

## 2018 Highlights in Derivatives Regulatory Developments

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The below contains certain high-level highlights in US derivatives regulatory developments in 2018.

### Commodity Futures Trading Commission (CFTC)

- **White Paper: CFTC Chairman Giancarlo Publishes White Paper on Swaps Regulation.** In April, CFTC Chairman Christopher Giancarlo and CFTC Chief Economist Bruce Tuckman published a white paper titled *Swaps Regulation 2.0: An Assessment of the Current Implementation of Reform and Proposals for Next Steps*. The white paper assesses the CFTC's implementation of Dodd-Frank swaps reforms in the areas of clearing, swaps reporting, swaps execution, swap dealer capital, the end-user exception, and uncleared initial margin and sets out proposals for next steps.
- **White Paper: CFTC Chairman Giancarlo Publishes White Paper on Cross-Border Approach for Swaps:** On October 1, Chairman Giancarlo published a white paper titled *Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-US Regulation*. The white paper recommends the CFTC regulate of swaps based on the goal of the particular regulation and the location of the swap activity. The white paper recommends that regulations that target systemic risk, including clearing, uncleared margin, capital, recordkeeping, regulatory reporting should apply to US firms' cross-border swaps activity on an entity basis, with substituted compliance available for comparable non-US jurisdictions. The white paper provides a different approach to regulations targeting market and trading practices, such as real-time reporting, trade execution, and business conduct, including a more flexible standard for assessing comparability for these regulations.
- **Proposed Rule: Derivatives Clearing Organization (DCO) Registration Exemption Process.** On August 8, the CFTC proposed to codify the existing CFTC process for granting exemptions from the DCO registration requirement to non-US CCPs. The proposed rule provides that the CFTC may grant an exemption from DCO registration if (i) the CCP is subject to "comparable, comprehensive supervision and regulation"; (ii) the CFTC has in place a Memorandum of Understanding with the CCP's home country regulator; (iii) the CCP only clears proprietary positions for US persons and no customer positions; and (iv) the CCP complies with certain reporting and information requirements.
- **Proposed Rule: Clearing Exemption for Certain Bank Holding Companies, Savings and Loan Holding Companies and Community Development Banks.** On August 28, the CFTC proposed to codify in rules exemptions from the clearing requirement for certain swaps entered into by bank holding companies and savings and loan holding companies with consolidated assets of \$10 billion or less, and community development financial institutions. The proposed codification is consistent with existing 2016 staff no-action letters that provide relief from the clearing requirement for such entities.
- **Proposed Rule: Changes to Rule for swap execution facilities (SEFs).** On November 5, the CFTC proposed changes to its existing SEF Rules that would (i) require all swaps subject to the CFTC's clearing determination that are listed on a SEF or DCM to be executed on a SEF; (ii) permit SEFs to allow any method of trading swaps, eliminating the RFQ-3 and order book requirements; and (iii) change the scope of entities required to register as SEFs or seek an exemption from registration.

- **Final Rule: CFTC Adopts Permanent \$8bn Swap Dealer Registration Threshold.** On November 12, the CFTC adopted an amendment to the definition of “swap dealer” to set the permanent aggregate gross notional threshold for the *de minimis* exception from swap dealer registration at \$8 billion in swap dealing activity over the preceding 12 months.

### **Securities and Exchange Commission (SEC)**

- **Final Rule: Communications Involving Security-Based Swaps (SBS).** On Jan. 5, the SEC issued a final rule excluding certain communications with respect to an SBS from being an “offer, offer to sell, or a solicitation of an offer to buy or purchase” for purposes of Section 5 of the Securities Act, as the previous exemptions for SBS from these provisions expired in Feb. 2018.
- **Proposed Rule: Capital, Margin, and Segregation Requirements.** On Oct. 11, the SEC repropose and reopened for comment rules in respect of Capital, Margin, and Segregation Requirements for security-based swap dealers (SBSDs) and major security-based swap participants (MSBSPs) and Capital Requirements for Broker-Dealers that the SEC had initially proposed in Oct. 2012. The SEC requested comments on all aspects of the proposals including certain changes set out in the reproposal.
- **Proposed Rule: Risk Mitigation Techniques for Uncleared SBS.** On Dec. 18, the SEC proposed rules that would require SBSDs and MSBSPs to: (i) reconcile outstanding SBS with certain counterparties periodically; (ii) engage in SBS portfolio compression; and (iv) execute written SBS trading relationship documentation with each counterparty, prior to, or contemporaneously with, executing an SBS.

### **US Prudential Regulators**

#### **Compliance Date: US Resolution Stay Rule.**

- The first phase of the US Resolution Stay Rules came into effect on Jan. 1, 2019. The Rules were enacted by the US Prudential Regulators (Federal Reserve Board, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency ) to support the US Special Resolution Regimes, Orderly Liquidation Authority under Title II of Dodd Frank (OLA) and Federal Deposit Insurance Act (FDIA). The Rules require global systemically important banks (GSIBs), their subsidiaries, and US operations of foreign GSIBs (together, Covered Entities) to comply with certain requirements in respect of qualified financial contracts, including swaps and other derivatives (QFCs).
- Subject to certain creditor protections and exclusions, the Rules require any QFCs with direct default or cross default rights that may be exercised against a Covered Entity or with explicit restrictions on the transfer of a QFC from a Covered Entity (Covered QFCs) to contractually prohibit (i) cross-default rights based on the parent or other affiliate of the Covered Entity becoming subject to resolution or insolvency proceedings and (ii) restrictions on transfer of credit support of such parent or affiliate. In respect of non-US entities or contracts that are not governed by US law, the Rules also require the contract to include an express recognition of the stay-and-transfer provisions of the FDIA and OLA.
- The Rules apply to new QFCs as of January 1, 2019 and require Covered Entities to remediate existing Covered QFCs on a phased-in basis: (i) Jan. 1, 2019 with other Covered Entities, (ii) Jul. 1, 2019 with financial counterparties other than community banks, and (iii) Jan 1, 2020 with all other counterparties and community banks.