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CABINET NEWS

Research and commentary on regulatory and other financial services topics

Certainty and Uncertainty

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Emerging Market Trends in Derivatives Industry

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In the post-pandemic world, several trends are developing that will fundamentally change the way financial market participants manage commercial risk or trade traditional and rapidly evolving novel assets, while new classes of participants are necessitating a fundamental rethink of how Federal and State regulators ensure safety and soundness of U.S. financial markets. This article identifies these trends and explores how these changes are likely to affect future regulations and compliance needs.

Proliferation of "Commodities"

The legal definition of "commodity" in the Commodity Exchange Act ("***CEA***")[1] is being stretched far beyond what anyone would have imagined 13 years ago when it was last significantly amended,[2] let alone 100 years ago when the CEA's predecessor legislation was first enacted.[3] This categorical expansion has huge implications for all participants in derivatives markets, as well as on the jurisdictional boundary between the two main market regulators in the United States – *i.e.*, the Commodity Futures Trading Commission ("***CFTC***") and the Securities and Exchange Commission ("***SEC***").

The term "commodity" is a term of art defined in the CEA; however, since inception, the scope of the term has expanded from primarily the grains to first include other agricultural products and then to include energy resources, precious metals, financial instruments and now digital assets. As the economy grows and more participants enter the markets, the scope of what constitutes a "commodity" will continue expanding and has recently started to include event outcomes, such as football games,[4] or real estate and art auctions, which raise the question of what is gaming, betting or hedging and speculation.

However, figuring out the legal nature of novel products, such as digital assets, can be difficult until Congress amends the CEA and provides greater clarity on the distinctions between securities, commodities, bank-regulated instruments and other novel products.[5] Meanwhile, the CFTC and the SEC continue to try to guide the marketplace. For example, the SEC's Division of Corporate Finance just recently opined on whether stablecoins are "securities."[6]

There are significant practical implications depending on the outcome of "commodity" classification, which include whether the CEA's federal preemption applies, the SEC's jurisdiction is triggered, whether State gambling and bucket shop rules apply,[7] how these instruments will be treated in bankruptcy, and to what extent the Uniform Commercial Code ("***UCC***") will apply.[8] One thing is certain, there will be much greater diversity in "commodities" in the near future.

"Retailification" of Commodity Markets

Commodity derivatives markets have traditionally been driven by professional participants, such as large farmers and commodity traders, as well as registered and regulated entities.[9] With the advent of crypto contracts, this has changed – the volumes of derivative transactions are increasingly being driven by retail traders (*i.e.*, by non-professional participants). Interestingly, however, the trend toward greater retail participation in derivatives markets is pronounced not only with digital assets, but in all other "traditional" commodity classes. This generational shift means that the CFTC and the National Futures Association ("***NFA***") will have to pivot to focus more on consumer protection issues because regulators cannot rely solely on market intermediaries and financial infrastructure providers to be responsible for protecting retail participants (who are increasingly using innovative technology and, *e.g.,* the mobile apps to trade futures contracts).

Ironically, as the retail volume and demand has increased, and more swaps are being cleared, the number of registered futures commission merchants ("***FCMs***") until very recently has been significantly dwindling. However, in the past year the trend has clearly reversed – and the demand for traditional registered FCMs and introducing broker ("***IB***") services started to grow with the realization that a registered FCM or an IB is an entry point into futures trading for retail participants.[10]

Even though the proposed Digital Assets Structure legislation will create several specific categories for digital assets intermediaries and trading venues, most likely these new entities will be registered, licensed and supervised based on the well-established practices with respect to already existing registered categories of market participants and financial infrastructure providers.

Drive to Accommodate Retail Participants

Given that retail participants can trade margined or leveraged commodities only on exchanges, *i.e.*, DCMs, there is an increasing pressure on DCMs to broaden their access points for retail participants who are interested in not just digital assets, but also more traditional commodity transactions and are utilizing decentralized finance ("***DeFi***") platforms. Conversely, unregistered platforms, such as DeFi, are under an increasing pressure to register as DCMs to sufficiently address and accommodate continuously growing retail demand in commodity contracts that qualify as "futures contracts."

To accommodate an increasing volume of retail participants, one of the tools that is being considered is the creation of fully margined and self-liquidating accounts, where retail market participants can bypass an intermediary, such as a registered FCM, and essentially become self-clearing members of clearing houses, *i.e.,* derivatives clearing organizations ("***DCOs***"). It is likely that the CFTC will eventually bless these structures (*e.g.*, allowing retail participants placing smaller lot futures trades on an app on their mobile phones at any time of the day). Of note, micro-sized contracts geared toward retail participants are already rapidly gaining in popularity.

After U.S. Congress finalizes its legislation on stablecoins and digital assets infrastructure and markets, the CFTC and the SEC will have to promulgate a number of new regulations, in great part addressing further protections to retail participants. It is only a matter of time when that happens.

Fractionalization and Specialization of Derivatives Contracts

Increasing sophistication in risk management demands a greater variety of risk management, speculative and liquidity tools that can address a wider diversity of derivatives contracts offered on DCMs, the smaller (micro) sizes of these contracts as well as longer (as well as shorter) duration[11] (*i.e.*, as compared to "industrial"-size contracts entered into by professional participants on traditional commodities for periods of months driven by production and natural commodity cycles). The move toward more bespoke and smaller-size contracts, as well as toward zero-day settlement vs. perpetual contracts, is indicative of the greater participation in such transactions by retail participants, which will continue and will pressure the CFTC to further refine its DCM self-certification process for futures contracts and options.

Markets are also experiencing an explosion in the varieties of assets that are being digitally tokenized in order to facilitate on blockchain trading by greater numbers of participants. Going far beyond turning carbon credits into digital tokens, the marketplace now has native tokens that are themselves HELOCs, auto titles and property titles – all created and traded exclusively on a chain. Tokens have also been introduced that represent money market funds, ETFs, bonds, precious metals, as well as fine art and other collectibles.[12] All of these new products will need to be given a new level of recognition and legal protection. If, or more likely when, the CFTC receives the grant of exclusive regulatory jurisdiction (in addition to its already existing enforcement jurisdiction) over spot digital assets, this will be a paradigm shift in market regulation.[13]

Erosion of Traditional Regulated Categories / Disintermediation

Financial engineers today are developing novel structures to meet customer demands, which include DeFi platforms, decentralized autonomous associations ("***DAOs***") offering commodity contracts traded on the blockchain, as well as the use of Artificial Intelligence ("***AI***"). As a result, a single entity may simultaneously meet the characteristics of a DCM / SEF, DCO, an IB or an FCM, a swap data repository ("***SDR***") and a swap dealer ("***SD***") or a security-based SD offering its services seamlessly across the globe. This means that the 100 year-old traditional regulatory approach implemented by the SEC and the CFTC is not flexible enough to properly regulate these new hybrid structures. So, regulators and the SROs will have to come up with a new regime to comprehensively regulate and effectively supervise these business arrangements. On May 5, the House of Representatives introduced a discussion draft of a

market structure bill to help provide direction to the regulators on digital assets,[14] which is an important step toward conceptualizing these new structures.

The trend of traditional financial services being disrupted by financial innovation is not limited to digital assets and commodities and securities. Throughout the financial sector, the promises of technology are transforming how banks and non-banks alike are offering everything from payments to deposits to personal financial management. From a regulatory standpoint, this has led to renewed interest that the prudential bank regulators, especially the Office of the Comptroller of the Currency ("***OCC***"), with its chartering authority, approve special-purpose chartered banks that would only carry out a limited number of banking functions. Additionally, Acting Comptroller Rodney Hood has expressed that one of the OCC's priorities is to further support the ability of banks generally to partner with fintechs, especially in the retail sector and as it relates to money transfers.

Reevaluation of the Term - "Gaming"

Distinction between "gambling" or "gaming" and trading commodities for a legitimate business purpose (and what a legitimate economic interest is) is at the heart of the CEA and has been argued in courts long before the enactment of the CEA in 1921 or the establishment of the CFTC in 1974.[15] The industry, the regulators and courts will continue grappling with these concepts and where the line lies delineating gambling, as is evidenced by recent litigation involving "event contracts,"[16] as well as recent CFTC proposed rulemaking on "event contracts" and an attempt to define what "gambling" is.[17] One thing is certain, "event contracts" and prediction markets are here to stay, and the definition and common public understanding of what gaming and gambling are in 2025 differs markedly from what was commonly understood just a few years ago. It is clear that the CFTC, and possibly Congress, will have further regulatory action on this class of contracts.

Increased Trading Efficiency and 24/7/365 Trading Flow

Increased trading efficiency and greater availability of real-time payments are just some of the benefits that could be possible as a result of a greater use of digital assets in the marketplace. When commodities are traded as tokens on the blockchain, for example, trading can occur 24/7/365 and need not be restrained by market hours and banking days. This is because blockchain technology achieves final settlement by definition when a token is exchanged from one party to the next, instantly at the speed of the internet, not the traditional banking system.

Similarly, if stablecoins are being used to pay for the purchase and redemption of the value of tokens, then as soon as a transaction is completed on the blockchain, then payment also achieves final settlement.

The CFTC has recently published a Request for Comment on 24/7 trading of DCMs, which is intended to match retail demand for continuous trading sessions (*e.g.*, in perpetuals on cryptos).[18] One thing is clear – if one DCM / SEF starts 24/7/365 trading, and if at least one DCO accommodates clearing of continuous markets, all other exchanges and trading venues will have to offer same functionalities; likewise, FCM or SDs will not be able to opt out from these markets because they will have exposures created over holidays and weekends and they would not be able to ignore them. In tandem, regulations, supervision and the entire U.S. financial infrastructure will need to quickly adapt to accommodate continuous transaction flow in practically infinite supply of various products. It is clear that this change is imminent.

Enforcement Priorities

The new leadership of the CFTC and the SEC (as well as the Department of Justice ("***DOJ***") have emphasized that enforcement priorities will be on the protection of retail participants and the public at large from fraud and manipulation, and that there will be no regulation by enforcement or prosecution.[19] Furthermore, there will be less of a need to regulate by enforcement if Congress finalizes its legal framework for stablecoins and digital assets and there will be clear guidance on these markets from the CFTC and the SEC.

At the same time, the CFTC's enforcement lawyers are increasingly reading from the SEC's rulebook, and the previously insider trading cases involving commodities are now commonplace, as are enforcement cases involving disclosures. Inevitably, retail participation will necessitate that the CFTC utilize similar tools as those used by the SEC to protect retail capital markets.

Accordingly, it is expected that enforcement will be of different qualify and will target different market actors both on the CFTC and the SEC side.

Conclusion

It is clear that in the next few years U.S. (and world) commodity and commodity and security derivatives markets will be fundamentally different. It is likely that retail participants will be day-trading on their mobile phones numerous futures and options contracts (including micro- and perpetual futures) 24/7/365 and that tokenized assets will be transferred instantaneously to collateralize these trades. There will be several new categories of registered market participants (*e.g.,* digital asset and digital commodity intermediaries and platforms and AI-driven advisers) in addition to traditional brokers and FCMs who will accommodate this trading flow. Increased risks to institutional and retail market participants will be (hopefully) matched with greater sophistication of regulators,' SRO's and DOJ's enforcement departments. In other words, no asset and no commodity and no market utility will remain unaffected by these rapidly emerging trends.

[1] *See* 7 U.S.C. § 1a(9).

[2] The Dodd-Frank Wall Street Reform and Consumer Protection Act 124 Stat. 1376-2223, (2010) significantly amended the CEA in 2010.

[3] *See*, first the Future Trading Act of 1921 (declared unconstitutional), and then enacted as the Grain Futures Act of 1922, 7 U.S.C. § 1 (1922).

[4] *See e.g.*, Kalshi, LLC v. CFTC, Appeal from Case No. 1:23-cv-03257 (May 5, 2025).

https://storage.courtlistener.com/recap/gov.uscourts.cadc.41256/gov.uscourts.cadc.41256.01208736517.1_1.pdf

[5] *See e.g.*, the Discussion Draft of the proposed Digital Assets Market Structure legislation introduced on May 5, 2025 in the House. **https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=409719**

[6] https://www.sec.gov/newsroom/speeches-statements/statement-stablecoins-040425

[7] For example, if more previously-recognized as gaming contracts are traded on a federally-registered commodity exchange, there will be less volume in economically similar contracts that would be subject to individual States' jurisdiction and more traded on federally-preempted commodity exchanges, *i.e.*, designated contract markets ("***DCMs***"). Admittedly, this shift in venue and jurisdictional reach will translate into enormous savings and convenience for individual traders.

[8] The UCC has been recently amended to add a digital asset focused article, Article 12 which defines and covers Controllable Electronic Records.

[9] *E.g.*, "eligible commercial entities" under § 1a(17) of the CEA, or "eligible contract participants" under § 1a(18) of the CEA.

[10] Because retail participants can only trade futures contracts (*i.e.*, cannot trade swaps), and the futures contracts can only trade on registered commodity exchanges, and because only registered FCM can facilitate such trading, by necessity retail participants must open futures trading accounts with the FCMs. Several recent CFTC enforcement actions sanctioning unregistered FCMs, IBs, swap execution facilities ("***SEFs***") and DCMs had clearly reconfirmed this point.

[11] *See, e.g.*, CFTC's Request for Comment involving perpetual contracts, published on April 21, 2025.

[12] *See, e.g.*, https://www.congress.gov/crs-product/IF12670

[13] *See*, digital assets and crypto legislation in the US. Senate and House – each of these proposed drafts extends CFTC's exclusive jurisdiction over spot (non-derivatives) markets in these commodities.

[14] *See,* https://financialservices.house.gov/uploadedfiles/tbaa_xml.pdf

[15] *See, e.g.*, Chicago Board of Trade v. Christie Grain & Stock Co., 198 U.S. 236 (1905).

[16] *See* note 3 above citing Kalshi

[17] *See, e.g.*, CFTC proposed rule on event contracts issued on May 10, 2024, Event Contracts, Notice of Proposed Rulemaking, 89 FR 48968 (June 10, 2024).

[18] *See,* CFTC Request for Comment on 24/7 Trading, published April 21, 2025.

[19] *See* Memorandum for All Employees, Office of the Deputy Attorney General, Ending Regulation by Prosecution, April 7, 2025, issued in response to President Donald J. Trump's Executive Order 14178 Strengthening American Leadership in Digital Financial Technology, issued January 23, 2025..

CFPB v. NCSLT Again Again Again

May 15, 2025

By Mercedes Kelley Tunstall
Partner | Financial Regulation

As if the saga of litigation involving the Consumer Financial Protection Bureau ("CFPB") and National Collegiate Master Student Loan Trusts ("NCSLT") that has been going on since 2017 has not been protracted and complicated enough, on April 29, 2025, the CFPB and the entities that represent the interests of NCSLT jointly stayed the settlement that had finally been reached between the parties. The Joint Agreed Motion to Stay Remaining Deadlines filed in the U.S. District Court for the Southern District of Texas stated that the parties wished to allow mediation to occur so that "appropriate resolution" could be finalized, implying that the **proposed stipulated final judgment** that required NCSLT to pay $2.25 million in consumer redress and to commit to a variety of compliance-related provisions is not appropriate.

For background reading, see our posts on this case from **November 2018**, **April 2021**, **December 2021**, **February 2022**, **April 2024**, and **May 2024**.

Despite the CFPB's request to stay its negotiated, proposed final judgment, the Third Circuit's decision in the litigation between the parties that was handed down in April 2024, still stands. That decision was focused upon the narrow question of whether statutory trusts, such as those that made up the NCSLT are "covered persons" for purposes of the Consumer Financial Protection Act ("CFPA") and are therefore subject to CFPB enforcement actions. The Third Circuit agreed that statutory trusts in this case are "covered persons." But that did not resolve the overall case between the two parties. Hence, the CFPB continued to push forward and filed a new complaint against NCSLT in May 2024, looking for equitable relief and consumer redress. And, it is in response to that complaint that the CFPB and NCSLT reached the proposed stipulated final judgment the Friday before Trump's swearing-in, on January 17, 2025.

In terms of what this means for the industry, we should know by late July whether the parties have been successful in their mediation, which will provide a strong signal as to how much concern there should be regarding CFPB enforcement against statutory trusts, at least while Trump is in office. In the meantime, and in light of many other pronouncements from the CFPB regarding changes in enforcement priorities, it is unlikely that the CFPB will bring additional enforcement actions against other statutory trusts. See this ***Inside Mortgage Finance article, "CFPB Drops Lawsuits Against Student Loan ABS"***.

Of course, unless Congress amends the CFPA to explicitly state that statutory trusts are not "covered persons" or makes broader changes to the CFPB overall, as soon as there is a change in administration, the Third Circuit decision will still be available for the CFPB to rely upon going forward. Because most statutes of limitation will not have run by 2029, even in the case that a facility expires within the next four years, we still recommend that statutory trusts continue to employ best practices regarding servicing and debt collection and ensure that deal documentation allows for compliance oversight of servicers and debt collectors by securitization sponsors and/or deal administrators.

Final UK Rules on Options for Fund Managers' Payment for Investment Research

May 15, 2025

By Alix Prentice
Partner | Financial Regulation

The UK's Financial Conduct Authority ("FCA") has published its final Policy Statement on Investment research payment optionality for fund managers (**PS25/4**) (see **here** for our note on PS25/4's preceding Consultation Paper). The proposal entails allowing fund managers to rebundle payment options for research with execution services, subject to a number of 'guardrails,' and PS25/4 represents a loosening of some of those guardrails to add more flexibility for firms choosing to make joint payments for research and execution.

As a reminder, MiFID II (the Markets in Financial Instruments Directive) required firms to unbundle research from trade execution, and these rules applied to fund managers. Managers then needed to chose between using their own funds to purchase research, or establish Research Payment Accounts for client payments.

Guardrails and changes

1. Firms are required to have written policies for each fund that opts for the joint payment option. However, in order to give more flexibility, firms will now be permitted to establish one standard policy across fund ranges that can be adapted per individual fund range or structure.
2. Research budgets can now be set either at fund level or aggregated over more than one fund if appropriate (and provided that rules on cross-subsidisation are followed). Further adjustments have been made to clarify that budgets can apply a cost allocation system that is appropriate and proportionate, but which still ensures that costs mirror the benefits received by the fund.
3. PS25/4 also clarifies that while firms responsible for account administration when taking up the joint payment option, taking into account commission sharing arrangements ("CSA"), this does not mean that each fund will need its own CSA when opting for this option.

The new rules came into force on 9 May 2025.

OCC Issues Interim Final Rule Undoing 2024 Merger Rule and Guidance

May 15, 2025

By Daniel Meade
Partner | Financial Regulation

On May 8, the Office of the Comptroller of the Currency ("OCC") issued an **interim final rule** rescinding the 2024 final rule to OCC merger procedures and an accompanying policy statement.

The day before the OCC's rescission of the 2024 bank merger rule, the Senate voted along party lines by a 52-47 vote to disapprove of the OCC's 2024 rule under the Congressional Review Act ("CRA"). The joint resolution now moves to the House of Representatives. It is unclear whether the House will take up the CRA joint resolution, or if House leadership may view the CRA disapproval as moot given the OCC's action to rescind the rule.

The OCC's action to rescind the 2024 rule and policy statement brings OCC review of Bank Merger Act applications back to the process that existed before the changes made in 2024. Thus, expedited review and streamlined business application provisions in 12 CFR 5.33 are restored. Additionally, the policy statement's tiering of scrutiny, with proposed mergers resulting in larger institutions automatically receiving more scrutiny will no longer be OCC policy. As an interim final rule, the OCC's action goes into effect immediately, but there is a 30-day comment period open until at least June 8 that could result in additional action by the OCC.

The OCC's action also follows the Federal Deposit Insurance Corporation's ("FDIC's) **proposal** in March to rescind its 2024 bank merger guidance document. The comment period for the FDIC's proposal to rescind its merger guidance and return to policy as it existed prior to 2024 closes on April 10, 2025. Both the FDIC and OCC states that these rescissions were being pursued to reduce uncertainty in the merger review process.

The Federal Reserve Board has had not made any changes to its merger review provisions in 2024, and therefore is unlikely to rescind any of its longstanding merger review policies.

Passive Trusts in Maryland — Progress Regarding the Emergency Regulations

May 15, 2025

By Mercedes Kelley Tunstall
Partner | Financial Regulation

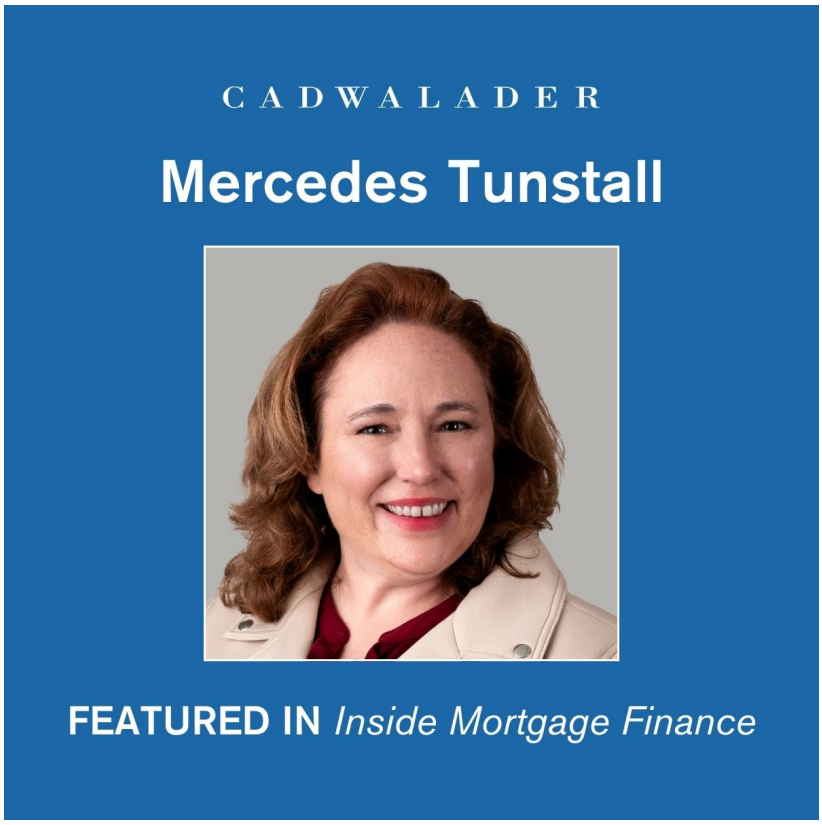
As we reported previously (click **here**), the Maryland Office of Financial Regulation ("OFR") issued emergency regulations this past January which indicated that passive trusts holding residential mortgage loans, even those used as part of securitizations, needed to hold Maryland mortgage lender licenses. On April 22, the Governor of Maryland signed the **Maryland Secondary Market Stability Act of 2025**, which took effect that same day and clearly **excludes** passive trusts from Maryland mortgage licensing requirements.

In particular, the legislation defines a passive trust as meaning a trust established under any state's law that meets all four of these requirements – a trust that: 1) acquires or is assigned mortgage loans, in whole or in part; 2) does not originate mortgage loans itself; 3) does not engage in mortgage brokering activities; and 4) is not engaged in mortgage servicing activities (except that it is permissible for the trust to accept and transmit payments upon instruction from the mortgage servicer).

This legislation was sorely needed to ensure that Maryland residential mortgages can continue to be included in secondary market transactions. And, the case which generated the case law that gave rise to the emergency regulations in the first place has not been appealed within the permitted timeframe, which means that there should not be additional case law that could conflict with the new legislation. Meanwhile, passive trusts that hold residential mortgage loans and are engaged in either mortgage servicing or mortgage brokering activities, **must still obtain a mortgage lender license in Maryland by July 6, 2025**, to avoid enforcement actions by the OFR.

CFPB Drops Lawsuit Against Student Loan ABS

May 15, 2025



Cadwalader partner **Mercedes Tunstall** spoke with *Inside Mortgage Finance* about the Consumer Financial Protection Bureau's (CFPB) recent decision to rescind its lawsuit against the National Collegiate Student Loan Trusts.

The CFPB's voluntary dismissal marks the end of eight years of litigation and offers some relief to financial entities concerned about asset-backed securities being considered covered persons under the Consumer Financial Protection Act (CFPA). However, Mercedes cautioned that this relief could change with a new presidential administration.

"Unless Congress specifically changes the CFPA, then as soon as there's a new administration, there's nothing in the law that would extinguish the CFPB's arguments that they had previously," said Mercedes.

Read the full article **here** (subscription required).

Cadwalader Clients & Friends Memos

May 15, 2025

Take a look at some of Cadwalader's recent Clients & Friends Memos.

"ToMAYto, ToMAHto": District Court Holds That Differences in State Law Determine Whether Unpaid Annual Pension Contributions Establish "Insolvency" for Chapter 9 Eligibility Purposes

Ivan Loncar, Casey Servais, Lary Stromfeld and Thomas Curtin have authored a Clients & Friends memo which discusses the following:

On March 21, 2025, the U.S. District Court for the Northern District of California affirmed a bankruptcy court's dismissal of the San Benito Healthcare District's chapter 9 bankruptcy petition on the grounds that the district's unpaid annual pension contributions did not suffice to establish that the district was "insolvent"—one of the prerequisites for chapter 9 eligibility. This outcome contrasts with a recent decision in Chester, Pennsylvania's chapter 9 proceeding, where Chester's unpaid annual pension contributions helped to establish that Chester was "insolvent" and therefore eligible for chapter 9. The differing outcomes in the two cases can be explained by differences in the applicable state laws.

Read more **here**.

Federal Trade Commission Launches Public Inquiry as It Prepares to Lead President Trump's Effort to Modify and Rescind Anticompetitive Federal Regulations; Department of Justice Launches Anticompetitive Regulations Task Force

Bilal Sayyed has authored a Clients & Friends memo which discusses the following:

In accord with President Trump's deregulatory agenda, the Federal Trade Commission is seeking comment from the public on federal regulations that "exclude new market entrants, protect dominant incumbents, and predetermine economic winners and losers" and the Department of Justice has recently announced an anticompetitive regulations task force to "advocate for the elimination of anticompetitive state and federal laws and regulations that undermine free market competition and harm consumers, workers and businesses."

Read more **here**.