

## Cabinet News and Views

Informed analysis for the financial services industry



# Change the Channel

October 6, 2022

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## In This Issue ...

Lots of news out of the UK this week, including just-announced final text of new crypto-assets regulation. Not to be outdone, U.S. regulatory agencies continue to be quite active, including an important enforcement action from the CFTC and SEC regarding off-channel business communications at major financial institutions. Readers will also want to take a look at the important speech from Federal Reserve Board Governor Michelle Bowman on supervision and regulation.

Pardon the commercial, but here's a plug for our upcoming 2022 Finance Forum in Charlotte. The agenda is taking shape, and we just announced a compelling keynote speaker. There's more info below, including the registration link.

We're always interested in what's on your mind – in general and with regard to this week's issue. Just drop me a note [here](#).

**Daniel Meade**

Editor, *Cabinet News and Views*

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## Eleven Financial Institutions Pay \$700 Million to Settle Recordkeeping and Supervision Violations Related to Off-Channel Business Communications



By **Peter Y. Malyshev**  
Partner | Financial Services



By **Kathryn Garland**  
Associate

On September 27, the Commodity Futures Trading Commission (“CFTC”) issued [orders](#) to settle charges against 11 major U.S. and international financial institutions and their swap dealer (“SD”) and futures commission merchant (“FCM”) affiliates registered with the CFTC.

The charges cited widespread use of unapproved communication methods such as personal text, WhatsApp and Signal among front-office personnel, records of which were not adequately maintained, preserved or produced in accordance with CFTC recordkeeping rules, and associated supervision failures.

During the CFTC’s investigations, each of the sanctioned entities acknowledged awareness of their front-office and supervisory employees’ ubiquitous use of unmonitored platforms for internal and external communications. The CFTC found that each registrant failed to maintain hundreds, if not thousands, of swaps- and commodities-related communications, in violation of CFTC recordkeeping rules. Moreover, the longstanding violations of each registrant’s own internal policies and procedures constituted a violation of duty to supervise and, therefore, SDs’ and FCMs’ management failed to execute their duties to diligently supervise their regulated swaps and commodities businesses. To settle the charges, the registrants paid a collective \$700 million and agreed to extensive remedial efforts and additional reporting obligations.

The charges come after one Wall Street SD’s \$200 million settlement on similar charges in December, and it is expected that the investigations into offline communications will continue. CFTC Acting Director of Enforcement Gretchen Lowe said: “[t]he Commission continues to focus on the importance of recordkeeping, supervision and other regulatory obligations. Registrants and other market participants subject to the federal commodities laws and regulations are encouraged to examine their own internal controls and supervision to ensure they are in compliance.”

The Securities and Exchange Commission (“SEC”) on the same day announced entry of orders filing and settling charges against several of these financial institutions and imposed civil monetary penalties for related recordkeeping and supervision violations.

The key takeaways from this CFTC and SEC enforcement sweep are:

- SDs and FCMs must ensure that all communications by their employees and particularly their associated persons and principals in connection with their

regulated business must be properly recorded.

- The use of WhatsApp and other communication devices are not in and of themselves prohibited. It is the fact that these devices do not offer a way to reliably record and preserve these communications and, therefore, communications via these devices could not be produced to the CFTC when requested.
  - SDs' and FCMs' internal policies and procedures must be revised to ensure compliance with CFTC regulations, and SDs' and FCMs' relevant personnel must be periodically trained to ensure compliance.
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## FRB Governor Bowman Spells Out Her Principles for Supervision and Regulation



By **Daniel Meade**  
Partner | Financial Regulation

Federal Reserve Board (“FRB”) Governor Michelle Bowman gave an important [speech](#) last week on the future of supervision and regulation at the Institute of International Finance.

Governor Bowman’s speech comes on the heels of Vice Chair of Supervision [Michael Barr’s first speech](#) on his supervisory and regulatory provisions. Governor Bowman sits on the Federal Reserve Board’s Committee. Until the FRB recently gained its full complement of members, she was the only member of that committee. Vice Chair Barr serves as the Chair of that committee in light of his position as Vice Chair of Supervision.

Governor Bowman noted that supervision and regulation of the largest banks changed significantly after the financial crisis, but has “evolved more gradually over the past 5 years.” She said that “our gradual and evolutionary approach was wise.”

Governor Bowman went on to say that she is strongly in support of the dual goals Vice Chair Barr laid out of making the financial system safer and fairer. In working toward those goals, she said that she would be guided by the standard of ensuring that “any further changes yield significant improvement to safety and soundness at reasonable cost and seek to avoid approaches that fail to consider the tradeoffs between cost and safety.”

Governor Bowman noted that she would be guided by four principles she has previously described.

- **Due process.** Said Governor Bowman: “Bank regulation and supervision should be transparent, consistent, and fair.” She noted this first principle can be thought of as due process.
- **Safety and soundness.** Governor Bowman stressed the importance of “striking the right balance between ensuring safety and soundness, on the one hand, and promoting acceptable and manageable risk-taking, including encouraging responsible innovation.”
- **Efficient regulation and supervision.** Governor Bowman’s third principle is “that effective regulation and supervision needs to be efficient.”
- **Legitimate prudential purpose.** Governor Bowman emphasized that “regulation and supervision should serve a legitimate prudential purpose, like promoting safety and soundness, or reducing financial stability risk.”

Governor Bowman noted that she would be using these principles as the regulators review certain “critical issues that are relevant to large banks.” She added that these issues include: stress testing (which she thinks could be reformed

in a way to limit the volatility of the testing); capital (which she noted is necessary but can be susceptible to over-regulation); bank mergers and acquisitions (which shouldn't have rules of the road that change during the application process); resolution or living wills (offering a counterpoint to [Acting Comptroller Hsu's idea](#) of requiring amendments to resolution plans when large regional banks merge); and crypto-assets (which have risks that need to be managed but shouldn't push this activity out of the banking system).

As noted above, the speech is an important statement from Governor Bowman, and notwithstanding the summary above, the full [speech](#) is very much worth a read.

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## EU Announces Final Text of Crypto-Assets Regulations



By **Michael Newell**  
Partner | Financial Services

The Council of the EU published two information notes (13198/22) and (13215/22) yesterday, with the final text of the following two new regulations:

- the proposed Regulation on [markets in crypto-assets](#) (MiCA) (2020/0265(COD)); and
- the proposed Regulation on information [accompanying transfers of funds and certain crypto-assets](#) (recast revised WTR) (2021/0241(COD)).

Each of these texts will now need to be formally passed by the European Parliament and will then come into force in member states in late 2024 (18 months after publication in the EU Official Journal, which is expected in early 2023).

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# FCA Issues Statement on the End of Synthetic Sterling LIBOR



By **Michael Newell**  
Partner | Financial Services

On September 29, the UK's Financial Conduct Authority ("FCA") issued a [statement](#) that the publication of the 1-month and 6-month synthetic sterling LIBOR would permanently cease at the end of March 2023.

## Background

As we [reported](#) in *Cabinet News and Views* on June 30, 2022, the FCA has been consulting on the winding down of 1-, 3- and 6-month synthetic sterling LIBOR settings and on the future of the remaining U.S. dollar ("USD") LIBOR settings.

On December 31, 2021, publication of 24 LIBOR settings ended. For 1-, 3- and 6-month sterling and Japanese yen LIBOR settings, the FCA required the administrator of LIBOR to continue publication on a synthetic (and unrepresentative) basis from the end of 2021. Under revised regulatory rules in the UK, publication of a synthetic rate can only be compelled to be published by the FCA for up to one year at a time for a maximum period of 10 years. This was to give the holders of certain legacy contracts more time to complete transition.

Publication of 24 of the 35 LIBOR settings ceased from January 1, 2022, with six sterling and Japanese yen LIBOR settings to continue for the duration of 2022 on a "synthetic" basis, and five U.S. dollar LIBOR settings permitted to be calculated using panel bank submissions until June 2023.

Separately, the Bank of England has previously published a policy statement on August 24, 2022 to add Secured Overnight Funding Rate ("SOFR") to the scope of contracts subject to the derivatives clearing obligation ("DCO") and remove contracts referencing U.S. dollar LIBOR.

## Consultation Decisions

In June 2022, the FCA consulted on winding down the 1-month and 6-month synthetic sterling LIBOR at the end of March 2023, ceasing the 3-month synthetic sterling LIBOR setting in an orderly fashion, and continuing exposures to the U.S. dollar LIBOR beyond end of June 2023.

In light of the feedback received, the FCA announced the following:

- publication of the 1-month and 6-month synthetic sterling LIBOR settings will permanently cease after final publication on March 31, 2023;
- no change to the announcement made on March 5, 2021 regarding the publication of synthetic Japanese yen LIBOR setting to permanently cease by the end of 2022;
- an appropriate date for cessation of 3-month synthetic sterling LIBOR setting to be considered as the FCA received support for its continuance beyond



March 31, 2023; and

- response in relation to U.S. dollar LIBOR settings to be provided in autumn.

Also in June 2022, the Bank of England published a consultation paper titled “Derivatives clearing obligation – modifications to reflect USD interest rate benchmark reform: Amendments to BTS 2015/2205” (the “June CP”). In the June CP, the Bank proposed to introduce a clearing obligation for overnight index swaps (“OIS”) that reference the Secured Overnight Funding Rate in the onshored BTS 2015/2205 from October 31, 2022 and to remove from the DCO contracts referencing USD LIBOR from around the date of CCPs’ contractual conversions of those contracts (which it anticipates will occur over a series of weekends in Spring 2023).

In its [policy statement](#) dated August 24, 2022, the Bank set out its final policy, which maintains the proposal in the June CP to add SOFR OIS contracts with an original maturity between 7 days and 50 years to the DCO from 31 October 2022 and to subsequently remove contracts referencing USD LIBOR from the DCO on April 24, 2022.

### **Guidance**

The FCA urges market participants to actively transition any outstanding LIBOR exposures to risk-free rates. Issuers and holders of outstanding bonds referencing LIBOR, lenders and borrowers, particularly private finance initial (“PFI”) loans, shall make appropriate transition arrangements as a matter of priority. For further information on the retirement of synthetic LIBOR benchmarks, please refer to our [Cabinet news issues](#) on [April 28](#) and [June 30](#).

*(The author wishes to thank paralegal Queenie Je for her assistance in the preparation of this article.)*

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## European Supervisory Authorities Publishes 2023 Work Programme



By **Michael Newell**  
Partner | Financial Services

On September 30, the Joint Committee of the European Supervisory Authorities (“ESAs”) (being the EBA, EIOPA and ESMA) published its work programme for 2023 (dated 5 September 2022) (JC 2022 28). The stated priorities include workstreams relating to Consumer Protection and Financial Innovation, Sustainable Finance, Cross Sectoral Risk Assessment, Securitisation and Digital Operational Resilience.

Of particular note were:

- **Sustainable Finance.** The ESAs intend to submit amendments to the adopted Commission Delegated Regulation (C(2022) 1931)(the “SFDR Delegated Regulation”) supplementing the Sustainable Finance Disclosure Regulation ((EU) 2019/2088) (“SFDR”). These amendments will be to the Regulatory Technical Standards (“RTS”) laid down in the SFDR Delegated Regulation relating to sustainability indicators in relation to adverse impacts (whether streamlining, extending, refining and considering improvements definitions, applicable methodologies, metrics and presentation). The ESAs may also put forward amendments relating to information provided in relation to financial products in pre-contractual documents, on websites, and in periodic reports on decarbonisation targets, including intermediary targets and milestones, where relevant, and actions pursued. The revised RTS are expected to be delivered by 28 April 2023. In addition, the ESAs will monitor the application of the SFDR to determine (i) whether optional implementing technical standards (“ITS”) on marketing communications are needed; and (ii) whether to issue additional Q&As or other level 3 tools to promote supervisory convergence on the practical application of the SFDR. The ESAs, together with the ECB, also intend to conduct a coordinated EU-level climate change stress test across the financial sector during 2023 to assess the resilience of the financial sector in line with the Fit-for-55 package.
- **Digital Operational Resilience.** The ESAs intend to develop technical standards on information and communications technology (“ICT”) risk management frameworks and guidelines on the methodology for calculating costs, as well as quantifying losses for response and recovery, as mandated under the proposed Regulation on digital operational resilience for the financial sector (DORA) (2020/0266(COD)). They also intend to produce standards and reports on reporting of ICT-related incidents.
- **Financial Innovation.** Through the European Forum for Innovation Facilitators (“EFIF”), the ESAs intend to promote increased coordination and cooperation among national innovation facilitators to foster the scaling up of innovation in the financial sector across the EU in line with the European Commission’s Digital Finance Strategy.

- **Securitisation.** The ESAs intend to develop further Q&As and other level 3 tools to promote a common understanding and supervisory convergence for a consistent approach to the Securitisation Regulation, including giving national regulators and stakeholders further guidance on the implementation of cross sectoral areas of the Securitisation Regulation.
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## 2022 Finance Forum Keynoter Muggsy Bogues: 'Small Ball Meets Big Finance'



Former NBA standout Muggsy Bogues will tip things off as keynote speaker at Cadwalader's 2022 Finance Forum on Thursday, October 27 at the JW Marriott in Charlotte.

At just 5-3, Muggsy played for 14 years in the NBA, including nine years with the Charlotte Hornets. Muggsy's theme is "Small Ball Meets Big Finance," and he'll focus on his lifelong responses in the face of adversity, moments that changed his life, and his ongoing commitment to excellence on and off the court.

The full Finance Forum program is nearly finalized. Click [here](#) for a list of current panel topics and to register.

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