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This Week in Derivatives

June 7, 2024

From the Derivatives Practice Group: This week, the European Supervisory Authorities each published a report on Greenwashing in the financial sector. The reports stress that financial market players have a responsibility to provide sustainability information that is clear, fair, and not misleading.

New Developments

- **CFTC's Global Markets Advisory Committee Advances Recommendations on Basel III Endgame and Variation Margin Processes.** On June 4, the CFTC's Global Markets Advisory Committee (GMAC) advanced two recommendations to examine the impacts of proposed U.S. bank capital requirements and to improve collateral and liquidity management for non-centrally cleared derivatives. The GMAC approved the two recommendations without objection. [NEW]

- **Biden-Harris Administration Announces New Principles for High-Integrity Voluntary Carbon Markets.** On May 28, the Biden-Harris Administration released a Joint Statement of Policy and new Principles for Responsible Participation in Voluntary Carbon Markets (VCMs) that codifies the U.S. government's approach to advance high-integrity VCMs. The Principles for Responsible Participation include: (1) carbon credits and the activities that generate them should meet credible atmospheric integrity standards and represent real decarbonization; (2) credit-generating activities should avoid environmental and social harm and should, where applicable, support co-benefits and transparent and inclusive benefits-sharing; and (3) corporate buyers that use credits should prioritize measurable emissions reductions within their own value chains, among others. The announcement of the Principles also highlighted valuable work performed by the CFTC, including new guidance at COP28 to outline factors that derivatives exchanges may consider when listing voluntary carbon credit derivative contracts to promote the integrity, transparency, and liquidity of these developing markets and a new Environmental Fraud Task Force to address fraudulent activity and bad actors in carbon markets.

- **IOSCO Board Re-Elects CFTC Chairman Behnam as Vice Chair.** The Board of the International Organization of Securities Commissions (IOSCO) has re-elected CFTC Chairman Rostin Behnam as a Vice Chair for the term 2024-2026, a role to which he was originally elected in October 2022. This year's election took place at IOSCO's 2024 Annual Meeting in Athens, Greece. As a member of the IOSCO Board's Management Team, Chairman Behnam helps guide IOSCO's policy development and overall management. In addition to steering the CFTC's engagement in an array of policy work within IOSCO, Chairman Behnam has co-led IOSCO's Financial Stability Engagement Group and currently co-chairs the Carbon Markets Workstream within IOSCO's Sustainable Finance Task Force.

- **CFTC Announces Updated Part 43 Block and Cap Sizes and Further Extends No-Action Letter Regarding the Block and Cap Implementation Timeline.** On May 23, the CFTC's Division of Data published updated post-initial appropriate minimum block sizes and post-initial cap sizes as determined under CFTC regulations. The Division of Market Oversight (DMO) also issued a letter further extending the no-action position originally taken in CFTC Letter No. 22-03 regarding the compliance dates for certain amendments, adopted in November 2020, to the CFTC's swap data reporting rules concerning block trades and post-initial cap sizes. The updated post-initial appropriate minimum block and cap sizes will be effective October 7. The updated post-initial appropriate minimum block and post-initial cap sizes, as well as other swap reporting rules, forms, and requirements, are at Real-Time Reporting | CFTC.

New Developments Outside the U.S.

- **ESAs and ENISA Sign a Memorandum of Understanding to Strengthen Cooperation and Information Exchange.** On June 5, the European Supervisory Authorities (EBA, EIOPA, and ESMA - the ESAs) announced that they have concluded a multilateral Memorandum of Understanding (MoU) to strengthen cooperation and information exchange with the European Union Agency for Cybersecurity (ENISA). This multilateral MoU formalizes the ongoing discussions between the ESAs and ENISA to strengthen their already close cooperation, as a result of the Directive on measures for a high common level of cybersecurity (NIS2 Directive) and the Digital Operational Resilience Act (DORA). [NEW]

- **ESAs Call for Enhanced Supervision and Improved Market Practice on Sustainability-related Claims.** On June 4, the European Supervisory Authorities (ESAs) published their Final Reports on Greenwashing in the financial sector. In their respective reports the ESAs reiterate the common high-level understanding of greenwashing as a practice whereby sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. According to the ESAs, Tthis practice may be misleading to consumers, investors, or other market participants. The ESAs stressed again that financial market players have a responsibility to provide sustainability information that is fair, clear, and not misleading. While the ESAs' reports focus on the EU's financial sector, they acknowledge that addressing greenwashing requires a global response, involving close cooperation among financial supervisors and the development of interoperable standards for sustainability disclosures. [NEW]

- **The EBA and ESMA Invite Comments on the Review of the Investment Firms Prudential Framework.** On June 3, ESMA and the European Banking Authority (EBA) published a discussion paper on the potential review of the investment firms' prudential framework. The discussion paper aims at gathering early stakeholder feedback to inform the response to the European Commission's call for advice. The consultation runs until August 30, 2024. To assess the impact of the possible changes discussed in the paper, the EBA also launched a data collection exercise on a voluntary basis. [NEW]

- **ESAs Publish Templates and Tools for Voluntary Dry Run Exercise to Support the DORA Implementation.** On May 31, the European Supervisory Authorities (EBA, EIOPA and ESMA – the ESAs) published templates, technical documents and tools for the dry run exercise on the reporting of registers of information in the context of Digital Operation Resilience Act (DORA) announced in April 2024. Financial entities can use these materials and tools to prepare and report their registers of information of contractual arrangements on the use of ICT third-party service providers in the context of the dry run exercise, and to understand supervisory expectations for the reporting of such registers from 2025 onwards.

- **Final MiCA Rules on Conflict of Interest of Crypto Assets Providers Published.** On May 31, ESMA published the Final Report on the rules on conflicts of interests of crypto-asset service providers (CASP) under the Markets in Crypto Assets Regulation (MiCA). In the report ESMA sets out draft Regulatory Technical Standards on certain requirements in relation to conflicts of interest for crypto-asset service providers (CASPs) under MiCA, with a view to clarifying elements in relation to vertical integration of CASPs and to further align with the draft European Banking Authority rules applicable to issuers of asset-referenced tokens.

- **ESMA Provides Guidance to Firms Using Artificial Intelligence in Investment Services.** On May 30, ESMA issued a Statement providing initial guidance to firms using Artificial Intelligence technologies (AI) when they provide investment services to retail clients. When using AI, ESMA expects firms to comply with relevant MiFID II requirements, particularly when it comes to organizational aspects, conduct of business, and their regulatory obligation to act in the best interest of the client.

- **ESMA Reports on the Application of MiFID II Marketing Requirements.** On May 27, ESMA published a combined report on its 2023 Common Supervisory Action (CSA) and the accompanying Mystery Shopping Exercise (MSE) on marketing disclosure rules under MiFID II. In the report, ESMA identifies several areas of improvements, such as the need for marketing communications to be clearly identifiable as such, and to contain a clear and balanced presentation of risks and benefits. In cases where products and services are marketed as having 'zero cost', ESMA identified they should also include references to any additional fees.

- **ESMA Consults on Commodity Derivatives Under MiFID Review.** On May 23, ESMA launched a public consultation on proposed changes to the rules for position management controls and position reporting. The changes come in the context of the review of the Market in Financial Instruments Directive (MiFID II). ESMA is consulting on changes to the technical standards (RTS) on position management controls, the

Implementing Technical Standards (ITS) on position reporting, and on position reporting in Commission Delegated Regulation (EU).

- **ESMA Consults on Consolidated Tape Providers and Their Selection.** On May 23, ESMA invited comments on draft technical standards related to Consolidated Tape Providers (CTPs), other data reporting service providers (DRSPs) and the assessment criteria for the CTP selection procedure under the Markets in Financial Instruments Regulation (MiFIR). The proposed draft technical standards are developed in the context of the review of MiFIR and will contribute to enhancing market transparency and removing the obstacles that have prevented the emergence of consolidated tapes in the European Union.

- **ESMA Makes Recommendations for More Effective and Attractive Capital Markets in the EU.** On May 22, ESMA published its Position Paper on "Building more effective and attractive capital markets in the EU". The Paper includes 20 recommendations to strengthen EU capital markets and address the needs of European citizens and businesses.

- **ESMA Consults on Three New Technical Standards.** On May 21, ESMA launched a public consultation on non-equity trade transparency, reasonable commercial basis (RCB) and reference data under the MiFIR review. ESMA is seeking input on three topics: (1) pre- and post-trade transparency requirements for non-equity instruments (bonds, structured finance products and emissions and allowances); (2) obligation to make pre-and post-trade data available on an RCB intended to guarantee that market data is available to data users in an accessible, fair, and non-discriminatory manner; and (3) obligation to provide instrument reference data that is fit for both transaction reporting and transparency purposes.

New Industry-Led Developments

- **Preparing for the Dynamic Risk Management Accounting Model.** On May 29, the International Accounting Standards Board (IASB) announced it has a project underway to develop a new model to account for dynamic risk management (DRM) activities under International Financial Reporting Standards (IFRS). It is widely expected that banks will need to apply this model, which could replace existing macro-hedge accounting models within IFRS. The IASB will also explore whether the DRM model could be applied to other risk types at a future date. ISDA published a whitepaper that sets out ISDA's preliminary observations on the tentative decisions made by the IASB to date. According to ISDA, these observations are based on the current understanding of the model and interpretations of ongoing discussions, but they do not represent a formal industry view, which will not be possible until the IASB has publishes a discussion paper, an exposure draft or a set of deliberations. [NEW]

- **ISDA Submits Policy Paper on Derivatives and EU Agenda to European Commission.** On May 24, ISDA shared its EU public policy paper, A Competitive, Resilient, Sustainable Europe: How derivatives can serve the EU's strategic agenda, with the European Commission. The paper offers a roadmap for how derivatives can play a positive role in supporting key EU strategic priorities for the bloc's 2024-2029 mandate. It shows that the financial system in general, and derivatives specifically, can help the EU to pursue competitiveness, economic security and a successful green transition. [NEW]

- **ISDA Tokenized Collateral Guidance Note.** On May 21, ISDA published a guidance note to inform how counsel may approach a legal opinion on the enforceability of collateral arrangements entered into under certain ISDA collateral documentation where the relevant collateral arrangement comprises tokenized securities and/or stablecoins (together, "Tokenized Collateral"). This guidance note sets forth (i) a basic taxonomy of common tokenization structures and (ii) a non-exhaustive list of key issues to consider when analyzing the enforceability of collateral arrangements involving Tokenized Collateral.

- **ISDA Response to SFC and HKMA Joint's Consultation Paper on Implementing UTI, UPI, and CDE.** On May 17, ISDA responded to the Securities and Futures Commission (SFC) and Hong Kong Monetary Authority's (HKMA) joint further consultation on enhancements to the OTC derivatives reporting regime for Hong Kong to mandate – (1) the use of Unique Transaction Identifier (UTI), (2) the use of Unique Product Identifier (UPI) and (3) the reporting of Critical Data Elements (CDE).

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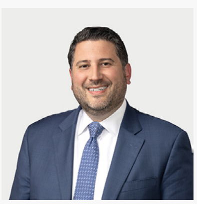

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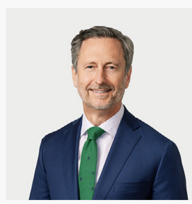

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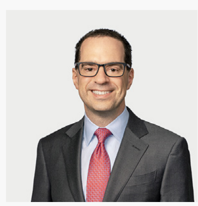

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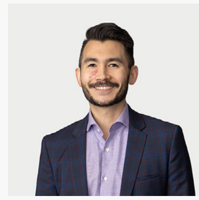

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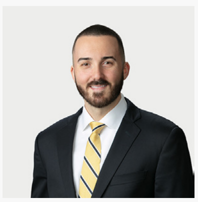

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