

Cabinet News and Views

Informed analysis for the financial services industry



What's the Plan?

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In This Issue ...

I'm not sure our readers were holding their collective breath in anticipation of the OCC's Bank Supervision Operating Plan for Fiscal Year 2023, which was announced last week. Still, the Operating Plan always matters and is carefully reviewed – and addressed – by the big banks, and this year's guidance will not be an exception. Take a look at my summary of the Operating Plan.

There was, however, a very notable development from the CFTC: its published order settling charges against a registered commodity trading advisor for failing to register as a swap execution facility. According to my colleague Peter Malyshev, this “represents the CFTC's first attempt to sanction an otherwise CFTC-registered entity under its recently expanded interpretation of what constitutes a SEF.” This is a very significant development, and Peter offers some context in his news analysis below.

Two important developments in the UK – on EU securitization regulation and the impact on directors' duties following the UK Supreme Court's ruling on the *Sequana* case – caught our eye as well, and so our two recent Clients & Friends memos are included in this week's *Cabinet News and Views*.

As always, we welcome any comments or questions. Just drop me a note [here](#).

Daniel Meade

Editor, *Cabinet News and Views*

OCC Releases Bank Supervision Operating Plan



By **Daniel Meade**
Partner | Financial Regulation

Last week, just after we went to press, the Office of the Comptroller of the Currency (“OCC”) released its [Bank Supervision Operating Plan for Fiscal Year 2023](#).

The Operating Plan sets out the OCC’s supervision priorities and objectives for the fiscal year, which began on October 1. Those priorities and objectives are:

- **Strategic and operational planning.** The Operating Plan sums up this item as safety and soundness and fairness, noting that “examiners should focus on strategic and operational planning to assess whether banks maintain stable financial positions, especially regarding capital, allowance for credit losses, management of net interest margins, liquidity, and earnings.”
- **Operational resiliency and cybersecurity.** The Operating Plan stated: “[O]perational resilience examinations should consider incident response and business resumption practices, with explicit evaluation of data backup and recovery capabilities. Information and cybersecurity examinations should focus on fundamental controls to identify, detect, and prevent threats and vulnerabilities; such controls include authentication, access controls segmentation, patch management, and end-of-life programs.”
- **Third parties and related concentrations.** The Operating Plan notes that examiners should monitor banks’ risk-management governance of their third-party relationships, and highlighted fintech relationships.
- **Credit risk management.** The OCC noted that credit losses have been at historical lows but that banks need to be prepared for a changing credit risk environment. The Operating Plan went on to state that “[r]isk-based examination work should focus on new products, areas of highest growth, or portfolios that represent concentrations.”
- **Allowances for credit losses.** The Operating Plan noted: “[As] banks finalize adoption of the current expected credit losses accounting standard according to promulgated schedules, examiners should assess the effectiveness of the implementation and ACL methodology at estimating lifetime expected losses.”
- **Interest rate risk.** The Operating Plan noted a focus on effective asset and liability risk management practices.
- **Liquidity risk management.** “[B]anking system liquidity remains strong,” according to the Operating Plan, “but sharp rate increases could adversely affect banks’ deposit volume or mix and reduce liquidity from investment portfolio pledging or sales because of unrealized losses.”

- **Consumer compliance.** The Operating Plan notes that examiners should focus on compliance management systems, in addition to statutory-required assessment.
- **Bank Secrecy Act.** In addition to OFAC compliance review, the Operating Plan encourages examiners to “continue to assess bank change management plans for implementing changes to existing BSA/AML compliance programs that will be necessary to implement the requirements of the Anti-Money Laundering Act of 2020.”
- **Fair lending.** The Operating Plan stated: “[F]air lending supervision activities should consider the full life cycle of credit products, such as mortgages, and the potential for mortgage lending discrimination resulting from appraisal bias or discriminatory property evaluations.”
- **Community Reinvestment Act.** The Operating Plan reminded examiners of the 2020 rescission of the previous CRA rule released by the OCC so that the OCC rule is in line with the 1995 Interagency rule. Examiners are also reminded that a final CRA rule could be released by the OCC, Federal Reserve and FDIC in FY 2023.
- **New products and services.** The Operating Plan notes that examiners should review bank management’s processes for the review of new product opportunities, and especially noted payments products and fintech and digital assets.
- **Climate-related financial risks.** The Operating Plan stated that “[d]uring FY 2023, the agency will continue information gathering efforts and plan on conducting additional industry outreach. At the largest banks, examiners will monitor the development of climate-related financial risk frameworks and will engage with bank management to understand the challenges that banks face in this effort, such as data and metrics, governance and oversight, policies, procedures, and limits, strategic planning, scenario analysis capabilities and techniques, and incorporation of the frameworks into current bank risk management processes.”

The Operating Plan offers some insights into what OCC examiners will be focusing on, but nothing in the plan should come as a surprise for anyone following Acting Comptroller Hsu’s recent speeches.

CFTC Sanctions Registered CTA for Operating Unregistered SEF



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

On September 26, the Commodity Futures Trading Commission (“CFTC”) published an order settling charges against Asset Risk Management, LLC (“ARM”), a registered commodity trading advisor (“CTA”) headquartered in Houston, Texas, for failing to register as a swap execution facility (“SEF”). This order represents the CFTC’s first attempt to sanction an otherwise CFTC-registered entity under its recently expanded interpretation of what constitutes a SEF. This broad interpretation was articulated in September 2021 in a controversial CFTC staff advisory, [CFTC Staff Letter No. 21-19](#) (“Advisory”), which materially alters market understanding of what is a SEF.

Instead of providing greater certainty to the market, the Advisory has accomplished the opposite; additionally, the ARM enforcement action demonstrates an increased risk for CFTC-registered and unregistered swap market participants to be assessed against an overexpanding notion of a SEF and/or potentially face aiding and abetting charges for having a business relationship with these entities.

The order finds that, for several years, ARM operated an unregistered SEF that provided clients the ability to execute natural gas and crude oil swaps by accepting bids and offers made by multiple participants on a trading system or platform in various swap tenors and volumes. To communicate with clients and counterparties and execute the swaps, ARM used various means of interstate commerce, including phone, instant messaging, and email.

As a CTA, ARM provided advice relating to these energy swaps and assisted its customers with executing swaps under their existing ISDA agreements with various swap counterparties. It is true that ARM’s customers were able to execute swaps with other multiple participants; however, it is also clear that ARM was not operating a trading facility as it is commonly understood. Instead, the CFTC made an argument that ARM provided participants with the “ability” to execute swaps with other participants and “facilitated” the execution of swaps.

This enforcement action is a classic example of regulation by enforcement because the Advisory was not adopted by the CFTC in compliance with the requirements of the Administrative Procedure Act (“APA”). In fact, in 2018, then-CFTC Chairman J. Christopher Giancarlo had introduced a formal proposed [rule](#) where a virtually identical interpretation of the concept of SEF was introduced. However, that rulemaking was formally [withdrawn](#) by then-CFTC Chairman Heath Tarbert in 2020. Publication and enforcement under the Advisory serve as CFTC’s back-door approach to amend the 2013 SEF [rule](#) without following the procedures under the APA.

All market participants should assess their swap execution processes in light of the Advisory and the CFTC’s ARM order.

European Commission Presents Report to the European Parliament and Council on Functioning of EU Securitisation Regulation

Earlier this week the European Commission published its review of the EU Securitisation Regulation.

Our Clients & Friends Memo, accessible [here](#), breaks down the report.

Sequana: What You Need to Know

The UK's Supreme Court has delivered its long-awaited decision in *BTI 2014 LLC v. Sequana S.A.* [2022] UKSC 25. It is a significant decision for the law of directors' duties. For the first time, the UK's highest appellate court has considered the circumstances in which directors can be liable for failing to take into account the interests of creditors, thereby upholding the Court of Appeal's 2019 decision. In doing so, the Supreme Court affirmed a line of common-law cases that have developed the law in this area and have held that directors are required to prioritize creditors' interests in an insolvent liquidation over those of shareholders, and to begin taking creditors' interests into account where insolvency "looms." The Court's unanimous decision is also noteworthy because it confirms the UK has definitively departed from the position in other common-law jurisdictions – including Delaware and Canada – that have declined to impose an equivalent duty.

You can access our Clients & Friends Memo [here](#).

Registration Deadline Approaching for 2022 Finance Forum



CADWALADER
FINANCE FORUM

CHARLOTTE
OCTOBER 27

Registration will be closing soon for Cadwalader's annual Finance Forum at the JW Marriott in Charlotte on Thursday, October 27.

Programming will begin at 1:00 p.m. and continue throughout the afternoon, followed by a networking reception. Click [here](#) for a list of current panel topics and to register.
