

## **BROKER-DEALER**

### **SEC and New Jersey US Attorney's Office Bring Parallel Charges in EDGAR Hacking Scheme**

On January 15, the Securities and Exchange Commission announced charges against nine defendants, alleging their participation in a previously disclosed scheme to hack into the SEC's EDGAR system and extract nonpublic information to use for illegal trading. The SEC charged a Ukrainian hacker, six individual traders in California, Ukraine and Russia, and two entities. In 2015, the SEC charged the hacker and some of the traders for their involvement in a similar scheme to hack into newswire services and trade on material nonpublic information (2015 Hack).

The complaint filed by the SEC alleges that the Ukrainian hacker implicated in the 2015 Hack, turned his attention to EDGAR following the 2015 Hack and, using deceptive hacking techniques, gained access in 2016. The hacker extracted EDGAR files containing nonpublic earnings results. He then communicated those nonpublic earning results to individuals who used the information to trade during the time period between when the files were extracted and when the companies released the information to the public. According to the complaint, the traders acted on the information before at least 157 earnings releases from May to October 2016 and generated at least \$4.1 million in illegal profits.

Specifically, the complaint alleges that the hacker circumvented EDGAR controls that require user authentication and then navigated within the EDGAR system. According to the complaint, the hacker obtained nonpublic "test files," which issuers can elect to submit in advance of making their official filings to help make sure EDGAR will process the filings properly. Issuers sometimes elected to include nonpublic information in test filings, such as actual quarterly earnings results not yet released to the public. The hacker extracted nonpublic test files from SEC servers, and then passed the information to different groups of traders.

The complaint charges each of the defendants with violating antifraud provisions of the federal securities laws and related SEC antifraud rules. The SEC is seeking a final judgment ordering the defendants to pay penalties, return their ill-gotten gains with prejudgment interest, and enjoining them from committing future violations of the antifraud laws. The SEC also named and is seeking relief from four relief defendants who profited from the scheme when defendants used the relief defendants' brokerage accounts to place illicit trades.

The US Attorney's Office for the District of New Jersey announced related criminal charges in connection with the SEC action.

In its announcement, the SEC emphasized the prevalence of risk posed to organizations, like itself, possessing valuable information and added that the SEC is committed to, and capable of, unraveling schemes of this sort and identifying their perpetrators.

Both the SEC action and the US Attorney's criminal case are ongoing. The full press release issued by the SEC is available [here](#).

## **FINRA Issues Regulatory Notice Regarding Updates to Supplemental Statement of Income**

On January 8, the Financial Industry Regulatory Authority issued a Notice advising its members of updates to the Supplemental Statement of Income (SSOI). The updates are designed to conform with amendments adopted by the Securities and Exchange Commission that simplify and update certain FOCUS reporting requirements applicable to broker-dealers. Pursuant to FINRA Rule 4524, the SSOI must be filed by all FINRA members to supplement the FOCUS Report. The SSOI must be filed within 20 business days at the end of each calendar quarter. The updated SSOI applies beginning with all SSOI filings that report on the period January 1 through March 31, and are due by April 26.

The Notice is available [here](#).

## **FINRA Issues Notice Related to Reporting Requirements for Auction Transactions**

On January 9, the Financial Industry Regulatory Authority issued a Notice to remind its members that they should not report auction transactions in US Treasury securities—including auction awards to either direct or indirect bidders—to the Trade Reporting and Compliance Engine (TRACE), as these transactions are excluded from the TRACE reporting requirements under FINRA Rule 6730(e)(8). Similarly, the delivery of securities after the auction by a FINRA member to the indirect bidder that represents an auction award also should not be reported to TRACE. FINRA advises that members that have erroneously reported such auction transactions must promptly cancel or reverse those transactions reports.

The Notice is available [here](#).

## **UK/BREXIT DEVELOPMENTS**

### **Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019 Laid Before Parliament**

On January 15, a draft version of the Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019, which have been laid before Parliament, was published together with a draft explanatory memorandum.

The purpose of the Regulations is to establish the financial services contracts regime (FSCR), a contractual run-off regime for European Economic Area (EEA) based financial institutions that currently operate in the United Kingdom that do not enter into the various temporary regimes available to such firms after the UK's exit from the European Union. The UK Financial Conduct Authority also recently opened a consultation on the operation of the FSCR (for more information on the FSCR, see the January 11 edition of [Corporate & Financial Weekly Digest](#)).

The Regulations will become effective the day after they are made.

The Regulations and explanatory memorandum are available [here](#).

## **EU DEVELOPMENTS**

### **European Commission Reports on the Operation of the AIFMD**

On January 10, the European Commission published a report (dated December 10, 2018) on the operation of the Alternative Investment Fund Managers Directive (AIFMD).

The EC commissioned KPMG to conduct a general survey of the main stakeholders most affected by the AIFMD and carry out an evidence-based study, the key findings of which are set out in the report. The report concludes that the AIFMD has clearly played a major role in helping to create an internal market for alternative investment funds (AIFs) and a harmonized and stringent regulatory and supervisory framework for alternative investment fund managers (AIFMs). It also finds that most of the provisions remain relevant, have added value to the European Union, have contributed to the achievement of the AIFMD's specific and operational objectives, and have done so effectively, efficiently and coherently. Of note is the finding that the EU management passport is working well.

However, certain areas were identified as requiring further analysis and improvement, for example:

1. A lack of transparency regarding differing national rules and supervisory processes relating to the marketing passports, caused by national competent authorities adopting different approaches about which activities are considered as “marketing.” Respondents to the survey have, therefore, observed that it would be of “EU added value” to retain the national private placement regimes, even if non-EU passports were to be introduced for non-EU AIFs and AIFMs;
2. Excessive investor disclosure requirements, which are often ignored by or prevent investors from obtaining a clear understanding of an AIF’s investment proposal;
3. Inadequate and duplicative reporting requirements, as well as reporting obligations that overlap with other EU legislation; and
4. The effectiveness of the valuation rules is impaired due to the binary choice between internal or external valuation and the diverging member states’ interpretations of the extent of the liability of external valuers.

The EC will continue its work on the AIFMD review and will report to co-legislators in 2019.

The EC’s report is available [here](#).

For additional coverage on financial and regulatory news, visit [Bridging the Week](#), authored by Katten's [Gary DeWaal](#).

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UK/BREXIT/EU DEVELOPMENTS

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\* Click [here](#) to access the *Corporate & Financial Weekly Digest* archive.

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