

This Week in Derivatives

February 9, 2024

From the Derivatives Practice Group: The SEC expanded the definitions of “Dealers” and “Government Securities Dealers” this week and Hong Kong weighed in on crypto and virtual asset regulation.

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.” [NEW]
- **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. [NEW]

- **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. [NEW]

- **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]
- **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. [NEW]
- **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. [NEW]
- **CFTC's Energy and Environmental Markets Advisory Committee to Meet February 13.** On January 30, 2024, CFTC Commissioner Summer K. Mersinger, sponsor of the Energy and Environmental Markets Advisory Committee (EEMAC) announced the EEMAC will hold a public meeting from 9:00 a.m. to 11:30 a.m. (MST) on Tuesday, February 13 at the Colorado School of Mines in Golden, Colorado. The CFTC stated that at this meeting, the EEMAC will explore the role of rare earth minerals in transitional energy and electrification, including the potential development of derivatives products to offer price discovery and hedging opportunities in these markets. Additionally, the meeting will include a presentation and discussion on the federal prudential financial regulators proposed rules implementing Basel III and the implications for and impact on the derivatives market. Finally, the two EEMAC subcommittees will offer an update on their continued work related to traditional energy infrastructure and metals markets.
- **CFTC Cautions the Public to Beware of Artificial Intelligence Scams.** On January 25, the CFTC's OCEO issued a customer advisory warning the public about Artificial Intelligence (AI) scams. [Customer Advisory: AI Won't Turn Trading Bots into Money](#)

[Machines](#) explains how the scams use the potential of AI technology to defraud investors with false claims that entice them to hand over their money or other assets to fraudsters who misappropriate the funds and deceive investors. The advisory warns investors that claims of high or guaranteed returns are red flags of fraud and that strangers promoting these claims online should be ignored. The CFTC stated that the advisory is intended to help investors identify and avoid potential scams and includes a reminder that AI technology cannot predict the future. It also lists four items investors may consider to avoid such scams: researching the background of a company or trader, researching the history of the trading website, getting a second opinion, and knowing the risks associated with the underlying assets.

- **CFTC Staff Releases Request for Comment on the Use of Artificial Intelligence in CFTC-Regulated Markets.** On January 25, the CFTC's Divisions of Market Oversight, Clearing and Risk, Market Participants, and Data and the Office of Technology Innovation issued a [request for comment](#) (RFC) in an effort to better inform them on the current and potential uses and risks of AI in the derivatives markets that the CFTC regulates. The RFC seeks comment on the definition of AI and its applications, including its use in trading, risk management, compliance, cybersecurity, recordkeeping, data processing and analytics, and customer interactions. The RFC also seeks comment on the risks of AI, including risks related to market manipulation and fraud, governance, explainability, data quality, concentration, bias, privacy and confidentiality and customer protection. The CFTC indicated that staff will consider the responses to the RFC in analyzing possible future actions by the CFTC, such as new or amended guidance, interpretations, policy statements, or regulations. Comments will be accepted until April 24, 2024.
- **CFTC Seeks Public Comment on Proposed Capital Comparability Determination for Swap Dealers Subject to Supervision by the UK Prudential Regulation Authority.** On January 24, the CFTC solicited public comment on a substituted compliance [application](#) requesting that the CFTC determine that certain CFTC-registered nonbank swap dealers located in the United Kingdom may satisfy certain Commodity Exchange Act capital and financial reporting requirements by being subject to, and complying with, comparable capital and financial reporting requirements under UK laws and regulations. The Institute of International Bankers, the International Swaps and Derivatives Association, and the Securities Industry and Financial Markets Association submitted the application. In connection with the application, the CFTC also solicited public comment on a proposed comparability determination and related order providing for the conditional availability of substituted compliance to CFTC-registered nonbank swap dealers under the UK Prudential Regulation Authority's prudential supervision. The comment period will be open until March 24, 2024.
- **BGC Group Announces Approval for FMX Futures Exchange.** On January 22, BGC Group, Inc. (BGC) announced that its FMX Futures Exchange (FMX) received approval from the CFTC to operate an exchange for U.S. Treasury and SOFR futures. BGC will combine their Fenics UST cash Treasury platform and FMX to work across the CME's U.S. interest rate complex. FMX is party to a clearing agreement with LCH SwapClear, a holder of interest rate collateral, which it indicated will allow for portfolio margining across rates of risk and provide for margin efficiencies and effective risk management.

New Developments Outside the U.S.

- **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. [NEW]
- **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. [NEW]
- **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 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. [NEW]
- **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]

- **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. [NEW]
- **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.
- **ESMA Publishes Risk Monitoring Report.** On January 31, the ESMA published its [first risk monitoring report of 2024](#), where it sets out the key risk drivers currently facing financial markets. Beyond the risk drivers, ESMA's report provides an update on structural developments and the status of key sectors of financial markets, during the second half of 2023. The report considers structural developments in various areas, including market-based finance, sustainable finance, securities markets, and asset management.
- **ESMA Consults on Reverse Solicitation and Classification of Crypto Assets as Financial Instruments Under MiCA.** On January 29, ESMA, published two [Consultations Papers on guidelines under Markets in Crypto Assets Regulation \(MiCA\)](#), one on [reverse solicitation](#) and one on the [classification of crypto-assets as financial instruments](#). ESMA is seeking input on proposed guidance relating to the conditions of application of the reverse solicitation exemption and the supervision practices that National Competent Authorities may take to prevent its circumvention. ESMA is also

seeking input on establishing clear conditions and criteria for the qualification of crypto-assets as financial instruments.

New Industry-Led Developments

- **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.
- **Joint Response to EC on BMR.** On January 23, ISDA, the Global Financial Markets Association and the Futures Industry Association (FIA) submitted a joint response to the EC call for feedback on the review of the scope and regime for non-EU benchmarks. The response sets out the associations' comments on the EC's proposal, along with potential draft amendments and additional revisions that were considered to support the EC's aims. In the response, the associations welcome the EC's recognition of the problems caused by the current drafting of the Benchmark Regulation (BMR). The associations support the aim of establishing a third-country regime that is sustainable in the long term once the current transitional regime expires, and overall consider that the proposal will result in a more proportionate regime for users and administrators of benchmarks.
- **ISDA, FIA Respond to MAS Consultation on Amendments to the Capital Framework for Approved Exchanges and Clearing Houses.** On January 22, ISDA and the FIA jointly [responded](#) to the [consultation](#) from the Monetary Authority of Singapore (MAS) on proposed amendments to the capital framework for approved exchanges and approved clearing houses. The scope of the response is limited to the capital framework for approved clearing houses. The associations stated that they welcomed the introduction of a separate liquidity requirement and proposed that MAS consider a more conservative minimum threshold of at least 12 months of operating expenses. They also agreed with the proposed amendments that capital components should only include equity instruments and exclude an approved clearing house's skin-in-the-game. For total risk requirement, the response suggests the alignment of the operational risk component with the liquidity risk requirement and the inclusion of some clarifications on the investment risk and general counterparty risk components.

Practice Group Members



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 Cabral
New York
212.351.6267
jcabral@gibsondunn.com



Adam Lapidus
New York
212.351.3869
alapidus@gibsondunn.com



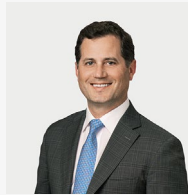
Stephanie L. Brooker
Washington, D.C.
202.887.3502
sbrooker@gibsondunn.com



Roscoe Jones Jr.
Washington, D.C.
202.887.3530
rjones@gibsondunn.com



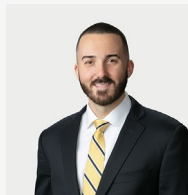
William R. Hallatt
Hong Kong
+852.2214.3836
whallatt@gibsondunn.com



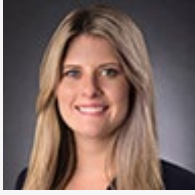
David P. Burns
Washington, D.C.
202.887.3786
dburns@gibsondunn.com



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

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