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## DERIVATIVES

*See "CFTC Takes Action on Rules Relating to Swaps and Swap Execution Facilities" in the CFTC section.*

## CFTC

### CFTC Takes Action on Rules Relating to Swaps and Swap Execution Facilities

On November 5, the Commodity Futures Trading Commission held an open meeting to consider the following matters relating to swaps and swap execution facilities:

- Final Rule: Amending the *De Minimis* Exception to the Swap Dealer Definition
- Proposed Rule: Amendments to Regulations on Swap Execution Facilities and Trade Execution Requirement
- Request for Comment Regarding the Practice of "Post-Trade Name Give-Up" on Swap Execution Facilities

*CFTC Adopts Permanent $8 Billion De Minimis Exception to the Swap Dealer Definition*

In a 5-0 vote, the CFTC adopted an amendment to the definition of the term "swap dealer" to set the permanent aggregate gross notional amount threshold for the *de minimis* exception at $8 billion in swap dealing activity entered into by a person over the preceding 12 months.

In the exercise of its authority under Section 1a(49) of the Commodity Exchange Act (CEA), the CFTC had excluded from the definition of a "swap dealer," as set out in Section 1.3 of the CFTC's regulations, persons whose activities falling within the definition of a swap dealer did not exceed an aggregate gross notional amount (AGNA) threshold of $3 billion (measured over the prior 12-month period), subject to a phase-in period during which the AGNA threshold was set at $8 billion (the "*de minimis* exemption"). The phase-in period was originally scheduled to terminate on December 31, 2017, but was extended, via successive orders, to December 31, 2019. Therefore, absent further CFTC action, market participants would be required to begin counting towards a lower threshold on January 1, 2019.

*CFTC Releases Notice of Proposed Rulemaking on Swap Execution Facilities and the Trade Execution Requirement*

In a 4-1 vote, the CFTC proposed to amend existing requirements and propose new requirements pertaining to swap execution facilities (SEFs) and the trade execution requirement, as set forth in the CEA. The proposed rules also codify a number of existing staff guidance documents and staff no-action relief letters.

Among other provisions, the proposed amendments would:

- Require certain swaps broking entities, including interdealer brokers and aggregators of single-dealer platforms, to register as SEFs. (Domestic swaps broking entities would receive a six-month delay from the SEF registration requirement; foreign swaps broking entities would receive a two-year delay from the SEF registration requirement.)
- Amend the SEF registration requirement to clarify that entities that meet the SEF definition would be required to register as an SEF, whether or not the swaps that they list for trading are subject to the trade execution requirement.
- Eliminate the "made available to trade" (MAT) determination process for SEFs and DCMs and establish a new approach based on a revised interpretation of the trade execution requirement in CEA section 2(h)(8). The trade execution requirement would apply to swaps that are both (1) subject to the clearing requirement and (2) listed by a SEF or DCM for trading. Based on this approach, a number of new interest rate swaps and credit default swaps would be subject to the trade execution requirement.
- Authorize a SEF to offer flexible methods of execution for all listed swaps, including swaps subject to the trade execution requirement. In conjunction with an SEF's ability to offer flexible execution methods, the exceptions to the prohibition on pre-arranged trading would be eliminated.
- Establish requirements for "SEF trading specialists" (i.e., SEF employees) who perform core functions that facilitate swaps trading and execution for an SEF. The proposed rules would also establish an SEF duty of supervision over SEF trading specialists.
- Allow an SEF to structure participation criteria and trading practices, including fee schedules, in a manner that align with the swaps market practices. Such criteria must be transparent, fair and non-discriminatory, and applied to all or "similarly situated" market participants in a "fair and non-discriminatory" manner, which means that such criteria should be non-arbitrary and based on objective, pre-established requirements or limitations.
- Codify existing staff guidance that requires SEFs to facilitate pre-execution credit screening for swaps intended to be cleared; and require market participants to identity a clearing futures commission merchant (FCM) before each order.
- Amend the financial resources requirements to clarify that an SEF would only need to maintain adequate financial resources to cover the operating costs needed to comply with the SEF core principles and CFTC regulations for a one-year period, as calculated on a rolling basis.
- Reduce the existing liquid resource requirement from six months of an SEF's operating costs to the greater of (1) three months of an SEF's projected operating costs; or (2) the projected costs for an SEF to wind down its business, as determined by the SEF. In determining projected operating costs, an SEF would be permitted to follow new proposed Acceptable Practices, which are based on staff guidance, that identify various operating costs that an SEF may exclude or pro-rate in its projected operating cost calculations. This calculation would be based on an SEF's current business model and any anticipated changes. An SEF's quarterly financial reports would be required to identify all of its expenses, including those that it has excluded from its calculations, and provide the basis for any amounts excluded or pro-rated from its projected operating costs.
- Streamline many SEF self-regulatory organization obligations and provide an SEF with the ability to tailor its rule enforcement program, disciplinary procedures and sanctions to its trading operations and market. Under the proposed rules, an SEF would also be able to choose additional types of entities to serve as a regulatory service provider to assist with fulfilling its compliance responsibilities.
- Streamline an SEF chief compliance officer's (CCO) existing duties, simplify the preparation and submission of an SEF's annual compliance report, and provide an SEF's senior officer (i.e., the CEO or equivalent officer) with the same oversight responsibilities over the CCO as the SEF's board.

The full notice regarding the proposed rule is available here.

*CFTC Requests Comment on Post-Trade Name Give-Up*

By a 5-0 vote, the CFTC also issued a request for comment that seeks public views as to the necessity or utility of post-trade name give-up practices in facilitating swaps trading where swap transactions are anonymously executed and intended to be cleared.

The full notice regarding the request for comment is available here.

## UK/BREXIT DEVELOPMENTS

### FCA Publishes Speech on Brexit Preparations

On November 5, , the UK Financial Conduct Authority (FCA) published a speech by Nausicaa Delfas, FCA Executive Director of International, on Brexit and maintaining market confidence.

The speech covers a wide range of Brexit topics and provides an overview of the FCA's current priorities relating to Brexit, including its work to ensure there is a robust regulatory framework on exit day, if the United Kingdom leaves the European Union without an agreed transition period (No-Deal Brexit). Ms Delfas sheds light on the temporary permissions regime being implemented in the case of a No-Deal Brexit, stating that 1,300 EU-based firms and funds have expressed an interest in the regime. The temporary permissions regime will allow EU firms and funds to continue regulated business in the United Kingdom in the case of a No-Deal Brexit (for further details, see the July 27 edition of *Corporate & Financial Weekly Digest*).

In relation to the FCA's expectations of firms, Ms Delfas states that firms should ensure that they are prepared, whatever the outcome of Brexit negotiations. The FCA expects firms to take their own legal advice on what a No-Deal Brexit might mean for them and their customers, and any steps they may need to take. The FCA also expects firms to understand the impact of Brexit on their customers, continue to service them fully and fairly, and communicate with them in a timely fashion. Firms should let customers know if there will be any change to their ability to provide services to them post Brexit, and if any changes may affect the customers' products or contracts.

Ms Delfas highlights the fact that the FCA's consumer objective goes beyond consumers in the United Kingdom and is relevant to consumers elsewhere who are served by UK firms. Ms Delfas states that the FCA has informed large international banks that they should only consider moving their activities which relate to non-EU clients away from the UK if it is demonstrably in the interests of such clients to do so.

Ms Delfas also discusses the risks which may arise in the event of a No-Deal Brexit, such as issues relating to data-sharing between UK and EU authorities, and the measures that have been taken to mitigate such risks. Ms Delfas highlights the importance of memoranda of understanding and other practical arrangements to support cross-border supervision of firms and data-sharing. In determining the future relationship between the EU and the UK, Ms Delfas calls for outcomes-based equivalence, as opposed to equivalence based on merely having sufficiently similar rules in place.

A copy of the speech is available here.

## EU/BREXIT DEVELOPMENTS

### EEA Passport Rights Regulations 2018 Published

On November 7, the European Economic Area (EEA) Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018 (Passport Rights Regulations) were published together with an associated explanatory memorandum.

The Passport Rights Regulations remove references to the EU's passporting framework from UK legislation. Additionally (as previously explained in the July 27 edition of *Corporate & Financial Weekly Digest*), they establish a temporary permissions regime (TPR) to enable EEA financial services firms currently operating in the United Kingdom using a passport to continue their activities in the United Kingdom for a limited period after the United Kingdom's withdrawal from the European Union on March 29, 2019 (Exit Day), if there is no transition period.

The Prudential Regulation Authority (PRA) also published a direction on November 7 that it gave under the Passport Rights Regulations. The PRA directs EEA firms, authorized by the PRA and that are carrying on a regulated activity in the United Kingdom under passporting arrangements, to notify it if they intend to obtain a deemed permission or variation under the TPR. Firms will have to make notifications by submitting the Temporary Permission Notification Form using the UK Financial Conduct Authority's Connect system, or by submitting an application to the PRA before Exit Day for UK-specific authorization as a branch. There will be no fee for notifications to enter the TPR and entry into the TPR will be confirmed by email.

The Passport Rights Regulations became effective on November 7, with the exception of certain regulations (such as the repeal of passport rights), which will become effective on Exit Day. EU firms wishing to file Temporary Permission Notification Forms must do so between January 7, 2019, and March 28, 2019.

The Passport Rights Regulations are available here.

The explanatory memorandum is available here.

The PRA's direction is available here.

### ESAs Publish Consultation Paper Relating to MLD4

On November 8, the Joint Committee of the European Supervisory Authorities (ESAs) published a consultation paper on draft joint guidelines on cooperation and information exchange between national competent authorities (NCAs) supervision credit and financial institutions for the purposes of the Fourth Money Laundering Directive (MLD4)

MLD4 includes a high-level requirement for EU NCAs to cooperate with each other regarding the supervision of anti-money laundering/ counter-terrorist financing (AML/CTF), but it does not provide details as to how this cooperation should be fulfilled. The Fifth Money Laundering Directive (MLD5) has subsequently amended MLD4, so that the legal basis for the cooperation and exchange of information between NCAs has also been clarified and specifies that member states must not prohibit or unreasonably restrict the exchange of AML/CTF information or cooperation between NCAs. However, again as with MLD4, MLD5 does not set forth how such requirements should be achieved.

The ESAs have therefore proposed improved supervisory cooperation and information exchange through AML/CTF colleges, as well as guidelines clarifying how to achieve such requirements. The guidelines (referred to as The AML Colleges Guidelines):

1. Set forth rules governing the establishment and operation of the AML/CTF colleges. They provide that all NCAs should identify firms that require an AML/CTF college to be established—and such colleges will provide a forum for cooperation and information exchange to those NCAs responsible for supervising the same firm in different jurisdictions;
2. Define the process for bilateral exchanges of information where there are only two NCAs supervising a firm.
3. Emphasize the need for AML/CTF supervisors and prudential supervisors to exchange information.
The ESAs will hold a public hearing on the draft guidelines at the European Banking Authority's London offices on December 18. The consultation period closes on February 8, 2019.

The consultation paper is available here.

**ESMA Proposes Regulatory Change To Support the Brexit Preparations of Counterparties to Uncleared OTC Derivatives**

On November 8, the European Securities and Markets Authority (ESMA) published a final report proposing new draft regulatory technical standards (RTS) contained in a draft Delegated Regulation that would amend the three

European Commission Delegated Regulations on the clearing obligation under the European Markets and Infrastructure Regulation (EMIR).

The draft RTS propose, in the context of the UK's withdrawal from the European Union, to introduce a limited exemption from the EMIR clearing obligation, in order to facilitate the novation of certain non-centrally cleared over-the-counter (OTC) derivative contracts to EU counterparties during a specific time-window. Without the exemption, contracts resulting from novations from UK to EU counterparties might be subject to clearing obligations that were not applicable at the time the original contracts were signed. The amendments contained in the RTS would only apply if the United Kingdom leaves the EU without the conclusion of a withdrawal agreement (No-Deal Brexit).

The exemption would only apply to the novation of an OTC derivative to a new EU counterparty, which would not trigger the EMIR clearing obligation, and would not extend to other life-cycle events performed by the parties in relation to such contract. The exemption would also be time-limited to twelve months after a No-Deal Brexit, to allow for the repapering exercise.

In order to fully utilize the exemption, ESMA states that parties should start negotiating the novations of their transactions within the scope of the proposed exemption as soon as possible, given the limited time period available. If the parties agree on the terms of a novation before the date of application of the RTS, they should provide that such novations will only take effect upon the occurrence of Brexit.

ESMA has sent the final report to the European Commission to submit the draft RTS for endorsement. Once the European Commission has endorsed them, they will be passed to the European Parliament and the Council of the EU for consideration and adoption, after which they will be published in the *Official Journal of the EU*.

The final 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 DEVELOPMENTS

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