

This Week in Derivatives

July 19, 2024

From the Derivatives Practice Group: This week, the Hong Kong Monetary Authority and Financial Services and the Treasury Bureau published the Consultation Conclusions on the Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong.

New Developments

- **President Biden Announced Intent to Nominate Julie Brinn Siegel as a Commissioner of the CFTC.** On July 11, President Biden announced his intent to nominate Julie Brinn Siegel to be a Commissioner of the CFTC. Siegel currently serves as the federal government's deputy chief operating officer as Senior Coordinator for Management at the Office of Management and Budget (OMB). Prior to that, Siegel served as Secretary of the Treasury Janet Yellen's Deputy Chief of Staff and served as Senior Counsel and Policy Advisor to U.S. Senator Elizabeth Warren (D-MA). Last month, President Biden nominated CFTC Commissioner Johnson to be Assistant Secretary for Financial Institutions at the Department of Treasury and nominated CFTC Commissioner Christy Goldsmith Romero to be Chair and Member of the Federal Deposit Insurance Corporation (FDIC) which, if confirmed by the Senate, would leave open two Democratic Commissioner seats at the CFTC. Siegel, if nominated and confirmed by the Senate, would take the seat of Commissioner Goldsmith Romero.
- **First Interagency Fraud Disruption Conference Focuses on Combatting Crypto Schemes Commonly Known as "Pig Butchering."** On July 11, the CFTC and the DOJ's Computer Crime and Intellectual Property Section's National Cryptocurrency Enforcement Team ("NCET") convened the first Fraud Disruption Conference to work on efforts to combat a type of fraud commonly known as "[pig butchering](#)". It is estimated that Americans are scammed out of billions per year, making this a top law enforcement

priority. The working group addressed strategies to prevent victimization; using technology to disrupt the fraud; and collaboration on enforcement efforts. Several agencies also collaborated on an anti-victimization messaging campaign to warn Americans to remain vigilant against emerging fraud threats.

- **Supreme Court Overrules Chevron, Sharply Limiting Judicial Deference To Agencies' Statutory Interpretation.** On June 28, the Supreme Court overruled *Chevron v. Natural Resources Defense Council*, a landmark decision that had required courts to defer to agencies', including the CFTC's, reasonable interpretations of ambiguous statutory terms. For a more detailed analysis of the ruling please refer to Gibson Dunn's client alert, available [here](#).
- **CFTC Announces Supervisory Stress Test Results.** On July 1, the CFTC issued [Supervisory Stress Test of Derivatives Clearing Organizations: Reverse Stress Test Analysis and Results](#), a report detailing the results of its fourth Supervisory Stress Test ("SST") of derivatives clearing organization ("DCO") resources. Among other findings, the 2024 report concluded the DCOs studied hold sufficient financial resources to withstand many extreme and often implausible price shocks. The purpose of the analysis was twofold: (1) to identify hypothetical combinations of extreme market shocks, concurrent with varying numbers of clearing member ("CM") defaults, that would exhaust prefunded resources (DCO committed capital, and default fund), and unfunded resources available to the DCOs (this represents the reverse stress test component), and (2) to analyze the impacts of DCO use of mutualized resources on non-defaulted CMs.

New Developments Outside the U.S.

- **ESAs Establish Framework to Strengthen Coordination in Case of Systemic Cyber Incidents.** On July 17, the European Supervisory Authorities ("ESAs") announced they will establish the EU systemic cyber incident coordination framework ("[EU-SCICF](#)"), in the context of the [Digital Operational Resilience Act \("DORA"\)](#), that will aim to facilitate an effective financial sector response to a cyber incident that poses a risk to financial stability, by strengthening the coordination among financial authorities and other relevant bodies in the European Union, as well as with key actors at international level. [NEW]
- **ESAs Publish Second Batch of Policy Products under DORA.** On July 17, the ESAs published the second batch of policy products under DORA. This batch consists of four final draft regulatory technical standards, one set of Implementing Technical Standards and 2 guidelines, all of which aim at enhancing the digital operational resilience of the EU's financial sector. [NEW]
- **Hong Kong HKMA and FSTB Publishes Results from Stablecoin Consultation.** On July 17, 2024, the Hong Kong Monetary Authority ("HKMA") and Financial Services and the Treasury Bureau ("FSTB") published the [Consultation Conclusions on the Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong](#) ("Consultation Conclusions"). The Consultation Conclusions outlined the legislative proposal to implement a regulatory regime for fiat-referenced stablecoin ("FRS") issuers

in Hong Kong. The regime will primarily focus on representations of value which rest on ledgers that are operated in a decentralized manner in which no person has the unilateral authority to control or materially alter its functionality or operation. Under this regime, FRS issuers will require a license. Foreign entities intending to apply for a license will be required to establish a Hong Kong subsidiary and have key management personnel in the territory. [NEW]

- **ESMA Consults on Firms' Order Execution Policies Under MiFID II.** On July 16, ESMA launched a consultation on draft technical standards specifying the criteria for how investment firms establish and assess the effectiveness of their order execution policies. The objective of the proposed technical standards is to foster investor protection by enhancing investment firms' order execution. [NEW]
- **ESMA Publishes 2023 Data on Cross-Border Investment Activity of Firms.** On July 15, ESMA announced they completed an [analysis of the cross-border provision of investment services](#) during 2023. The main findings include that a total of around 386 firms provided services to retail clients on a cross-border basis in 2023; compared to 2022, the cross-border market for investment services grew by 1.6% in terms of firm numbers, and by 5% in terms of retail clients, while the number of complaints increased by 31%; and Germany, France, Spain, and Italy are the most significant destinations (in terms of number of retail clients) for investment firms providing cross-border services in other Member States. [NEW]
- **ESAs Consult on Guidelines under the Markets in Crypto-Assets Regulation.** On July 12, the ESAs published a [consultation paper](#) on Guidelines under Markets in Crypto-assets Regulation ("MiCA"), establishing templates for explanations and legal opinions regarding the classification of crypto-assets along with a standardized test to foster a common approach to classification.
- **ESAs Report on the Use of Behavioral Insights in Supervisory and Policy Work.** On July 11, the ESAs published a [joint report](#) following their workshop on the use of behavioral insights by supervisory authorities in their day-to-day oversight and policy work. The report provides a high-level overview of the main topics discussed during the workshop held in February 2024 for national supervisors and other competent authorities, where participants explored the added value of behavioral insights in their work by exchanging their experiences and discussing the challenges they face.
- **ESMA Publishes the 2024 ESEF Reporting Manual.** On July 11, ESMA published the update of its [Reporting Manual on the European Single Electronic Format \("ESEF"\)](#) supporting a harmonized approach for the preparation of annual financial reports. ESMA has also updated the Annex II of the Regulatory Technical Standards ("RTS") on ESEF.
- **ESMA Publishes Statement on Use of Collateral by NFCs Acting as Clearing Members.** On July 10, ESMA issued a [public statement](#) on deprioritizing supervisory actions linked to the eligibility of uncollateralized public guarantees, public bank guarantees, and commercial bank guarantees for Non-Financial Counterparties ("NFCs") acting as clearing members, pending the entry into force of EMIR 3.

- **ESMA Launches New Consultations.** On July 10, ESMA published a new [package](#) of public consultations with the objective of increasing transparency and system resilience in financial markets, reducing reporting burden and promoting convergence in the supervisory approach.
- **ESMA Consults on Rules to Recalibrate and Further Clarify the Framework.** On July 9, ESMA launched new consultations on different aspects of the Central Securities Depositories Regulation (“CSDR”) Refit. The proposed rules relate to the [information to be provided by European CSDs](#) to their national competent authorities (“NCA”s) for the review and evaluation, the [information to be notified to ESMA by third-country CSDs](#), and [the scope of settlement discipline](#).
- **ESMA Consults on Liquidity Management Tools for Funds.** On July 8, ESMA announced it is seeking input on draft [guidelines](#) and [technical standards](#) under the revised Alternative Investment Fund Managers Directive (“AIFMD”) and the Undertakings for Collective Investment in Transferable Securities (“UCITS”) Directive. Both Directives aim to mitigate potential financial stability risks and promote harmonization of liquidity risk management in the investment funds sector.
- **ESMA Consults on Reporting Requirements and Governance Expectations for Some Supervised Entities.** On July 8, ESMA launched two consultations on proposed guidance for some of its supervised entities. The consultations are aimed at the following entities supervised by ESMA: Benchmark Administrators, Credit Rating Agencies, and Market Transparency Infrastructures. The Consultation Paper sets out the information ESMA expects to receive and a timeline for supervised entities to provide the required information. The objective of the Draft Guidelines is to ensure consistency in cross-sectoral reporting.
- **ESMA Puts Forward Measures to Support Corporate Sustainability Reporting.** On July 5, ESMA published a [Final Report on the Guidelines on Enforcement of Sustainability Information](#) (“GLES”) and a [Public Statement on the first application of the European Sustainability Reporting Standards](#) (“ESRS”). ESMA reports that these documents will support the consistent application and supervision of sustainability reporting requirements.
- **ESMA Releases New MiCA Rules To Increase Transparency for Retail Investors.** On July 4, ESMA published the second [Final Report under the Markets in Crypto-Assets Regulation \(MiCA\)](#) covering eight draft technical standards that aim to provide more transparency for retail investors, clarity for providers on the technical aspects of disclosure and record-keeping requirements, and data standards to facilitate supervision by National Competent Authorities (“NCAs”). The report covers public disclosures, as well as descriptions on how issuers should disclose price-sensitive information to the public to prevent market abuses, such as insider dealing.
- **ESMA Reappoints Three Members to its Management Board.** On July 4, ESMA announced that it has reappointed three current members to its [Management Board](#). The appointments took place at the Board of Supervisors meeting on July 3. The

Management Board, chaired by Verena Ross, Chair of ESMA, is responsible for ensuring that the Authority carries out its mission and performs the tasks assigned to it under its founding Regulation.

New Industry-Led Developments

- **ISDA Publishes Whitepaper: Hedge Accounting Under US GAAP.** On July 16, ISDA published a [whitepaper](#) that explores the issues faced by financial and non-financial institutions in applying hedge accounting for interest rate risk, foreign exchange risk and other risks. It highlights both the prescriptive nature of Accounting Standards Codification 815 and the inconsistent interpretations among auditors, which together create operational burdens and can limit hedging strategies. The paper proposes potential solutions to these challenges, including the expansion of hedge eligibility and the revision of hedge accounting criteria, to allow better use of existing risk management tools. [NEW]
- **ISDA and SIFMA Submit Addendum on GIRR Curvature to US Basel III NPR.** On July 15, ISDA and the Securities Industry and Financial Markets Association (“SIFMA”) submitted [an addendum](#) to the joint US Basel III “endgame” notice of proposed rulemaking. The addendum contains a proposal for general interest rate risk (“GIRR”) curvature to fix an issue that was recently identified. [NEW]
- **ISDA Chief Executive Officer Scott O’Malia Offers Informal Comments on Terminating Derivatives Contracts.** On July 15, ISDA CEO Scott O’Malia opined on the process to terminate a derivatives contract. ISDA is developing two initiatives – the ISDA Close-out Framework and the ISDA Notices Hub – that will help ensure a key part of the termination process is more efficient. The [ISDA Close-out Framework](#) is designed to illustrate the various steps and decisions firms need to take and is intended as a preparatory tool for future stress events. The [ISDA Notices Hub](#) allows the instantaneous delivery and receipt of notices via a secure online platform, eliminating risk exposures and potential losses that can result from delays in terminating derivatives contracts. [NEW]
- **Trade Associations Submit Letter on EMIR IM Model Validation.** On July 8, ISDA, the Alternative Investment Management Association (“AIMA”), the European Fund and Asset Management Association (“EFAMA”) and the Securities Industry and Financial Markets Association’s asset management group (“SIFMA AMG”) submitted [a letter](#) to the ESAs and the European Commission on initial margin (“IM”) model approval requirements set out in the European Market Infrastructure Regulation (“EMIR 3.0”). The letter highlights challenges posed by the three-month period granted to the European Banking Authority and NCAs to validate changes to an IM model and describes how the ISDA Standard Initial Margin Model (“ISDA SIMM”) schedule can be amended to address these issues.
- **ISDA Proceeds with Development of an Industry Notices Hub.** On July 1, ISDA announced it will proceed with the development of an industry-wide notices hub, following strong support from buy- and sell-side institutions globally. The new online platform will allow instantaneous delivery and receipt of critical termination-related notices and help to

ensure address details for physical delivery are up to date, reducing the risk of uncertainty and potential losses for senders and recipients of these notices.

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



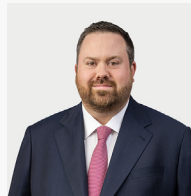
Jason Cabral
New York
212.351.6267
jcabral@gibsondunn.com



Adam Lapidus
New York
212.351.3869
alapidus@gibsondunn.com



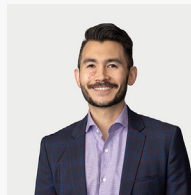
Stephanie L. Brooker
Washington, D.C.
202.887.3502
sbrooker@gibsondunn.com



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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