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Jurisdictional Boundaries Between CFTC Swaps and SEC Security-Based Swaps Clarified



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On September 19, 2023, the jurisdictional boundaries between the regulation of swaps by the Commodity Futures Trading Commission (the “CFTC”) and the regulation of security-based swaps (“SBSs”) by the Securities and Exchange Commission (the “SEC”) were clarified for the first time in a decision by the United States District Court for the Southern District of New York (the “SDNY”).

In *CFTC v. Archegos Capital Management LP*, the SDNY **held** that the CFTC does not have jurisdiction over either (a) total return swaps (“TRSs”) based on exchange-traded funds (“ETFs”) or (b) custom baskets of securities that can be rebalanced on a discretionary basis. We **discussed** the grey area of swap and SBS regulation between the CFTC and the SEC in prior coverage last year. This holding eliminated some of this grey area when it confirmed the SEC’s assertion that such TRSs qualify as SBSs that fall within the SEC’s exclusive jurisdiction.

This decision follows (and aligns with) the reasoning given in the SEC’s June 9, 2022 advisory that **clarified** the SEC’s position on TRSs based on ETFs, and also enshrines in case law the guidance **given** in the joint CFTC and SEC rulemaking from 2012 on custom baskets of securities managed on a discretionary basis.

The two components to the SDNY’s decision are as follows:

1. A TRS based on an ETF that is in turn based on a broad-based security index (“BBSI”) (such as the S&P 500) is not itself based on a BBSI—for clarity, a TRS based on a BBSI would be within CFTC’s exclusive jurisdiction—but instead is based on a

single security (*i.e.*, the ETF). In other words, there is no look-through from the ETF to the underlying BBSI. The court also rejected the CFTC's assertion that such a TRS may qualify as a "mixed" swap that would be subject to shared CFTC and SEC jurisdiction, providing the rationale that a "mixed" swap is a narrow category and does not fit within the description in the Joint Release.

2. Whether a TRS based on a custom basket of securities is a SEC-regulated swap or a CFTC-regulated swap turns on the classification of any such basket as a narrow-based security index ("NBSI") (which is within the SEC's jurisdiction) or a BBSI (which would be within the CFTC's jurisdiction). The court found that the custom basket of securities at issue was subject to "direct or indirect discretionary authority" and, therefore, was not determined by the "predetermined criteria or predetermined self-executing formula." Thus, in accordance with the Joint Release, the court concluded that the index qualified as an NBSI, making the TRS an SBS subject to the SEC's jurisdiction.

Although this decision has better elucidated the boundary between CFTC-regulated swaps and SEC-regulated SBSs, there still remain certain other jurisdictional issues to be clarified between the agencies relating to other products, such as digital assets.
