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CFTC Finalizes Several Long-Awaited Rules in September and October

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Futures and Derivatives; Commodity Futures Trading Commission

On September 17 and October 6, 2020, the Commodity Futures Trading Commission ("CFTC" or "Commission") held open meetings (the "September Meeting" and the "October Meeting," respectively) to consider a number of final rules, each of which the Commission approved unanimously. The September Meeting considered rules impacting market participants, such as swap dealers ("SDs"), swap execution facilities ("SEFs"), swap data repositories ("SDRs"), and foreign derivatives clearing organizations ("DCOs"), and the October Meeting passed a rule impacting commodity pool operators ("CPOs"). The following outlines key points from these open meetings and the new CFTC rules.

I. The September Meeting: Amendments to Swap Data Reporting.

The Commission simultaneously considered three final rules relating to different components of the CFTC's swap data reporting requirements: real-time public reporting, regulatory reporting, and data verification, as detailed in Parts 43, 45, and 49 of the CFTC's Regulations, 17 C.F.R. 43, 45, and 49 (2020). Part 43 governs real-time public reporting requirements, where swap pricing and transaction information must be publicly disseminated via an SDR, generally as soon as technologically practicable ("ASATP"). Part 45 governs regulatory reporting of swap data and recordkeeping rules. As distinguished from Part 43 reporting, Part 45 reporting is sent to an SDR and is not publicly disseminated. Part 49 governs SDR registration requirements, SDR operational duties, and the Commission's oversight over SDRs generally, including rules on the verification of data submitted to SDRs. Each of the final rules is nearly 300 pages in length, impacts nearly every aspect of the applicable regulations, and imposes, with one exception, a compliance date that is 18 months from the date of publication in the Federal Register. Detailed descriptions of the rules are below.

A. Real-Time Public Reporting Requirements (Part 43).

Pursuant to Part 43, SDs and other reporting parties, such as SEFs and designated contract markets ("DCMs"), provide real-time reporting of swap pricing and transaction data to SDRs, which, in turn, make the data public on the so-called "public tape." This enables price discovery and well-functioning markets. Part 43 also includes provisions relating to the treatment and public reporting of large notional trades (called "blocks") and to the "capping" of swap trades that reach a certain notional amount.

The final rule to Part 43 reflects a years-long effort by the CFTC to review Part 43 along a number of policy goals, including liquidity, transparency, and price discovery in swaps markets. The final rule is intended to advance these goals by standardizing and clarifying real-time reporting data elements. The following highlights some key features of the final rule:

- *Original block trade reporting delay upheld.* The final rule maintains the 15 minute to 24 hour delay for block trade reporting, rejecting the proposed rule's contemplation of a 48 hour delay. The Commission did not adopt this proposed change as a majority of commenters' argued that it would negatively affect market transparency, price discovery, and liquidity.
- *Increased thresholds for block and cap trades.* The most controversial topic in the final rule on Part 43 relates to the treatment of block and cap trades. The rule changes the minimum threshold for block trade treatment, raising the amount needed from a 50 percent to 67 percent notional calculation, and increases the threshold for capping large notional trades from 67 percent to 75 percent. To offset this significant change, the CFTC revised the swaps categories on which appropriate minimum block sizes are based by dividing them into five asset classes with subdivisions under each, namely interest rate swaps, credit default swaps, foreign exchange, equity, and other commodity swaps. Within these categories, the Commission grouped together swaps with similar quantitative or qualitative characteristics to determine the appropriate minimum block size applicable. This significantly increased the block size for some swaps and reduced or exempted others. The compliance date for these new thresholds is 30, rather than 18, months.

Certain Commissioners expressed concern with the increase in the threshold for block trade treatment. Commissioner Quintenz argued that it inappropriately sacrifices market liquidity for real-time price transparency and was not founded on rigorous analysis. Commissioner Stump agreed and contended that the final rule was "raising block sizes instead of leveraging data." Commissioner Stump requested that Chairman Tarbert commit to reconsidering the block trade threshold after 30 months in light of the improved data that will be available to the CFTC, arguing that the CFTC should take formal and informal opportunities, such as roundtable meetings, to discuss the block trade thresholds with market participants and the public. Chairman Tarbert agreed to do so.

- *Standardized terms*. The final rule revises Rule 43's Appendix A list of swap terms that must be reported in order to standardize the terms across SDRs. Commission staff noted that this addressed the ambiguity market participants confront when complying with reporting requirements. The Part 43 list of reportable terms is a subset of Part 45, whose terms are discussed below. The final rule also standardizes the format of the report and requires SDRs to confirm that each report contains the required terms.
- *Delays for post-priced swaps*. For post-priced swaps, namely swaps whose price is determined after execution, the final rule permits delaying reporting the swap until the price is determined later in the day or by 11:59 PM ET. For variable terms swaps for which the price is known at execution, but some other term is left for future determination (*e.g.*, quantity), reporting parties remain obligated to report the swap ASATP after execution.

- *Prime brokerage swaps*. For prime brokerage swaps, the Commission added a number of definitions to adequately describe the swap transactions involving a prime brokerage. The rule recognizes that reporting the offsetting swap with a prime brokerage, the so-called "mirror swap," is duplicative of the swap triggering the offset and thus requires only the "trigger" swap to be reported.

B. Amendments to Swap Data Recordkeeping and Reporting Requirements (Part 45).

The final rule to Part 45 revises CFTC regulations for regulatory swap data reporting and recordkeeping requirements for SDRs, DCMs, DCOs, SEFs, SDs, major swap participants ("MSPs"), and market participants that are neither SDs nor MSPs. Highlights of the rule are:

- *Addition of uncleared margin data.* This final rule, for the first time, gives the CFTC access to uncleared margin data by creating 15 fields on margin and collateral elements. This will significantly improve the CFTC's ability to monitor for systemic risk for registered entities like DCOs, SDs, and MSPs. The final rule eases burdens on other reporting counterparties by removing the requirement to report valuation data and not extending the margin reporting to these entities.
- *Standardized and harmonized reporting fields.* The final rule establishes 128 standardized reporting fields to replace the fields currently used by individual SDRs. These fields were determined with reference to the technical guidance on the critical data elements for reporting being developed by the Committee on Payments and Market Infrastructures ("CPMI") and the International Organization of Securities Commissions ("IOSCO"). The final rule also adopts CPMI/IOSCO's Unique Transaction Identifier in place of the current Unique Swap Identifier, bringing Part 45 closer in alignment to other regulators, enabling better data sharing among regulators, and lowering reporting burdens on market participants.
- *Reporting of swap creation data.* The final rule requires SEFs, DCMs, and other reporting counterparties to report a single swap creation data report, regardless of whether the swap is intended to be cleared. This will streamline reporting and avoid duplicative information to SDRs. Further, the final rule extends the deadline to report swap creation data to SDRs to one full day following execution, often termed T+1. This change will harmonize the CFTC's reporting timeline with that of the Securities and Exchange Commission ("SEC"). The deadline is extended up to two days, or T+2, for end users that are engaging in swaps trading to hedge business risks.

C. Amendments to the CFTC's Regulations Relating to Certain Swap Data Repository and Data Reporting Requirements (Parts 43, 45, and 49 Verification).

The final rule on data verification impacts Parts 43, 45, and 49, and is intended to improve the accuracy of data reported to, and maintained by, SDRs, and to provide enhanced and streamlined oversight of SDRs and data reporting generally. Chairman Tarbert noted that the improvement in data accuracy will address a "garbage in, garbage out" problem with swaps data, because the modified framework will create a mechanism to verify data accuracy and correct errors. Below are key portions of the rule.

- *The validation process.* The final rule as it applies to Part 43 requires each SDR to validate every swap transaction and pricing data submitted to it and to notify the reporting counterparty, SEF, or DCM, ASATP, regarding whether the report satisfied the SDR's validation procedures. The final rule builds upon this in Part 45 by requiring reporting counterparties, SEFs, and DCMs to comply with the SDR's validation

procedures, noting that the reporting obligation is not complete until the validation procedures are satisfied. Finally, the final rule amends Part 49 to require SDRs to accept, record, and disseminate correction data for all open swaps ASATP. This includes building a mechanism for SDs and other reporting counterparties to be able to access their swap data to verify its accuracy and correct any errors.

- *The verification process.* The final rule provides in Part 45 that SDs, MSPs, and DCOs must verify the accuracy of their swap data every 30 days, while all other reporting counterparties must review their data once per quarter. Should an error be found at any time, SDs, MSPs, and DCOs must correct and resubmit the data ASATP, but no less than seven days after the error is discovered. If an error is discovered by non-reporting counterparties, they must report the error to the reporting counterparty or the SEF/DCM where the swap was executed ASATP, but no less than three days after discovery.
- *Logging the verification and any errors.* In lieu of reporting to the SDR the results of the verification, the final rule requires SDs, MSPs, DCOs, and other reporting counterparties to keep a log of each verification and any corrections undertaken. In a nod to the Commission's enforcement cases regarding swaps reporting violations, reporting counterparties who fail to timely correct errors within the time prescribed must inform the CFTC's Director of Market Oversight ("DMO") or a DMO delegate of that fact and further identify the initial scope of the error and any remediation plan, should one exist.

II. The September Meeting: Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations.

The CFTC unanimously approved a final rule that, subject to certain limitations, amends Parts 39 and 140, 17 C.F.R. 39 and 140 (2020), to permit DCOs organized outside of the United States ("Non-U.S. DCOs") to register with the CFTC but to comply with applicable Core Principles of the Commodity Exchange Act ("CEA") through compliance with their home country regulatory regime. This final rule reflects the positive and sustained dialogue between the CFTC and its counterparts in the European Union, the European Commission, and European Securities Markets Authority.[1] During presentation of the final rule to the Commission, CFTC Staff noted that currently, there are at least three foreign DCOs likely to take advantage of this alternative compliance.

A. Conditions to Obtain Alternative Compliance.

Non-U.S. DCOs will only be able to take advantage of the alternative compliance regime if they satisfy the following conditions:

[1] CFTC Chairman Tarbert and European Commission Vice President Dombrovskis published an opinion article in the Wall Street Journal hailing the alternative compliance framework as a "significant step" toward "supervisory cooperation to ensure a robust and transparent global financial sector." Valdis Dombrovskis and Heath Tarbert, *A New Pact Will Help Derivatives Markets: The EU and U.S. are committed to sound regulation*, Wall St. J. (Sept. 16, 2020), https://www.wsj.com/articles/a-new-pact-will-help-derivatives-markets-11600297002.

1. The CFTC determines that compliance by the DCO with its home country regulatory regime constitutes compliance with the Core Principles set forth in section 5b(c)(2) of the CEA;

2. The DCO is in good regulatory standing in its home jurisdiction;

3. The DCO does not pose a substantial risk to the U.S. financial system; and

4. A memorandum of understanding ("MOU") or similar arrangement satisfactory to the CFTC is in place with the DCO's home country regulator.

B. Two-Part Test on Substantial Risk.

The final rule codifies a two-part test, based on the amount of initial margin required at the DCO, to assess whether a non-U.S. DCO poses a substantial risk to the U.S. financial system.

- The first prong of the test is met when the required initial margin from U.S. clearing members at the non-U.S. DCO meets or exceeds 20 percent of the required initial margin for U.S. clearing members at all registered and exempt DCOs.
- The second prong is satisfied when the required initial margin at the non-U.S. DCO attributable to U.S. clearing members meets or exceeds 20 percent.

C. Applicability of CFTC Customer Protection Safeguards.

Non-U.S. DCOs taking advantage of the alternative compliance regime still must comply with the CFTC's customer protection safeguards and swap data reporting requirements. Non-U.S. DCOs that are deemed by the CFTC to pose substantial risk to the U.S. financial system may not take advantage of this alternative compliance regime.

III. The September Meeting: Amendment to Pending Proposed Rule on Part 190, Bankruptcy Regulations.

The Commissioners also voted unanimously to approve a supplemental notice of proposed rulemaking relating to the CFTC's proposed amendment to its regulations on bankruptcy proceedings for commodity brokers under Part 190, 17 C.F.R. 190 (2020). This rule is expected to be finalized by the end of 2020. More information on this supplemental notice is available in Commissioner Berkovitz's statement.

IV. The October Meeting: Revisions for CPO Form and Agency Information Sharing.

A. Revisions to Form CPO-PQR.

The Commission voted unanimously to adopt a final rule that makes amendments to Form CPO-PQR. Pursuant to CFTC Regulation 4.27, 17 C.F.R. § 4.27 (2020), CPOs are required each quarter to provide through Form CPO-PQR specific information on their firm and the pools they operate; CPOs also provide similar information on another Form CPO-PQR that is required to be concurrently filed with the National Futures Association ("NFA"), the self-regulatory association that oversees certain CFTC registered entities, like CPOs. The final rule generally aligns the CFTC form with the NFA's similar form, and, accordingly, amends Part 4.27 to allow CPOs to file the NFA's form in lieu of the CFTC's revised form. However, the rule makes clear that the Form PF used by SEC Registered Investment Advisors will no longer be accepted as a substitute for Form CPO-PQR. The required compliance date will be the first quarter of 2021, with a filing date of May 30, 2021. The following outlines the changes imposed by the final rule.

- The final rule eliminates Schedules B and C of the current form, but maintains the Pool Schedule of Investments, which was part of Schedule B.
- The rule also amends the form's information requirements and instructions to request Legal Entity Identifiers for CPOs and their operated pools that have them, and to delete questions regarding pool auditors and marketers.
- Finally, the form eliminates existing reporting thresholds.

B. MOU between the CFTC and the Office of Financial Research ("OFR").

The CFTC also announced the execution of an MOU with the U.S. Treasury Department's OFR, which establishes a framework for the CFTC to be able to share with the OFR information and data it receives as reported on Forms CPO-PQR. This extends to both historical and future data from Form CPO-PQR.

- *Republican Dissent.* Interestingly, the Chairman's fellow Republican Commissioners dissented from this move, citing concerns with sharing confidential, proprietary information without a use case first being established.[2] Commissioner Stump, in particular, expressed concern with the MOU's allowance for the OFR to use the data from the Form CPO-PQR in its work product, which can made public after it is aggregated, anonymized and masked. Commissioner Quintenz questioned whether the OFR needed such detailed information on specific market participants to make determinations on systemic risk.
- *Democratic Support*. By contrast, Democratic Commissioner Berkovitz noted in his concurring statement that the SEC has been providing the OFR with its similar Form PF for some time and stressed the OFR's anonymization of data before publication.[3]

V. Bipartisanship in Recent Commission Rule-Making: Will It Last?

The tone throughout both of these open meetings was more collegial than the July 22 and 23, 2020, open meetings, in which the CFTC approved on party lines the final rules on capital rules and cross-border application of the registration threshold for SDs and MSPs. (See our blog post covering this meeting.) This comity among Commissioners may not last, given controversial proposed rules that are set to be voted upon in the coming weeks. For example, the Commission is holding another open meeting on October 15, 2020, in which it will vote on the

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[2] *See Dissenting Statement of Commissioner Brian Quintenz Regarding Memorandum of Understanding with Office of Financial Research Governing Sharing of CPO-PQR Data*, https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement100620quintenz-dissenting-statement-regarding, and *Dissenting Statement of Commissioner Dawn D. Stump Regarding the Memorandum of Understanding between the CFTC and the Office of Financial Research Regarding the Sharing of Data and Information Collected on Form CPO-PQR*, https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement10062010620-statement-commissioner-dawn-d-stump-open (Oct. 6, 2020).

[3] *See Supporting Statement of Commissioner Dan M. Berkovitz Regarding MOU with the Office of Financial Research*, https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement100620b (Oct. 6, 2020).

final rule on Position Limits for Derivatives.[4] The position limits rule has long been a contentious issue with the Commission and its final passage will be a huge accomplishment for the Chairman. (Covington's client alert on the proposed rule for position limits can be found here, and will be updated once the rule is made final.) Based on the comments from the Commissioners when this rule was re-proposed on January 30, 2020, the final rule will likely meet opposition from the Democratic Commissioners and only pass on party lines.

VI. The Work Continues: Extensive Rule-Making Schedule for the Remainder of 2020.

Chairman Tarbert has committed his tenure to finishing a number of Dodd-Frank rules that have lingered inside the agency, including those that may ease some of the burdens brought on by Dodd-Frank regulation. In accomplishing this goal, the Commission has held in the past 12 months 17 open meetings to consider and vote on proposed and final rules. This number far exceeds the total number of open meetings held in the prior six years. The Chairman has stated that, in addition to the October 15 open meeting, the CFTC will hold several more meetings before the end of the calendar year to consider final rules on electronic trading, foreign commodity funds, margin for security futures, margin for uncleared swaps, and clearing requirements for central banks, sovereigns and other entities. While the Republican Commissioners see these rule-making efforts as necessary steps in "righting the ship" of agency regulation,[5] the Democratic Commissioners believe certain rules are an unacceptable rollback of necessary regulation to avoid future financial crises.[6] Should the agency leadership turn over in January based on November's Presidential election, this could set up a readdress of some rules under a Democratic-led CFTC.

In either event, *i.e.*, a Republican or Democratic-led CFTC, the Covington Futures & Derivatives Practice Group will be ready to assist clients in responding to any regulatory changes and any related enforcement scrutiny brought by the CFTC.

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[4] During the October 15 meeting, the Commission will also vote on final rules on Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (Phase VI Compliance Date Extension) and Exemption from Registration for Certain Foreign Intermediaries, and Position Limits for Derivatives. *See* https://www.cftc.gov/PressRoom/PressReleases/8281-20.

[5] *See POLITICO Pro Q&A: CFTC Chairman Heath Tarbert*, https://www.politico.com/news/2020/07/22/cftc-heath-tarbert-378514 (July 22, 2020) ("The goal of this first year, much of it has been on, let's focus on wrapping up unfinished business, which is the Dodd-Frank Act").

[6] *See e.g.*, *Opening Statement of Commissioner Dan M. Berkovitz at July 22 Commission Meeting*, https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement072220 (Jul. 22, 2020) ("Over the past decade, the CFTC has worked diligently to develop regulations to implement the Dodd-Frank framework. . . . Unfortunately, our progress is now threatened. . . . These new rules will not provide the protections Congress intended. Rather, they are designed to either confirm the status quo or cut back existing protections.").

If you have any questions concerning the material discussed in this client alert, please contact the following members of our CFTC or Financial Services practices:

Anne Termine	+1 202 662 5827	atermine@cov.com
Uttara Dukkipati	+1 202 662 5274	udukkipati@cov.com
Andrew Ruben	+1 212 841 1032	aruben@cov.com
Devika Singh	+1 202 662 5689	dsingh@cov.com
Bruce Bennett	+1 212 841 1060	bbennett@cov.com
Michael Nonaka	+1 202 662 5727	mnonaka@cov.com
Randy Benjenk	+1 202 662 5041	rbenjenk@cov.com
Jeremy Newell	+1 202 662 5569	jnewell@cov.com
Karen Solomon	+1 202 662 5489	ksolomon@cov.com
D. Jean Veta	+1 202 662 5294	jveta@cov.com