GIBSON DUNN

This Week in Derivatives

December 6, 2024

From the Derivatives Practice Group: The CFTC released fiscal year 2024 enforcement results this week, touting record monetary relief of over $17.1 billion.

New Developments

- **CFTC Staff Issues Advisory Related to the Use of Artificial Intelligence by CFTC-Registered Entities and Registrants.** On December 5, the CFTC's Divisions of Clearing and Risk, Data, Market Oversight, and Market Participants issued a staff advisory on the use of artificial intelligence in CFTC-regulated markets by registered entities and registrants. The advisory is intended to remind CFTC-regulated entities of their obligations under the Commodity Exchange Act and the CFTC's regulations as these entities begin to implement AI. CFTC staff noted that it is closely tracking the development of AI technology and AI's potential benefits and risks and that it values its ongoing dialogue with CFTC-regulated entities and intends to monitor these entities' use of AI as part of the agency's routine oversight activities. According to the CFTC, the advisory is informed, in part, by public comments received in response to the staff's January 25, 2024 Request for Comment on AI. [NEW]

- **CFTC Releases FY 2024 Enforcement Results.** On December 4, the CFTC announced record monetary relief of over $17.1 billion for fiscal year 2024. With the resolution of digital asset cases that resulted in the agency's largest recovery ever, this record amount included $2.6 billion in civil monetary penalties and $14.5 billion in disgorgement and restitution. In FY 2024, the agency brought 58 new actions including, in the CFTC's words, precedent-setting digital asset commodities cases, its first actions addressing fraud in voluntary carbon credit markets, complex manipulation cases in various markets, and significant compliance cases – including its largest compliance case ever. The CFTC also said that it continued to vigorously litigate pending actions, resulting in significant litigation victories and recoveries. [NEW]

- **Commissioner Johnson Announces CFTC Market Risk Advisory Committee Meeting on December 10.** On November 26, CFTC Commissioner Kristin N. Johnson, sponsor of the Market Risk Advisory Committee ("MRAC") announced that the MRAC will hold a public meeting on Tuesday, Dec. 10, from 9:30 a.m. to 12:30 p.m. (EDT) at the CFTC's Washington, D.C., headquarters. At the meeting, the MRAC will discuss current topics and developments in the areas of central counterparty risk and governance, market structure, climate-related risk, and innovative and emerging technologies affecting the derivatives and related financial markets. [NEW]

- **SEC Chair Gensler to Depart Agency on January 20.** On November 21, the Securities and Exchange Commission (the "SEC") announced that its 33rd Chair, Gary Gensler, will step down from the Commission effective at 12:00 pm on January 20, 2025.

- **CFTC's Global Markets Advisory Committee Advances Recommendation on Tokenized Non-Cash Collateral.** On November 21, the CFTC's Global Markets Advisory Committee (the "GMAC"), sponsored by Commissioner Caroline D. Pham, advanced a recommendation to expand the use of non-cash collateral through the use of distributed ledger technology. The GMAC's Digital Asset Markets Subcommittee also presented on the progress of its Utility Tokens workstream. The recommendation by the GMAC's Digital Asset Markets Subcommittee was approved without objection, marking the 14th GMAC recommendation advanced to the CFTC in the last 12 months, the most of any advisory committee ever in the same timeframe. The CFTC said that the recommendation provides a legal and regulatory framework for how market participants can apply their existing policies, procedures, practices, and processes to support use of DLT for non-cash collateral in a manner consistent with margin requirements.

New Developments Outside the U.S.

- **IOSCO Publishes Final Report on Regulatory Implications and Good Practices on the Evolution of Market Structures.** On November 29, IOSCO published its Final Report on the Evolution in the Operation, Governance, and Business Models of Exchanges. According to IOSCO, the Final Report addresses significant changes in exchange business models and market structures, highlighting the impact of increased competition, technological advancements, and cross-border activity on exchanges. Additionally, it outlines a set of six good practices for regulators to consider in the supervision of exchanges that cover three key areas: (1) Organization of Exchanges and Exchange Groups (2) Supervision of Exchanges and Trading Venues within Exchange Groups and (3) Supervision of Multinational Exchange Groups. [NEW]

- **BoE Publishes Report on Its System-Wide Exploratory Scenario Exercise and Stress Test Results for UK CCPs.** On November 29, the Bank of England ("BoE") published a final report on its system-wide exploratory scenario ("SWES") and the results of its 2024 supervisory stress test of UK central counterparties ("CCPs"). As part of the

SWES exercise, 50 participating firms, including banks, insurers, pension schemes, hedge funds, asset managers and CCPs, had to assess how they would be impacted by a hypothetical stress scenario, including severe but plausible shocks to a wide range of market prices and indicators over 10 business days, including moves similar to those seen during the UK gilt market crisis in 2022 and the 2020 dash for cash. BoE noted key observations, including (1) the simulated market shocks generated significant liquidity needs for non-bank financial intermediaries, (2) financial participants' collective actions amplify the initial shock, (3) the gilt repo market was central in helping to absorb the shock, but its capacity in times of stress remains limited, (4) the exercise confirms the resilience of UK CCPs to a stress scenario similar to the worst ever historical stress and (5) there were material differences between firms' and CCPs' expectations on projections of initial margin increases, with banks and non-bank financial intermediaries generally overestimating changes in CCP initial margin. The BoE indicated that its supervisory stress test of UK CCPs also confirmed the resilience of UK CCPs to a stress scenario similar to the worst ever historical stress and indicated (1) CCPs were found to experience greater mutualized losses in this exercise compared to previous ones, (2) the ability of clients of defaulting members to port positions has a material impact on the credit stress test results and (3) the exercise also considered the cost of liquidating concentrated positions held by defaulters, with results showing that including concentration costs (assuming no porting) can have a material impact on the depletion of resources. [NEW]

- **IOSCO Publishes Report on Principles for Regulation of Commodity Derivatives.** On November 25, IOSCO published Targeted Implementation Review on Principles for the Regulation and Supervision of Commodity Derivatives Markets. According to IOSCO, the report was initiated in response to heightened volatility in commodity markets to assess the implementation of principles 9 (OTC transparency), 12 (authority to obtain information), 14 (large positions), 15 (intervention powers in the market) and 16 (unexpected disruptions in the market). In the report, IOSCO recommends that its members should promote international consistency and cooperation in regulating commodity derivatives markets, ensure that exchanges and regulators can access and consolidate data in relation to large positions from on-exchange and OTC trades. They should also balance risk management and price discovery when applying market control measures and improve communication between authorities in times of crises, the report recommends. [NEW]

- **ESMA Announces Further Guidance on Exclusion Criteria for the Selection of Consolidated Tape Providers.** On November 25, ESMA clarified details for some of the documents that future applicants will be expected to provide when participating in the selection process for Consolidated Tapes Providers ("CTPs"). During the first stage of the selection procedure, the exclusion criteria will be used to assess if applicants can be invited to submit their applications in the second stage of the procedure. ESMA will require specific documentation from applicants, including a declaration of honor and valid evidence on exclusion criteria. ESMA's publication includes an indicative overview of the relevant certificates issued in each EU Member State for such evidence. [NEW]

- **ESMA Responds to the European Commission Consultation on Non-Bank Financial Intermediation.** On November 22, ESMA sent its response to the European Commission consultation on assessing the adequacy of macroprudential policies for Non-Bank Financial Intermediation ("NBFI"). In its response, ESMA makes key proposals in several areas, including liquidity management, money market fund regulation, supervision and data, and coordination between competent authorities. [NEW]

- **IOSCO Publishes Consultation Report on Pre-Hedging.** On November 21, IOSCO published a Consultation Report inviting feedback on its recommendations relating to pre-hedging practices. The Consultation Report offers a definition of pre-hedging and proposes a set of recommendations intended to guide regulators in determining acceptable pre-hedging practices and managing the associated conduct risks effectively.

- **The ESAs Publish Joint Guidelines on the System for the Exchange of Information Relevant to Fit and Proper Assessments.** On November 20, the European Supervisory Authorities (the "ESAs") announced the development of an ESAs F&P Information System with the purpose of enhancing information exchange between supervisory authorities within the European Union ("EU") and across different parts of the financial sector. The Joint Guidelines aim to clarify its use and how data can be exchanged. The Joint Guidelines are intended to ensure consistent and effective supervisory practices within the European System of Financial Supervision ("ESFS") and facilitate information exchange between supervisors. They apply to competent authorities within the ESFS and focus on two main areas: use of the F&P Information System and information exchange and cooperation between the competent authorities when conducting fitness and propriety assessments.

- **Active Account Requirement - ESMA is Seeking First Input Under EMIR 3.** On November 20, the European Securities and Markets Authority ("ESMA") published a Consultation Paper on the conditions of the Active Account Requirement ("AAR") following the review of the European Market Infrastructure Regulation ("EMIR 3"). The amending Regulation introduces a new requirement for EU counterparties active in certain derivatives to hold an operational and representative active account at a CCP authorized to offer services and activities in the EU. ESMA is seeking stakeholder input on several key aspects of the AAR, including: the three operational conditions to ensure that the clearing account is effectively active and functional, including stress-testing; the representativeness obligation for the most active counterparties; and reporting requirements to assess their compliance with the AAR. ESMA indicated that it will consider the feedback received to this consultation by January 27, 2025 and aims to submit the final draft regulatory technical standards to the European Commission within six months following the entry into force of EMIR 3. ESMA will organize a public hearing on January 20, 2025.

- **ESMA Proposes to Move to T+1 by October 2027.** On November 18, ESMA published its Final Report on the assessment of shortening the settlement cycle in the EU. The report highlights that increased efficiency and resilience of post-trade processes that should be prompted by a move to T+1 would facilitate achieving the objective of further promoting settlement efficiency in the EU, contributing to market integration and to the Savings and Investment Union objectives. ESMA recommended that the migration to T+1 occurs simultaneously across all relevant instruments and that it is achieved in Q4 2027.

Specifically, ESMA recommended October 11, 2027 as the optimal date for the transition and suggested following a coordinated approach with other jurisdictions in Europe.

New Industry-Led Developments

- **ISDA Response to European Commission's Consultation on Macroprudential Policies for NBFIs.** On November 21, ISDA responded to the European Commission's consultation on assessing the adequacy of macroprudential policies for NFBI. In the response, ISDA covers a range of key topics, including the need to consider the diversity of the NBFI sector, possible solutions to challenges in meeting collateral requirements, the importance of bank intermediation capacity, the need for deep and liquid core funding markets, enhanced data sharing among regulators and the vital role played by non-cleared derivatives markets, especially in times of stress. [NEW]

- **ISDA Letter to FASB on Hedge Accounting Improvements.** On November 25, ISDA submitted a comment letter to the Financial Accounting Standards Board ("FASB") in response to its exposure draft (ED) on File Reference No. 2024-ED200, Derivatives and Hedging (Topic 815) – Hedge Accounting Improvements. In the comment letter, ISDA explains it supports the FASB's proposals in the ED and believes the ED achieves the FASB's objective of improving the application and relevance of the derivatives and hedging guidance**.** [NEW]

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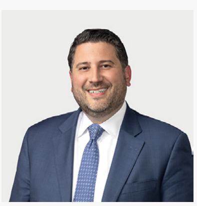

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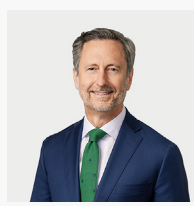

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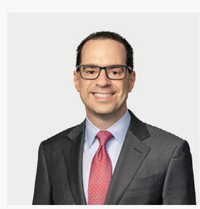

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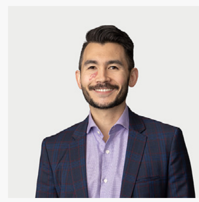

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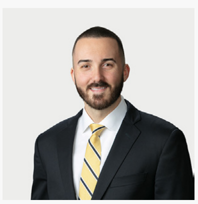

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