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Derivatives, Legislative and Regulatory Weekly Update (February 16, 2024)

Client Alert | February 16, 2024

From the Derivatives Practice Group: *This week, ISDA, ESMA, and the CPMI published reports on various derivatives initiatives and reforms.*

New Developments

- **SEC Adopts Rule to Expand Definitions of "Dealers" and "Government Securities Dealers."** On February 6, the SEC adopted a rule that requires market participants to register as "dealers" or "government securities dealers" for the first time and become members of a self-regulatory organization (SRO). The final rule, codified in Exchange Act Rules 3a5-4 and 3a44-2, purports to define the phrase "as a part of a regular business" in Sections 3(a)(5) and 3(a)(44) of the Securities Exchange Act of 1934 to identify certain activities that would cause persons engaging in such activities to be "dealers" or "government securities dealers" and be subject to the registration requirements of Sections 15 and 15C of the Act, respectively. Under the final rule, any person that engages in activities as described in the rule is a "dealer" or "government securities dealer" and, absent an exception or exemption, required to: register with the SEC under Section 15(a) or Section 15C, as applicable; become a member of an SRO; and be subject to applicable SRO and Treasury rules and requirements. Notably, the rule is non-exclusive, meaning that even if a firm does not meet any of the criteria in the rule, the SEC claims that the firm could still be a dealer anyway depending on the "facts and circumstances."
- **SEC and CFTC Adopt Amendments to Enhance Private Fund Reporting.** On February 8, the SEC adopted amendments to Form PF, the confidential reporting form for certain SEC-registered investment advisers to private funds, including those that also are registered with the CFTC as commodity pool operators or commodity trading advisers. According to the SEC, the amendments, which the CFTC concurrently adopted, are designed to enhance the ability of the Financial Stability Oversight Council (FSOC) to monitor and assess systemic risk and to bolster the SEC's oversight of private fund advisers and the agency's investor protection efforts. The SEC and CFTC also agreed to a memorandum of understanding related to the sharing of Form PF data. The SEC stated that, among other things, the amendments to Form PF will enhance how large hedge fund advisers report investment exposures, borrowing and counterparty exposure, market factor effects, currency exposure, turnover, country and industry exposure, central clearing counterparty reporting, risk metrics, investment performance by strategy, portfolio liquidity, and financing and investor liquidity in an effort to provide better insight into the operations and strategies of these funds and their advisers and improve data quality and comparability. Further, the amendments will require additional basic information about advisers and the private funds they advise, including identifying information, assets under management, withdrawal and redemption rights, gross asset value and net asset value, inflows and outflows, base currency, borrowings and types of creditors, fair value hierarchy, beneficial ownership, and fund performance, which, according to the SEC, will provide greater insight into private funds' operations and strategies, assist in identifying trends, including those that could create systemic risk, improve data quality and comparability, and reduce reporting errors. The amendments will also require more

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detailed information about the investment strategies, counterparty exposures, and trading and clearing mechanisms employed by hedge funds, while also removing duplicative questions.

- **CFTC Global Markets Advisory Committee Advances Key Recommendations.** On February 8, the CFTC's Global Markets Advisory Committee (GMAC), sponsored by Commissioner Caroline D. Pham, formally advanced eight recommendations to the CFTC that are intended to enhance the resiliency and efficiency of global markets, including U.S. Treasury markets, repo and funding markets, and commodity markets. To date, this is the largest number of recommendations advanced by a CFTC Advisory Committee in a single meeting. The GMAC's Global Market Structure Subcommittee prepared four recommendations: (1) appropriately calibrated block and cap sizes under CFTC Part 43 swap data reporting rules, intended to enhance market liquidity and financial stability; (2) addition of certain central counterparties (CCPs) as permitted counterparties under CFTC Rule 1.25(d), intended to promote the well-functioning of the repo market; (3) expansion of cross-margining between the CME Group and the Fixed Income Clearing Corporation, intended to support greater efficiency in the U.S. Treasury markets; and (4) best practices for exchange volatility control mechanisms, intended to address market stress and market dislocation during periods of high volatility. The GMAC's Technical Issues Subcommittee prepared four additional recommendations, as follows: (5) adoption of lessons learned from a global default simulation across CCPs, intended to address systemic risk and promote financial stability; (6) harmonization of the treatment of money market funds as eligible collateral, intended to improve market liquidity; (7) improvement of trade reporting for market oversight, intended to ensure international standardization and global aggregation and analysis of data to address systemic risk; and (8) improvement of trade reporting for market oversight, intended to facilitate data sharing across jurisdictions for systemic risk analysis.
- **CFTC Customer Advisory Alerts App and Social Media Users to Financial Romance Fraud.** On February 7, the CFTC's Office of Customer Education and Outreach (OCEO) issued a customer advisory alerting dating/messaging app and social media users to a scam asking for financial support or giving investment advice using the platforms. The *Customer Advisory: Six Warning Signs of Online Financial Romance Frauds*, reminds app and social media users to be wary of texts and messages from strangers that promote cryptocurrency investments. According to the OCEO, the text could actually be from international criminal organizations that trick victims into investing money in cryptocurrency or foreign currency scams only to defraud them. The OCEO stated that the scam can take advantage of even the savviest of investors because fraudsters develop relationships with their victims through weeks of seemingly authentic text messaging conversations, a practice known as "grooming." The advisory points out several warning signs of a financial grooming fraud, which include fraudsters attempting to move conversations from a dating or social media platform to a private messaging app, as well as their claims of wealth from cryptocurrency or foreign currency trading due to insider information. The advisory also includes steps users can take to avoid financial grooming frauds.
- **CFTC Extends Public Comment Period on Proposed Rule on Protection of Clearing Member Funds.** On February 2, the CFTC extended the deadline for the public comment period on a proposed rule to address protecting clearing member funds held by derivatives clearing organizations. The deadline is being extended to March 18, 2024. The CFTC stated that it provided the extension in response to a request by a commenter.
- **Commissioner Pham Announces Additional Executive Staff Appointments.** CFTC Commissioner Caroline D. Pham announced new executive staff appointments in her Washington, D.C. office on February 1. Taylor Foy joins Commissioner Pham's team as a Senior Advisor and Nicholas Elliot has joined as a Confidential Assistant and Policy Advisor.

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New Developments Outside the U.S.

- **CPMI, IOSCO Publish Paper on Streamlining VM in Centrally Cleared Markets**. On February 14, the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) published a discussion paper on streamlining variation margin (VM) in centrally cleared markets. The discussion paper follows the review of margining practices, published in 2022 by the Basel Committee on Banking Supervision, the CPMI and IOSCO. The discussion paper sets out eight effective practices, covering intraday VM call scheduling and frequency, treatment of excess collateral, the pass-through of VM by central counterparties (CCPs) and transparency between CCPs, clearing members and their clients. The deadline for comment is April 14. [NEW]
- **ESMA Withdraws Euronext Authorization as a Data Reporting Service Provider Under MIFIR Upon the Entity's Request**. On February 13, ESMA withdrew the authorization of Euronext Paris SA (Euronext) as a Data Reporting Service Provider (DRSP) under the Markets in Financial Instruments Regulation (MiFIR). Euronext was authorized as both an Approved Reporting Mechanism and an Approved Publication Arrangement under MiFIR since January 3, 2018. MiFIR provides that ESMA shall withdraw the authorization of a DRSP where the DRSP expressly renounces its authorization. ESMA's withdrawal decision follows the notification by Euronext of its intention to renounce its authorization under the conditions set out in Article 27e(a) of MIFIR. [NEW]
- **ESMA Publishes Latest Edition of its Newsletter**. On February 13, ESMA published its latest edition of the Spotlight on Markets Newsletter. The newsletter focused on the last ESMA consultation package related to the Markets in Crypto Assets Regulation (MiCA). ESMA invited stakeholders to send their feedback on reverse solicitation and classification of crypto assets as financial instruments by April 29, 2024. The newsletter also launched a call for candidates for ESMA's Securities Markets Stakeholder Group and called interested parties who can give a strong voice to consumers, industry, users of financial services, employees in the financial sector, SMEs as well as academics to apply by March 18. [NEW]
- **Hong Kong Government Launches Consultation on Regulating OTC Trading of Virtual Assets.** On February 8, the Hong Kong government launched a public consultation on legislative proposals to introduce a licensing regime for providers of over-the-counter trading services of virtual assets (VAs). Under the proposed licensing regime, any person who conducts a business in providing spot trading services of VAs-for-money or money-for-VAs will be required to be licensed by the Commissioner of Customs and Excise, irrespective of whether the services are provided through a physical outlet and/or digital platforms. Licensees will be required to comply with AML/CFT requirements and other regulatory requirements. The public consultation period ends on April 12, 2024.
- **HKMA Consults on Capital Treatment of Cryptoasset Exposures.** On February 7, the Hong Kong Monetary Authority (HKMA) published a Consultation Paper on CP24.01 Cryptoasset Exposures setting out a proposal for implementing new regulations on the prudential treatment of cryptoasset exposures based on the Basel Committee on Banking Supervision's Prudential treatment of cryptoasset exposures standard. According to the consultation paper, for the purpose of the prudential treatment of cryptoasset exposures, cryptoassets will be defined as private digital assets that depend on cryptography and distributed ledger technologies or similar technologies. The HKMA has scheduled a preliminary consultation on the proposed amendments to the rules in the second half of 2024 and aims to put new standards into effect no earlier than July 1, 2025.
- **EU Co-Legislators Reach Provisional Agreement on EMIR 3.** On February 6, the EU co-legislators reached a provisional political trilogue agreement on the European Market Infrastructure Regulation 3. On the issue of an active account requirement, while the agreement is based on the less punitive operational active

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account with representativeness approach proposed by the Council of the EU, the European Parliament has proposed that counterparties should clear at least five trades through an EU CCP in each of the most relevant subcategories. The original approach proposed by the council only required one trade per relevant subcategory. On the topic of supervision, the agreement includes a new role for the European Securities and Markets Authority (ESMA) as co-chair of CCP supervisory colleges alongside national competent authorities and a coordinating role in an emergency.

- **ESA's Joint Board of Appeal Confirms ESMA's Decision to Withdraw the Recognition of Dubai Commodities Clearing Corporation.** On February 6, the Joint Board of Appeal of the European Supervisory Authorities (the ESAs) unanimously decided to dismiss the appeal brought by Dubai Commodities Clearing Corporation (DCCC) against ESMA and to therefore confirm the ESMA decision to withdraw its recognition. The application was brought in relation to ESMA's Decision, adopted under Article 25p of Regulation (EU) No 648/2012 (EMIR), to withdraw the recognition of DCCC as a Tier 1 third-country CCP. The decision is a consequence of the United Arab Emirates (UAE) being included by the European Commission on the list of high-risk third countries presenting strategic deficiencies in their national anti-money laundering and counter financing of terrorism (AML/CFT) regime, provided for in the Commission Delegated Regulation (EU) 2016/1675. The Joint Board of Appeal of the ESAs had decided to suspend the ESMA decision in October 2023 until the outcome of the appeal was concluded. With today's publication, the suspension has expired and the ESMA decision has become fully operational.
- **ESMA Publishes Guidelines on CCP Recovery and Resolution.** On February 2, ESMA published two sets of guidelines relating to the EU CCP Recovery and Resolution Regulation. The first set of guidelines provides EU authorities with guidance on the provisions that should be included in cooperation arrangements with third-country authorities, on matters such as the exchange of information for the preparation and maintenance of resolution plans, and on the mechanisms for prompt informing to parties before any early intervention power or resolution action. The second set of guidelines provides EU authorities with guidance on practical arrangements for the establishment and functioning of the resolution college for EU CCPs, and to facilitate the effective operation of the college.
- **ESAs Recommend Steps to Enhance the Monitoring of BigTechs' Financial Services Activities**. On February 1, the ESAs published a Report setting out the results of a stock take of BigTech direct financial services provision in the EU. The Report identifies the types of financial services currently carried out by BigTechs in the EU pursuant to EU licenses and highlights inherent opportunities, risks, regulatory and supervisory challenges. The stock take showed that BigTech subsidiary companies currently licensed to provide financial services pursuant to EU law mainly provide services in the payments, e-money and insurance sectors and, in limited cases, the banking sector. However, the ESAs have yet to observe their presence in the market for securities services. To further strengthen the cross-sectoral mapping of BigTechs' presence and relevance to the EU's financial sector, the ESAs propose to set-up a data mapping tool. The ESAs explained that this tool is intended to provide a framework that supervisors from the National Competent Authorities would be able to use to monitor on an ongoing and dynamic basis the BigTech companies' direct and indirect relevance to the EU financial sector.

New Industry-Led Developments

- **ISDA Response to Australian Treasury on Financial Market Infrastructure Reforms**. On February 9, ISDA and the Futures Industry Association submitted a joint response to the Australian Treasury's draft financial market infrastructure reform package. In the response, the associations considered the proposed crisis

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resolution regime, which would provide the Reserve Bank of Australia (RBA) with powers to step in and resolve a crisis affecting a domestic central counterparty (CCP), with the aim of ensuring the continuity of critical clearing functions and maintaining financial stability in Australia. The associations expressed concerns with some of the provisions contemplated in the draft regime and asked if the issues highlighted in the response (such as the ability of the RBA or statutory manager to direct and make changes to the operating rules, the lack of explicit definitions of and safeguards on resolution powers and the interaction with close-out netting) could be addressed. [NEW]

- **ISDA Response on Anti-Greenwashing Rules**. On January 26, ISDA submitted a response to the UK Financial Conduct Authority's consultation on GC23/3: Guidance on the Anti-Greenwashing Rule. In the response, ISDA highlights that actual or perceived misrepresentation of sustainability features may have a detrimental impact on investor and consumer perceptions of sustainable finance products, and ISDA supports efforts to enhance trust in the market. ISDA considers that sustainability-linked derivatives, environmental, social and governance derivatives and voluntary carbon credits fall within the scope of the rule.

The following Gibson Dunn attorneys assisted in preparing this update: Jeffrey Steiner, Adam Lapidus, Marc Aaron Takagaki, Hayden McGovern, and Karin Thrasher. Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Derivatives practice group, or the following practice leaders and authors: Jeffrey L. Steiner, Washington, D.C. (202.887.3632, jsteiner@gibsondunn.com) Michael D. Bopp, Washington, D.C. (202.955.8256, mbopp@gibsondunn.com) Michelle M. Kirschner, London (+44 (0)20 7071.4212, mkirschner@gibsondunn.com) Darius Mehraban, New York (212.351.2428, dmehraban@gibsondunn.com) Jason J. Cabral, New York (212.351.6267, jcabral@gibsondunn.com) Adam Lapidus – New York (+1 212.351.3869, alapidus@gibsondunn.com) Stephanie L. Brooker, Washington, D.C. (202.887.3502, sbrooker@gibsondunn.com) Roscoe Jones Jr., Washington, D.C. (202.887.3530, rjones@gibsondunn.com) William R. Hallatt, Hong Kong (+852 2214 3836, whallatt@gibsondunn.com) David P. Burns, Washington, D.C. (202.887.3786, dburns@gibsondunn.com) Marc Aaron Takagaki, New York (212.351.4028, mtakagaki@gibsondunn.com) Hayden K. McGovern, Dallas (214.698.3142, hmcgovern@gibsondunn.com) Karin Thrasher, Washington, D.C. (202.887.3712, kthrasher@gibsondunn.com) © 2024 Gibson, Dunn & Crutcher LLP. All rights reserved. For contact and other information, please visit us at www.gibsondunn.com. Attorney Advertising: These materials were prepared for general informational purposes only based on information available at the time of publication and are not intended as, do not constitute, and should not be relied upon as, legal advice or a legal opinion on any specific facts or circumstances. Gibson Dunn (and its affiliates, attorneys, and employees) shall not have any liability in connection with any use of these materials. The sharing of these materials does not establish an attorney-client relationship with the recipient and should not be relied upon as an alternative for advice from qualified counsel. Please note that facts and circumstances may vary, and prior results do not guarantee a similar outcome.

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