adherence to Impartial Conduct Standards, as well as certain contract and disclosure requirements
- The Principal Transactions Exemption
  - Available for transactions effected on a principal or riskless principal basis
  - Only available for CDs, UITs, and "Debt Securities," which includes U.S. Government and agency securities as well as registered debt offerings by a U.S. corporation
  - Requires adherence to Impartial Conduct Standards, as well as certain contract and disclosure requirements and meeting additional conditions for "Debt Securities"
- Both exemptions became available June 9, 2017

The Impartial Conduct Standards

- Compliance with BIC or the Principal Transactions Exemption currently requires adherence to the Impartial Conduct Standards
- Must act in the best interest of the client
  - Advice should reflect the care, skill, prudence, and diligence that a prudent person would use
  - Advice must be based on the investment objectives, risk tolerance, financial circumstances, and needs of the client
  - Advice must be furnished without regard to the interests of the fiduciary
- No excessive compensation/best execution
  - Should be attentive to market prices and benchmarks
  - Higher fees permitted for more difficult or time-consuming products and services
  - Best execution required on principal transactions
  - See FINRA Rules 2121 and 5310
- Disclosures must not be materially false or misleading
  - Fees; conflicts of interest

Impact on Broker-Dealer Practices

- Know your customer
  - Fundamental to meeting a best interest standard
- Product diligence
  - Best interest analysis more rigorous than suitability analysis; requires closer comparison of costs/risks of similar products
- Underwriting and product distribution arrangements
  - Revise distribution channels for products that don't qualify for the Principal Transactions Exemption
- Internal compensation arrangements
  - Eliminate/closely monitor arrangements that might incentivize recommendations not in the client's best interest
- Move to level-fee accounts
- Training
  - An essential element of the controlling person defense

Re-evaluation of the Fiduciary Rule

- Presidential directive
  - Potential harm to investors due to a reduction of access to retirement product structures and related financial advice;
  - Potential dislocations or disruptions within the retirement services industry; and
  - Potential increase in litigation and/or prices that investors must pay
- DOL evaluation
  - Re-evaluating the conditions of the BIC and Principal Transactions exemptions
    - For example, dropping prohibition against class action waivers
  - Striking a balance between protecting investors and investor access
  - Evaluating how industry is adopting to Impartial Conduct Standards
- SEC activity
  - Disclosure-based approach vs. standard of conduct-based approach
  - How are broker conflicts impacting investors
  - Implications of robo-advisers, fee-based accounts, etc.

Future of the Fiduciary Rule

- Judicial and legislative challenges continue
- States have entered the fray
  - Nevada and Connecticut have enacted; NY and others considering
  - Potential preemption for broker-dealers
- Industry appears to be coalescing around a fiduciary standard that would require acting in the best interest of the retail customer
  - However, the new standard would accommodate commissions and principal transactions in all product classes, subject to a principles-based standard of conduct (best interest) and rigorous disclosure requirements (full disclosure of fees and material conflicts of interest)
- Increased focus on conflict identification and mitigation
- Greater cooperation between SEC and DOL enhances likelihood of a true uniform standard that would apply across all retail accounts

SEC and Capital Markets-Related Developments

CHOICE, CHOICE 2.0 and Other Legislative Measures

- Both the original Financial CHOICE Act and CHOICE 2.0 contained quite a number of securities law-related provisions that would have, among other things:
  - Limited the SEC's independence and imposed strict "regulatory accountability" and cost-benefit requirements
  - Repealed various Dodd-Frank Act-related regulations, including those requiring risk retention in securitization transactions, the incentive-based compensation and pay ratio disclosures, the conflicts minerals, and resource extraction rules
  - Encouraged capital formation by providing SOX 404(b) relief for low revenue issuers, amending crowdfunding regulations, adopting a safe harbor for micro offerings, scaling smaller reporting company disclosure requirements, extending test-the-waters to all companies, and increasing the Regulation A threshold to $75 million
- Although CHOICE did not garner support, pursuant to the Congressional Review Act, the resource extraction payment disclosure rules were repealed in February 2017
- Various JOBS Act 2.0 measures that had been subsumed into CHOICE 2.0 have been re-introduced in Congress as standalone bills, and quite a number have advanced on the House side, but it is unlikely that these measures will advance in the Senate

Treasury Report

- The second installment of the Treasury Report addressed recommendations relating to the capital markets and covered a number of measures that were addressed in the CHOICE Act; for example, the Report recommended that the Dodd-Frank Act rules requiring specialized disclosures, such as conflicts minerals disclosures, should be repealed and withdrawn
- The Report also suggested various capital formation measures, including that the SEC:
  - Review the Regulation S-K requirements in order to eliminate duplicative, redundant, or outdated disclosures
  - Permit all issuers, not only EGCs, to conduct test-the-waters discussions
  - Allow EGCs to retain their status for up to 10 years
  - Explore a number of options to evaluate the role of proxy advisory firms, including regulation of their activities, and increasing the requirements for shareholder proposals
  - Extend the benefits of scaled disclosure to “smaller reporting companies”
  - Consolidate and harmonize the rules and regulations relating to research

- Review the regulations relating to Tier 2 Regulation A offerings and crowdfunding to allow for more flexibility
- Expand the categories of sophisticated investors included as “accredited investors”
- Revise its securities offering reform rules to permit business development companies to use streamlined reporting and filing procedures now available to WKSIs
- Loosen restrictions on registered closed-end funds structured as “interval” funds
- Amend many of the rules relating to securitization, recognizing that the Dodd-Frank Act and Reg AB II have dampened the attractiveness of securitization

Treasury Report, cont’d.

The “New” SEC

- For the first time in a long time, the SEC now has five commissioners
- The chair of the SEC, Jay Clayton, has set the tone for the Commission, recommitting to the SEC’s mission of protecting investors, maintaining the integrity of markets, and promoting capital formation
- Chair Clayton has emphasized that the Commission will focus on the retail investor, including through active enforcement initiatives, by promoting a fiduciary standard, improving investor education initiatives, and improving disclosures
- Few resources will be devoted to pursuing Dodd-Frank Act-mandated rulemaking, and attention will turn to promoting capital formation and other matters; the new agenda was released in December 2017

Focus on Capital Formation

- In the summer of 2017, the Division of Corporation Finance announced that it would permit all issuers to submit draft registration statements relating to IPOs for review on a nonpublic basis
- A domestic issuer, a foreign private issuer (FPI), or a Canadian issuer relying on the Multijurisdictional Disclosure System (MJDS) that is not an EGC may submit a registration statement in draft form for an initial registration
- A non-EGC issuer that relies on the new confidential submission process can submit amended drafts for confidential review
- A public filing must be made, in the case of an IPO, at least 15 days before the date on which the issuer conducts a road show, as such term is defined in Securities Act Rule 433(h)(4) (consistent with the policy applicable to EGCs)
- Non-EGC issuers will not be able to rely on the other JOBS Act accommodations for EGCs (for example, no test-the-waters safe harbor, no disclosure accommodations, etc.)
- In announcing this approach, SEC Staff also noted the Staff's willingness to consider requests for waivers under Regulation S-X 3-13

- An issuer will be able to submit a registration statement for confidential review for offerings made within the first year after an issuer has become an SEC-reporting company (whether through an IPO or a direct listing)
- In the case of a follow-on offering, an issuer that has relied on the confidential review process must publicly file the registration statement at least 48 hours prior to any requested effective time and date
- This new approach for follow-on offerings will provide a lot of flexibility
- The new SEC confidential review process also applies to registration statements filed to register a class of securities under the Exchange Act (i.e., a Form 10 or a Form 20-F)
- Prior to the adoption of this policy, an EGC that was planning a traditional IPO would have been able to confidentially submit a Form S-1 for review by the SEC Staff, but if the EGC had opted to register under the Exchange Act (and not pursue a traditional IPO), the Form 10 filing would have been immediately public
- The new policy should level the playing field and make the process similar for issuers undertaking IPOs and those undertaking direct listings
- An issuer that confidentially submits an initial registration statement under Exchange Act Section 12(b) must file it publicly at least 15 days prior to the anticipated effective date of the registration statement

Capital Formation, cont'd.

Regulatory Agenda

- The Commission's near-term agenda does not include a number of the Dodd-Frank-related measures that were pending, such as the pay-for-performance, clawback, incentive-based compensation, and hedging rules
- In the near-term, the Commission will focus on, among other things:
  - The proposed changes to Regulation S-K required by the FAST Act
  - Changes to Regulation S-K and Regulation S-X to address duplicative or outdated disclosure requirements
  - Various changes to Regulation S-X, including changes to guarantor disclosures and changes relating to acquired businesses
  - Amendments to the Smaller Reporting Company definition to provide for further scaled disclosures

Other Priorities for SEC-Reporting Companies

- In connection with preparing their annual reports on Form 10-K and planning ahead, public companies are focused on, among other things:
  - The effect of the legislation referred to as the Tax Cuts and Jobs Act on their financial results and MD&A disclosures
  - The adoption of the new GAAP revenue standard
  - Adapting to the changes to the independent auditor's report, including working with auditors to plan for the ultimate inclusion of disclosures regarding critical audit matters
  - Preparing for adoption of the new lease standard and the new credit loss standard

SHEARMAN & STERLING LLP

Investment Funds and Investment Advisers: What to Expect from Regulatory Burden Relief

Jay G. Baris

International Financial Law Review

January 18, 2018

SEC Priorities for Investment Management

- December 14, 2017: the SEC announced a broad rulemaking agenda that included a blueprint of things to come in asset management regulation
- Trend – slow the pace of regulations that may increase regulatory burden
- What's in? Notable regulatory changes on the horizon include
  - New rules and amendments to allow certain ETFs to operate without first obtaining exemptive orders
    - Proposed Rule Stage
  - Proposal of a "uniform fiduciary standard" for broker-dealers and advisers
    - Moved from Long-Term Actions to Proposed Rule stage
  - Amendments to Reg. S-X regarding auditor independence when auditor holds equity securities of its audit client
    - Proposed Rule State

SEC Priorities for Investment Management

- What's in? Notable regulatory changes on the horizon include
  - Amend marketing rules under the Advisers Act
    - New item under Long-Term Actions
  - Restrictions on proprietary trading involving hedge funds and private equity funds
    - Proposed Rule Stage
  - Investment company reporting modernization with option for website transmission of shareholder reports
    - Final Rule Stage
  - Board Outreach Initiative
    - Announced by Dalia Blass on December 7, 2017
    - Division of Investment Managing "asking if funds could benefit from recalibrating the 'what' and the 'how' of board responsibilities"

SEC Priorities for Investment Management

- What's out? Notable regulatory items put on the "long-term action" (back burner) list or eliminated from active considerations include new rules that would
  - Limit use of derivatives by registered investment companies and BDCs
    - Moved from Final Rule Stage to Long-Term Actions
  - Require stress testing for large asset managers and large investment advisers
    - Long-Term Actions
  - Require mandatory electronic submissions for orders under the Advisers Act and confidential treatment requests on Form 13F
    - Long-Term Actions
  - Address fraud, manipulation, and deception in connection with security-based swaps
    - Long-Term Actions

SEC Priorities for Investment Management

- What's out? Notable regulatory items put on the "long-term action" (back burner) list or eliminated from active considerations include new rules that would
  - Require broker-dealer liquidity stress testing, early warning, and account transfer requirements
    - Long-Term Actions
  - Amend accredited investor definition
    - Long-Term Actions
  - Require adviser business continuity and transition plans
    - Eliminated from the Final Rule State
  - Require third-party assessments
    - Eliminated from Long-Term Actions

SEC Enforcement Priorities for 2018

SEC announced the creation of a Cyber Unit and a Retail Strategy Task Force

- Cyber unit
  - Cyber unit to combat cyber-related threats, including ICO schemes and schemes involving blockchain technology, which are "among the greatest risks facing our securities markets"
  - Jay Clayton: "very little distinction" between asking investors to put money in cryptocurrency and "handing people a piece of paper that says stock"
  - 2017 actions provide a glimpse of things to come
    - July 2017: SEC published a Report of Investigation, concluding that the federal securities may apply to certain ICOs or other distributed ledger or blockchain means for raising capital ("DAO Report")
    - December 2017: the SEC halted an ICO of a utility token, holding that the tokens were securities ("Munchee Order")
  - Retail Strategy Task Force
    - Focus on protecting individual investors
    - Example – steering clients to higher-cost mutual fund class shares, abuses in wrap fee accounts, investment adviser recommendations to buy and hold highly volatile products like inverse ETFs and suitability issue

FINRA Regulatory and Examination Priorities

FINRA published regulatory and examination priorities on January 8, 2018

- Fraud continues to be a major focus
  - Insider trading, microcap pump-and-dump schemes, issuer fraud, and Ponzi-type schemes among others
- High-risk firms and brokers
- Operational and financial risks
  - Customer production and asset verification
  - Technology governance
  - Cybersecurity
  - AML
  - Liquidity risk
  - Short sales

FINRA Regulatory and Examination Priorities

- Sales practice risks
  - Suitability
  - ICOs and cryptocurrencies
  - Margin
  - Securities backed lines of credit
- Market integrity
  - Manipulation
  - Best execution
  - Regulation SHO
  - Fixed income data integrity
  - Options
  - Market access
  - Alternative trading surveillance systems

FINRA Regulatory and Examination Priorities

- Financial exploitation of specified adults
- Rule 4512 amendments (customer account information)
- FinCEN customer due diligence rule (CCD)
- Rule 2232 (customer confirmation)
- Sales practice risks
- Margin requirements for covered agency transactions (Rule 4210)
- Consolidated FINRA registration rules