CADWALADER

Cabinet News and Views

Informed analysis for the financial services industry

Coming Attractions

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Just a couple of hours before our colleague Sophie Cuthbertson was scheduled to participate earlier this week in the LIBOR panel at SFVegas, the biggest structured finance conference in the U.S., the Federal Reserve issued a notice of proposed rulemaking – we all know it as an NPR – that provided guidance on identifying SOFR rates related to legacy contracts. With her deep knowledge of LIBOR and some last-minute cramming on the new Fed guidance that would have made her law professors proud, Sophie was able to incorporate some of this new thinking into her panel presentation.

While the June 30, 2023 end of LIBOR as we know it is no surprise, the regulators still have some work to do here, and so announcements like Tuesday's, even though anticipated in the industry, did create a bit of a scramble. We will continue to provide updates and guidance in the weeks and months to come.

We also encourage you to read our "Cadwalader Corner Q&A" with Prof. Pete Hahn, highly respected in the financial services community in Europe as a former regulator, banker and academic at The London Institute of Banking & Finance. In particular, take a look at Prof. Hahn's views on fintech and cryptocurrencies.

As always, we welcome your thoughts on this week's issue of *Cabinet News and Views* and other timely topics. Just write to us here.

Daniel Meade and **Michael Sholem**
Co-Editors, *Cabinet News and Views*

Coming Attractions at the Federal Reserve

By **Daniel Meade**
Partner | Financial Regulation

In the last week, the Federal Reserve has announced two forthcoming dates when the Fed would be releasing two important announcements: (1) the results of its annual bank stress tests will be released on June 23 at 4:30 p.m. EDT; and (2) a second tool to help community financial institutions implement the Current Expected Credit Losses ("CECL") accounting standard will be released as part of a June 16 "Ask the Fed" webinar.

For this year's stress test, 34 large banks/bank holding companies were tested under a scenario where the U.S. unemployment rate rises 5.75 percentage points to a peak of 10% over two years. The stress test's increase in unemployment is accompanied by a 40% decline in commercial real estate prices, widening corporate bond spreads, and a collapse in asset prices, including increased market volatility. In addition to that base hypothetical scenario, institutions with large trading operations were tested against a global market shock component, and institutions with substantial trading or custodial operations were tested against the default of their largest counterparty.

The CECL tool which the Fed announced that it will release this month, known as the Expected Losses Estimator ("ELE"), is a spreadsheet-based tool to assist community banks in calculating their CECL allowances. Federal Reserve Governor Miki Bowman stated in the press release that the release of these two CECL tools "continue our work to tailor supervisory approaches to fit the size, risk and business model of financial institutions. I am confident these tools will assist our smaller banks enabling them to prioritize serving the financial needs of their communities and customers."

U.S. Senators Propose First Comprehensive Regulation for Digital Assets


By **Peter Y. Malyshev**
Partner | Financial Services


By **Mercedes Kelley Tunstall**
Partner | Financial Regulation

Earlier this week, U.S. Sens. Kirsten Gillibrand (D-N.Y.) and Cynthia Lummis (R-Wyo.) introduced the first comprehensive legislation to establish a regulatory framework for digital assets to promote innovation, delineate regulatory jurisdiction, provide customer protection, ensure transparency and integrate digital assets into the existing regulatory regimes (the Responsible Financial Innovation Act, or the "RFI"). Many of the principles laid out in the RFI were first articulated in President Biden's March 3, 2022 Executive Order on Ensuring Responsible Development of Digital Assets.

The RFI aims at covering the entire universe of the digital assets industry, including cryptocurrencies (cryptos), stablecoins, smart contracts, distributed ledger technologies and defi platforms. Importantly, for the first time, the RFI will address jurisdictional reach and the mandates of several U.S. federal agencies with respect to digital assets, including the Commodity Futures Trading Commission ("CFTC"), the Securities and Exchange Commission ("SEC"), the U.S. bank prudential regulators ("USPRs"), the Internal Revenue Service ("IRS") and even the Federal Regulatory Energy Commission ("FERC") in connection with the energy used to mine digital assets.

At the core of the RFI is the notion that most cryptos are "commodities" and not "securities" and introduces the purpose of the assets and rights conveyed test to provide clearer guidelines for businesses in choosing, respectively, the CFTC's or the SEC's regulatory regime. Further yet, it gives broader authority to the CFTC to regulate digital assets spot markets, which to this day remain the largest blind regulatory spot where most of the crypto fraud occurs. Under the Commodity Exchange Act of 1936 ("CEA"), the CFTC only has enforcement authority over spot commodity markets – while, as amended by the RFI, the CEA will provide the CFTC exclusive jurisdiction over spot digital assets markets, enabling the CFTC to fully regulate these markets (in addition to retaining its enforcement authority).

Finally, the RFI addresses the bankruptcy treatment of the digital assets, as well as enhanced customer protection and the payments innovation. Several provisions of the RFI focus on banking innovation and cybersecurity and the interagency cooperation between the CFTC, SEC, IRS, USPR, and FERC, and direct the establishment of the industry self-regulatory organization for the digital assets industry.

UK Treasury Opens Consultation into Proposed Insolvency Regime to Manage Failure of Stablecoin Firms

By Michael Sholem
Partner | Financial Regulation

On May 31, 2022, the UK Treasury announced a consultation on the government's proposals to manage the failure of systemic digital settlement asset ("DSA") (including stablecoin) firms by adapting the existing Financial Market Infrastructure Special Administration Regime ("FMI SAR").

According to an article in the *Financial Times*, the Treasury stated that the failure of a systemic stablecoin could endanger the "continuity of services critical to the operation of the economy and access of individuals to their funds or assets." The failure of the terra stablecoin has greatly intensified the concerns of many regulators over the lack of transparency and potential weaknesses of the market. The Treasury said that "events in cryptoasset markets have further highlighted the need for appropriate regulation to help mitigate consumer, market integrity and financial stability risks."

The government considers that the Bank of England ("BoE") and not the Financial Conduct Authority ("FCA") should be the lead regulator in the administration of systemic DSA firms. It is proposed that the BoE will be given the power to direct an appointed administrator. According to the consultation, the government intends to modify the FMI SAR to include an additional objective covering the return or transfer of funds and custody assets which may only be considered when the FMI SAR is applied in relation to systemic DSA firms. Furthermore, it is suggested that the BoE should consult with the FCA (1) before directing administrators with regard to the regime's objectives and (2) when seeking a special administration order for a systemic DSA firm subject to regulatory requirements imposed by both the BoE and FCA. The government said the new rules would "allow administrators to take into account the return of customer funds and private keys as well as continuity of service."

The Treasury have asked for responses to the following questions:

1. Do you have any comments on the intention to appoint the FMI SAR as the primary regime for systemic DSA firms which aren't banks?
2. Do you have any comments on the intention to establish an additional objective for the FMI SAR focused on the return or transfer of customer funds, similar to that found in the Payment and E-Money Special Administration Regime, to apply solely to systemic DSA firms?
3. Do you have any comments on the intention to provide the BoE with the power to direct administrators, and to introduce further regulations in support of the FMI SAR to ensure the additional objective can be effectively managed, or what further regulation may be required?
4. Do you have any comments on the intention to require the BoE to consult with the FCA prior to seeking an administration order or directing administrators where regulatory overlaps may occur?

Submissions must be made by August 2, 2022, following which the government will consider all submissions and publish its response.

CFTC Considers Greater Regulation of Carbon Offset Markets

By **Peter Y. Malyshev**
Partner | Financial Services

On June 2, 2022, the Commodity Futures Trading Commission ("CFTC") convened for the first time market participants to discuss the state and the challenges of the U.S. voluntary carbon credit ("VCC") markets and, at the end of the meeting, published a Request for Information ("RFI") on Climate-Related Financial Risk. This convening was an important step in CFTC's broader initiative to conceptualize its jurisdictional reach over environmental, social and governance ("ESG") commodity markets generally.

From the outset, CFTC leadership and participants recognized that the CFTC has only a limited enforcement jurisdiction over ESG commodities and specifically carbon credits, allowing the CFTC to prosecute for fraud and manipulation. Even though ESG commodities are generally considered "commodities" under the Commodity Exchange Act of 1936 ("CEA"), CFTC's exclusive (or regulatory) jurisdiction is triggered only when derivatives or "commodity interests" are involved, which are swaps, options and futures. Given that most of the VCC markets, as well as ESG commodity markets, are spot or forward markets, CFTC's regulatory reach is limited, as it is not a general consumer protection agency.

Nevertheless, the CFTC chose to hold the convening to address the increasing use of sustainability-linked derivatives ("SLDs") both in the OTC and regulated exchange markets that are being used by market participants to mitigate climate risks, as well as secure financing of ESG projects.

At the conclusion of the VCC convening, the CFTC published the RFI, seeking "public comment on climate-related financial risk to better inform its understanding and oversight of climate-related financial risk as pertinent to the derivatives markets and underlying commodities markets." Information obtained from the RFI will assist further work of CFTC's Climate Risk Unit, as well in formulating CFTC's future policies addressing climate risks and the developing spot and derivative markets in ESG commodities.

Senate Banking Committee Clears Three Financial Regulatory Nominations, Including Michael Barr for Fed Vice Chair of Supervision

By **Daniel Meade**
Partner | Financial Regulation

Yesterday, in a welcome glimmer of bipartisanship, the Senate Banking Committee voted to move three of President Biden's financial regulatory nominees to the full Senate.

Michael Barr's nomination to be Vice Chair of Supervision and a member of the Federal Reserve Board advanced on a 17-7 vote. The nominations of Jaime Lizárraga, a Democrat, and Mark Uyeda, a Republican, to be Commissioners at the Securities and Exchange Commission were both advanced to the full Senate on voice votes.

Next Week in Barcelona?

A full contingent of Cadwalader attorneys will be in Barcelona next week for the 26th Annual Global ABS conference.

Conference attendees are encouraged to stop by Cadwalader Conexión (meeting room M218) to take a breather, enjoy refreshments, and discuss all things structured finance, including CRE CLOs, CMBS, RMBS, warehouse lending and more. View our full schedule here.

Peter Malyshev to Participate on FIA Forum: Commodities 2022 Panel

Cadwalader partner Peter Malyshev will be one of the speakers at the upcoming "FIA Forum: Commodities 2022" conference on June 21-22 in Houston, Texas.

Peter will participate in the Wednesday, June 22 panel, "Compliance and Operations Hot Topics." The panel will be moderated by Petal Walker, Managing Director, Risk & Financial Advisory, Deloitte & Touche LLP.

Peter's practice focuses on regulatory, compliance and transactional matters relating to commodities, derivatives, and securities products regulated by the U.S. Commodity Futures Trading Commission and the U.S. Securities and Exchange Commission.

Registration and other information is available here.