SVB and Signature Bank Resolution – CFTC-Related Implications

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Many of the transactions involving qualified financial contracts ("QFC") with Silicon Valley Bank ("SVB") and Signature Bank constitute Commodity Futures Trading Commission ("CFTC") jurisdictional transactions that may be affected by recent SVB and Signature Bank failures. Note that under the authority of the Federal Deposit Insurance Act ("FDIA") practically all obligations and transactions with SVB and Signature Bank have been transferred to new entities that are not in Federal Deposit Insurance Corporation ("FDIC") receivership: Silicon Valley Bridge Bank, N.A. ("SVB Bridge") and Signature Bridge Bank, N.A. ("Signature Bridge"), respectively. Below we briefly discuss these practical CFTC-related implications.

1) <u>Which contracts and transactions are subject to the CFTC's jurisdiction?</u>

a) *Commodity Spot and Deliverable Forwards*. For all QFCs involving "commodities," which include foreign exchange ("FX"), cryptos, broad-based security indices, credit events, interest rates, gold, energy, etc. (but not securities), the CFTC has anti-fraud and anti-manipulation jurisdiction. This means that any counterparty to these trades must act reasonably and not engage in fraudulent activity, such as insider trading or cornering the market no matter what the market conditions are. Typically these QFCs are traded on "spot" (*e.g.*, deliverable within 2 business days) or on deliverable forward basis between commercial participants in their line of business.

b) *Commodity Derivatives*. QFCs qualifying as commodity swaps, options on swaps, futures, or options on futures are considered derivatives over which the CFTC has exclusive jurisdiction, meaning that the CFTC can proscribe the

rules how these transactions are executed, reported, documented, who can trade them, and where and how. This category also includes swaps that are required to be cleared and traded (*e.g.*, interest rate and credit default swaps) as well as those that are not so required.

c) *FX Contracts*. These QFCs fall into the above categories, with one exception – foreign exchange forwards ("FXF") and foreign exchange swaps ("FXS") that are exempted from some of the CFTC regulations. Therefore, FX QFCs may include: (a) spot and deliverable forward FX contracts, (b) FXF and FXS, and (c) cross-currency swaps and all other FX-related swaps and options, including non-deliverable forwards ("NDFs").

d) *Scope*. In reviewing your transactions with SVB Bridge and Signature Bridge, you need to specifically classify the type of transactions you have with these counterparties because CFTC regulatory implications with each will be different. Note that a similar analysis would need to be conducted for security-based swaps ("SBS") under Securities and Exchange Commission ("SEC") regulations.

2) <u>What commodity derivatives are impacted?</u>

a) *Commodity Futures*. Futures and options on futures are executed on an exchange ("DCM") and cleared through a derivatives clearing organization ("DCO"). Even if SVB or Signature Bank were initially counterparties to any of the futures trades, the DCO and exchanges will be working directly with SVB Bridge and Signature Bridge, and no counterparties will be affected. Likewise, all National Futures Association ("NFA") members trading with these bridge banks, such as futures commission merchants ("FCMs"), introducing brokers ("IB") or commodity trading advisers ("CTAs"), will need to review and update their documentation, such as FCM, IB or CTA agreements.

b) *Commodity Swaps*. Any over-the-counter ("OTC") swap that has not been cleared through a DCO and that had SVB or Signature Bank as a counterparty will be affected – this includes all commodity swaps and options. Likewise, all commodity swaps with SVB and Signature Bank executed through a swap execution facility ("SEF") or a DCO will be affected.

3) <u>How are swaps specifically affected?</u>

a) *Reporting – Modifications, Transfer and Terminations*. As a result of the FDIC receivership, the counterparty to the swap has changed – it is no longer SVB or Signature Bank, but SVB Bridge and Signature Bridge, respectively, and any swap or an option would have been transferred to the relevant bridge entity by the FDIC. Part 45 of the CFTC regulations requires that a reporting counterparty (usually a swap dealer) send a report of a "life-cycle" event to the swap data repository ("SDR") regardless of whether the swap was executed OTC or through a SEF/DCM. A life-cycle event includes a "counterparty change resulting from assignment or novation, a partial or full termination of the swap; a change to the end date for the swap; a change in cash flow or rates originally reported; availability of legal entity identifier for a swap counterparty previously identified by some other identifier; or a corporate action affecting a security or securities on which a swap is based

(*e.g.*, merger, dividend, a stock split or bankruptcy)." Part 45.1. Therefore, at a minimum, a reporting counterparty will need to send a report of the change of the counterparty identity from SVB or Signature Bank to the relevant bridge bank. The report must be sent to the SDR no later than the end of the second (2nd) business day of the occurrence of the event (i.e., Wednesday, March 15, 2023). It does not matter that the counterparty had changed as a result of the FDIC receivership (*i.e.*, without your consent). If a transaction is terminated before the original term (*e.g.*, on a consensual basis or as a result of the exercise of an early termination right by a counterparty), that would also constitute a life-cycle event and will need to be reported to an SDR.

b) *Reporting – Bridge Banks' Perspective.* In the event that a QFC reporting counterparty was SVB or Signature Bank (which would be the case if their counterparty was a non-financial entity or a financial end-user), this regulatory obligation will transfer to the bridge banks along with the QFCs. Therefore, it would remain SVB Bridge's and Signature Bridge's obligation to make the required reports under Part 45 of CFTC regulations (and Part 43 if applicable). According to FDIC's March 14, 2023 financial institutions letter, Tax Identification Numbers, accounts details and pre-failure identification should remain in effect; presumably, legal entity identifiers ("LEIs") used for swaps reporting should also remain active.

c) *Clearing Issues.* In addition to reviewing and assessing each transaction, it is necessary to assess the status of the successor entity – the bridge bank. All clearing determinations will need to be made for the successor bridge entity, although, most likely, the outcome will be the same. Same considerations would apply for third-party entities that will be clearing these swaps.

d) *Uncleared Margin Issues.* Similarly to clearing, all decisions relating to uncleared swaps also will need to be made with respect to initial and variation margin.

4) Are there swap dealer unique requirements?

a) *External Business Conduct Standards.* Registered swap dealers must follow Part 23 of the CFTC regulations. All of these rules remain applicable, including reporting, disclosure, documentation, know your customer, suitability, etc. For example, if an old trade with SVB was terminated, and a new trade with SVB Bridge was negotiated as a separate trade, then the swap dealer will need to provide mid-market marks (and then daily marks) under CFTC regulation 23.431 to SVB Bridge.

b) *Receivership.* Note that the transfer to a new entity (*e.g.*, a bridge bank by the FDIC) does not qualify as an execution of a new transaction, and therefore it is not necessary to provide mid-market marks to the bridge bank for transferred trades.

5) What other considerations should we keep in mind?

a) *Compliance Policy.* First and foremost, you need to act reasonably, in good faith and consistently with your compliance policies and procedures as well

as the documentation executed with SVB and Signature Bank that is now transferred to the bridge bank.

b) *ISDA Documentation.* There are numerous documentation-related matters that ultimately will need to be worked through, including the review of ISDA's 2018 Resolution Stay Protocol's applicability, or a review of the transfer or downgrade provisions. Note that because of the stay of termination and the transfer of QFCs to the bridge banks that are not in receivership, there are currently no actionable events of default or termination rights unless there is another separate default (or a default arises in the future).

c) *Looking Forward.* During the time of market instability, companies trading CFTC-jurisdictional contracts are well advised to take the following steps:

- clearly identify all CFTC-jurisdictional (and other) transactions with your counterparties (*e.g.*, are these commodity products or securities products);

- clearly identify and assess from the regulatory perspective the types of transactions you have (*e.g.*, whether these are spots, forwards, futures, options on futures, cleared or uncleared swaps, OTC options, FXF and FXS, NDFs, etc.);

- clearly identify all regulatory obligations related to these transactions (*e.g.*, who is required to conduct the reporting, documentation, monitor position limits, post and collect margin, facilitate the clearing of these transactions, maintain the collateral, etc.);

- verify your counterparty's regulatory status (*e.g.*, if they are a registered or a de minimis swap dealer, a CTA, FCM, IB or any other regulated entity such as a broker dealer regulated by the SEC);

- assess the impact of any potential regulatory or enforcement action on your counterparty (*e.g.*, by the SEC or U.S. Department of Justice); and

- assess the efficacy of your internal disaster recovery and business continuity programs, and create a detailed plan of action in the event your counterparty fails or you have reasonable grounds for insecurity.