Securities Regulation Daily Wrap Up, DERIVATIVES—CFTC rolls out further industry relief, warns investors of COVID-19-related fraud, (Mar. 18, 2020)

Securities Regulation Daily Wrap Up

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By Lene Powell, J.D.

A final rule amendment extends a deadline for small swaps entities on initial swaps margin, and several no-action letters provide relief for derivatives exchanges experiencing staff displacements due to the COVID-19 pandemic.

Shortly after providing no-action relief for a broad swath of derivatives market participants, the CFTC issued further relief in response to the COVID-19 (coronavirus) pandemic. The Commission finalized a rule extending by one year a deadline for small swaps entities to begin exchanging initial margin for uncleared swaps. In addition, the Division of Market Oversight issued three no-action letters providing temporary, targeted relief to swap execution facilities (SEFs) and certain designated contract markets (DCMs). The letters give extra time to submit annual compliance and quarterly financial reports, as well as relief from certain audit trail requirements such as recording oral communications.

Separately, the CFTC issued a Customer Advisory warning investors to beware of fraudsters preying on pandemic fears.

Swaps margin. The CFTC's initial margin requirements for uncleared swaps currently apply to the 40 largest swap dealers, covering about 97 percent of the U.S. portion of the global swaps market. Currently, the final "Phase 5" of the swaps margin compliance regime is scheduled to expand margin requirements to an additional 700 smaller entities as of September 1, 2020.

In October 2019, the CFTC proposed a final rule amendment to extend the Phase 5 deadline by one year to September 1, 2021. According to the Commission, extending the deadline would give entities an extra year to prepare and help avoid market strain from so many newly in-scope counterparties engaging the same limited number of IM service providers.

According to Chairman Heath Tarbert, there is universal agreement that the extension will mitigate rather than exacerbate risk. Commissioners Dan Berkovitz, Brian Quintenz, and Rostin Behnam issued statements in support.

Berkovitz said that although he does not generally favor deadline extensions when a long lead-in period has been provided, he voted for the amendment because:

- It applies only to initial margin and does not affect variation margin requirements that are already effective.
- The likely effect on systemic risk mitigation will be quite limited, because the deadline is extended only for financial end users with average daily aggregate notional amounts (AANA) less than $50 billion, representing approximately three percent of the total AANA of entities subject to the margin rules.
- Other U.S. and foreign regulators are adopting similar extensions.
- Financial market turmoil from the global coronavirus pandemic makes the relief for smaller financial end users particularly timely.

Swap execution facilities (SEFs). The Division of Market Oversight (DMO) issued two no-action letters providing targeted relief to SEFs due to the dislocation of personnel:

- Under CFTC Letter No. 20-07, DMO will not recommend enforcement action against any SEF for the failure to comply with the following Commission regulations: 37.205(a)-(b), 37.400(b), 37.406, 37.1000(a)(1), and 37.1001 to the extent that non-compliance arises from the inability of SEFs to record voice communications as a result of the displacement of voice trading personnel from their normal business sites in connection with the COVID-19 pandemic response. The relief expires June 30, 2020, and is subject to certain conditions.
- Under CFTC Letter No. 20-08, DMO will not recommend enforcement action against any SEF or SEF chief compliance officer (CCO) for failure to submit: (1) an annual compliance report (ACR) within the 60-day period prescribed in Commission regulation 37.1501(f)(2); or (2) the fourth quarter financial report pursuant to Commission regulation 37.1306(d), within the 60-day period prescribed. The relief is subject to certain conditions.

Designated contract markets (DCMs). Under CFTC Letter No. 20-09, DMO will not recommend action against any DCM for the failure to comply with audit trail and related requirements pursuant to Commodity Exchange Act Sections 5(d)(4) and (10), as well as Commission regulations thereunder, to the extent that non-compliance relates to the displacement, in connection with the COVID-19 pandemic response, of Affected Market Participants from an exchange's trading floor and/or other designated premises from which customer orders may be placed. The relief expires on June 30, 2020, and is subject to certain conditions.

Customer advisory. The CFTC's newest customer advisory warns that although commodity futures and options do allow traders to hedge against market risk, fraudsters commonly use major news events like the COVID-19 pandemic to manipulate emotions and make their cons seem more credible.

Counterintuitively, people who are *more* financially literate and experienced are more likely to be victimized by investment fraud, the advisory noted. This might be because experienced traders are more likely to trade or are more likely to be overconfident. The advisory cautions traders to be aware of potential mental blind spots such as confirmation bias, sunk cost bias, and "hot hand" bias. The advisory also flags common fraud tactics, including urgency, promises of large and/or guaranteed returns, credibility building and testimonials, and the offer of free gifts.

Finally, the advisory urges investors to check individuals' registration status at cftc.gov/check and report possible fraud at cftc.gov/complaint.

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