

## This Week in Derivatives

February 23, 2024

**From the Derivatives Practice Group:** The CFTC issued a no-action letter, approved three proposed rules and extended the comment period on a fourth this week.

### New Developments

- **CFTC Staff Issues No-Action Letter Regarding Pre-Trade Mid-Market Mark for Certain Interest Rate Swaps Referencing SOFR.** On February 22, the CFTC's Market Participants Division (MPD) issued a [no-action letter](#) applicable to all registered swap entities in relation to the requirement in Regulation 23.431 that swap dealers and major swap participants (swap entities) disclose to certain counterparties the Pre-Trade Mid-Market Mark (PTMMM) of a swap. The no-action letter states that MPD will not recommend the CFTC take an enforcement action against a registered swap entity for its failure to disclose the PTMMM to a counterparty in certain interest rate swaps referencing the Secured Overnight Financing Rate that are identified in the no-action letter, provided that: (1) real-time tradeable bid and offer prices for the swap are available electronically, in the marketplace, to the counterparty; and (2) the counterparty to the swap agrees in advance, in writing, that the registered swap entity need not disclose a PTMMM for the swap. According to the CFTC, the no-action letter provides a similar no-action position as that in CFTC Staff Letter No. [12-58](#) for certain interest rate swaps referencing the London Interbank Offered Rate. CFTC Commissioner Christy Goldsmith Romero [objected](#) to the no-action letter, arguing that it inappropriately shifts the burden of understanding swap dealer's conflicts and incentives back onto counterparties, upending the Dodd-Frank Act's intent. [NEW]

- CFTC Approves Three Proposed Rules and Other Commission Business.** On February 20, the CFTC approved three proposed rules through its seriatim process: (1) [Regulations to Address Margin Adequacy and to Account for the Treatment of Separate Accounts by Futures Commission Merchants](#); (2) [Foreign Boards of Trade](#); and (3) [Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions](#). All three proposals have a comment deadline of April 22, 2024. Additionally, the CFTC issued an [order](#) of exemption from registration as a derivatives clearing organization (DCO) to Taiwan Futures Exchange Corporation and approved an [amended order](#) of registration for ICE NGX Canada, Inc., adding environmental contracts to the scope of contracts it is eligible to clear as a DCO. [NEW]
- CFTC Extends Comment Period on Proposed Rules for Operational Resilience Frameworks.** On February 20, the CFTC [extended the comment period](#) on its proposed rules implementing requirements for operational resilience frameworks for futures commission merchants, swap dealers and major swap participants. The new deadline is April 1, 2024. [NEW]
- CFTC GMAC to Meet March 6.** The CFTC's Global Markets Advisory Committee (GMAC) will meet on Wednesday, March 6 at 10am ET. The GMAC will hear presentations from its Global Market Structure Subcommittee, Technical Issues Subcommittee and Digital Asset Markets Subcommittee, and consider their recommendations. [NEW]
- 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 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.

## New Developments Outside the U.S.

- **HKMA Sets Out Expectations on Tokenized Product Offerings.** On February 20, the Hong Kong Monetary Authority (HKMA) published a [circular](#) covering the sale and distribution of tokenized products. According to the HKMA, the prevailing supervisory requirements and consumer/investor protection measures for the sale and distribution of a product are also applicable to its tokenized form as it has terms, features and risks similar to those of the underlying product. The HKMA clarified that authorized institutions should conduct adequate due diligence and fully understand the tokenized products before offering them to customers and on a continuous basis at appropriate intervals. Authorized institutions are also expected to act in the best interest of their customers and make adequate disclosure of the relevant material information about a tokenized product, including its key terms, features and risks. Finally, the HKMA indicated that authorized institutions should put in place proper policies, procedures, systems and controls to identify and mitigate the risks arising from tokenized product-related activities. [NEW]
- **HKMA Sets Standards for Digital Asset Custodial Services.** On February 20, the HKMA issued [guidance](#) for authorized institutions interested in offering custody services for digital assets. The HKMA expects authorized institutions to undertake a comprehensive risk assessment followed by the implementation of appropriate policies to manage identified risks. The entire process should be overseen by the board and senior management. The HKMA also requires authorized institutions to conduct independent systems audits, store a substantial portion of client digital assets in cold storage, ensure that private keys are secured within Hong Kong and provide all records to HKMA whenever requested. Authorized institutions should notify the HKMA and confirm that they meet the expected standards in the guidance within 6 months from the date of the guidance (i.e. February 20, 2024). [NEW]
- **ASIC Publishes Third Consultation Paper on OTC Derivatives Reporting.** On February 15, the Australian Securities and Investments Commission (ASIC) published [Consultation Paper \(CP\) 375: Proposed changes to the ASIC Derivatives Transaction Rules \(Reporting\): Third consultation](#). CP 375 proposes the following changes to [ASIC](#)

[Derivative Transaction Rules \(Reporting\) 2024](#): simplify the exclusion of exchange-traded derivatives; simplify the scope of foreign entity reporting; remove the alternative reporting provisions; clarify the exclusion of FX securities conversion transactions; and add additional allowable values for two data elements. Additionally, CP 375 proposes minor changes to [ASIC Derivative Transaction Rules \(Clearing\) 2015](#): simplify and align the exclusion of exchange-traded derivatives with the 2024 reporting rules and make minor updates to re-reference certain definitions to their changed location in the Corporations Act 2001. The proposed changes would commence on October 21, 2024, except for the changes to the scope of foreign entity reporting and the removal of alternative reporting provisions, which would commence on April 1, 2025. ASIC indicated that it does not expect most reporting entities to face any material additional compliance burden upon implementation of the proposed changes. However, a small number of international reporting entities and some small-scale exempt reporting entities may be impacted, according to ASIC. The consultation period will run until March 28, 2024. [NEW]

- **Council of the EU Ratifies EMIR 3 Agreement at Ambassador Level.** On February 14, the European Market Infrastructure Regulation 3 (EMIR 3) package (regulation and directive), as negotiated in the trilogues, was approved at ambassador level. The texts are available [here](#). According to ISDA, the final text maintains the Council of the EU's less punitive approach of an operational active account with representativeness. It also introduces a requirement for financial counterparties and non-financial counterparties above certain de minimis thresholds to hold an active account at an EU CCP and to clear a number of representative trades in that account. The directive amending the Capital Requirement Regulation is intended to provide more specific tools and powers under Pillar 2 in the context of excessive concentration to CCPs. [NEW]
- **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 CCPs and transparency between CCPs, clearing members and their clients. The deadline for comment is April 14.
- **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.

- 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.
- 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 EMIR 3. On the issue of an active account requirement, while the agreement is based on the less punitive operational active 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.

## New Industry-Led Developments

- **ISDA Responds to FCA on Commodity Derivatives.** On February 15, ISDA and the Association for Financial Markets in Europe (AFME) submitted a [joint response](#) to the UK Financial Conduct Authority (FCA) consultation on the [reform of the UK commodity derivatives regulatory framework](#). The consultation sought to remove unnecessary burdens on firms and strengthen the supervision of the UK's commodity derivatives markets. The associations indicated that they strongly support the FCA's proposal to apply a narrower position limits regime that it views as more proportionate to the risks associated with certain commodity derivatives contracts. However, the associations expressed concern over the proposed approaches for setting position limits and adding additional reporting obligations. They noted that the complex and burdensome frameworks proposed can, in their view, discourage participation in UK trading venues by non-UK participants and may have a negative impact on the competitiveness of UK markets. The response also recommends a longer implementation period of at least 24 months, based on the association's perception of the scale of the operational and technical changes required. [NEW]
- **ISDA Responds 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 resolution regime, which would provide the Reserve Bank of Australia (RBA) with powers to step in and resolve a crisis affecting a domestic 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.

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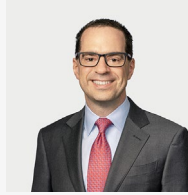
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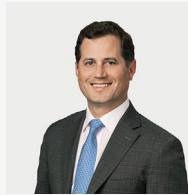
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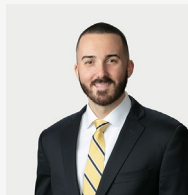
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