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Facing unexpected events in the US financial markets: advice for regulated and unregulated entities

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US and global regulators are once again focused on having market participants design and implement business continuity and disaster recovery (BCDR) plans, as well as corresponding policies and procedures. This renewed focus is not solely in response to the disruption caused by the coronavirus (COVID-19) pandemic to markets, business and society, as plenty of events in the last two decades have proved that market participants should expect the unexpected. While it can be incredibly difficult to divine the nature of the next crisis, market participants must make efforts to anticipate novel disruptions with BCDR plans, policies and procedures.

During the pandemic, US regulators took several steps toward strengthening the resiliency of US financial institutions, including by providing more comprehensive guidance on BCDR plans. In fact, the National Futures Association's (NFA's) first COVID-19-related advisory on 4 March 2020 advised its members to first review their BCDR plans to ensure that they met the NFA's guidance adopted almost 20 years earlier in response to the 11 September 2001 attacks. Prior to March 2020, the Commodity Futures Trading Commission (CFTC) and the NFA had established foundational BCDR regulations, but the disasters, disruptions and emergencies the plans were tested on were more sporadic and ephemeral in nature – such as when Hurricane Sandy seriously interrupted the Depository Trust & Clearing Corporation's (DTCC's) operations in 2012.

However, the pandemic posed new challenges in both its duration and in its lockdown orders that required market participants to find ways to operate while unable to gather at the workplace for long periods of time. Regulators had a lot of ground to cover, and fast, to create a framework to support and guide market participants through this novel, pervasive and persistent disruption.

The CFTC took a five-fold approach to tackling its role as a regulator amid persistent disruption: (i) day to day supervisory guidance to regulated entities during their transition to a predominantly remote workforce (e.g., periodic calls to swap dealers to ensure they continued operating); (ii) issuance of relief to market participants to allow them to continue operating while not being able to meet certain regulatory requirements (e.g., voice recordings, time-stamping or physical presence of personnel); (iii) regulatory relief aimed at extending compliance deadlines in recognition of the pandemic's lingering effects and nature (e.g., two extensions of the initial margin compliance phases); (iv) market monitoring in the environment of extreme volatility (crude oil prices saw negative numbers in May 2020); and (v) enforcement, enforcement advisories and monitoring of fraud in the new business environment.

The CFTC and the NFA also adopted measures to facilitate the continuity of business during extended lockdowns that made it impossible for many workers to be present in the office, presenting significant regulatory, compliance and practical challenges to CFTC registrants and NFA members. Due to lockdowns, floor brokers (FBs) could not be present on their trading floors. In response, the CFTC paved the way for FBs to operate remotely, provided that their designated contract market's BCDR plans allowed them to operate in off-site locations. The NFA also provided relief to associated persons (APs) of swap dealers who were listed as working at specific branch offices, updating its rules to permit APs to temporarily work from locations not listed as a 'branch office' and without a branch manager present, as long as the firm implemented and documented alternative methods to adequately supervise AP's activities, while also meeting record-keeping requirements.

The remarkable adjustment both the regulators and the regulated made to adopt a 'new normal' with solidly implemented BCDR schemes is inspirational as we look to a new frontier: the unregulated. In today's economy and resulting from business practices and technologies that emerged during the pandemic, unregistered market participants, particularly in the commodities space, move incredibly large volumes of swaps and commodities, but are not subject to the same requirements as registered entities. Under existing rules, even though the failure of just one of these large, unregistered players could cause extreme harm and disruption in the commodity markets, the same regulators that require lengthy documentation for APs working at home are completely in the dark when it comes to knowing whether a large international commodity trading company has a BCDR plan at all.

And while robust BCDR plans may help ensure safe and sound business continuity at the height of disaster, they are not enough to protect the integrity of the markets from deceptive and manipulative practices when the global markets (and society at large) are most vulnerable. For example, during the 2021 Texas power crisis that resulted from winter storms and unusually cold temperatures that left 4.5 million homes without power, directly or indirectly causing hundreds of deaths, certain unregulated traders made billions in profits while others sustained enormous losses. Price-gouging among commodity traders abounded, and in some cases, energy providers passed on those incredibly high prices to their consumers.

The CFTC and NFA should engage in comprehensive BCDR rulemaking that addresses all market participants while also requiring the kind of the flexibilities that allowed registrants to respond robustly to the pandemic with their BCDR plans. In addition, even though many commodities and derivatives traders are not regulated by the CFTC, the CFTC should issue an advisory establishing industry standards for BCDR-related market practices that should be adopted by unregistered market participants. By doing so, the CFTC would establish that it would be unreasonable for large commodity traders that pose systemic risk to fail to abide by the same BCDR rules as registrants of similar size and power in the markets.

Finally, on a global level, regulators will also need to take into account business practices and technologies that emerged during the pandemic in their future rulemakings, such as digital supervision of remote staff and the mechanisms that are available to mitigate volatility and ensure systemic safety in the face of the next unprecedented event. Global regulators and market participants demonstrated resiliency throughout the pandemic and came out on the other side with better, stronger BCDR plans and a heightened ability to face the next crisis. But they must keep pressing to rein in unregistered players that may yet cause significant damage to the markets because they have not developed proper BCDR plans and are not restrained from turning the next tragedy into foolhardy opportunity at the expense of investors, end-users and the integrity of markets. ■