CADWALADER

Changes

August 4, 2022

Table of Contents:

- In This Issue ...
- Proposed Legislation to Regulate Digital Commodity
- The Department of Labor's Proposed Amendments to the QPAM Exemption
- FDIC Makes Clear That It Does Not Insure Crypto Exchanges
- Changes to UK Financial Promotion Rules
- Capital Relief Trades Webinar Series, Part 4: CRT Structuring in the United Kingdom and EU

In This Issue ...

The 24/7 news cycle kept churning this week, but hopefully not lost in the shuffle was the Federal Reserve Board's announcement on the individual capital requirements for all large banks, following the June announcement of Dodd-Frank Act Stress Test results. Let's not forget: this supervision is there for a very good reason – namely, to ensure that banks are sufficiently capitalized to absorb losses during times of stress. We look at the FRB announcement, and other key announcements from U.S. and UK agencies, this week.

As always, we welcome your thoughts. Just write to us here.

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

Proposed Legislation to Regulate Digital Commodity

By Peter Y. Malyshev
Partner | Financial Services

On August 3, Senate Agriculture Committee Chairwoman Debbie Stabenow, a Democrat from Michigan, and John Boozman, the top Republican on the committee, introduced a bipartisan bill aimed at regulating digital assets.

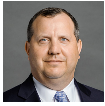
They join several other senators and representatives who have introduced a multitude of bills to regulate markets in digital assets in the past two years. However, Stabenow-Boozman's Digital Commodities Consumer Protection Act of 2022 ("DCCPA") is narrower than some of the proposals (such as the proposal from Senators Lummis and Gillibrand in June or the House proposal) and is more focused on the regulatory gaps that are most evident in crypto spot markets where Bitcoin, Ethereum and other cryptocurrencies and digital assets trade.

Specifically, similarly to other recently proposed bills, the DCCPA amends the Commodity Exchange Act of 1936 ("CEA") to grant to the Commodity Futures Trading Commission ("CFTC") exclusive jurisdiction over digital commodity markets (except for when digital commodities are used to purchase goods or services). To date, the CEA only gives the CFTC limited authority to prosecute fraud and manipulation in spot markets, which means that the CFTC cannot currently dictate how, where, by whom and under what conditions spot transactions in digital commodities take place. The CFTC, however, has exclusive jurisdiction over derivatives – which is only a small portion of digital commodity markets.

For the first time, DCCPA provides a clear definition of "digital commodity" and includes this new category in the broader definition of "commodity" as well as derivatives involving these commodities in the category of "commodity interests." The bill also requires that entities that facilitate trading in digital commodities register with the CFTC as platforms, brokers, dealers and custodians and provides rules on how these markets should be governed. Unlike the Lummis-Gillibrand bill, DCCPA does not address in detail instruments that would otherwise qualify as securities and would be regulated by the Securities and Exchange Commission or as banking products and would be regulated by state or federal bank regulators.

CFTC Chairman Ross Behnam made a statement welcoming introduction of this bill. It is worth noting that Behnam, before being appointed to the CFTC, was on Senator Stabenow's staff and, from the design of this bill, it is clear that the CFTC provided technical assistance.

The Department of Labor's Proposed Amendments to the QPAM Exemption



By **James Frazier**
Partner | Executive Compensation, Benefits & ERISA

On July 26, the United States Department of Labor ("DOL") issued proposed amendments to Prohibited Transaction Class Exemption 84-14, the so-called "QPAM Exemption." The QPAM Exemption is an important prohibited transaction class exemption widely utilized by asset managers to provide relief for potential prohibited transactions that could arise in transactions between plans subject to ERISA and/or Section 4975 of the Code and financial services and other firms that are "parties in interest" under ERISA or "disqualified persons" under the Code (*e.g.*, fiduciaries, plan sponsors, service providers and entities related to the foregoing by ownership) to such plans.

To utilize the QPAM Exemption, the relevant asset manager must meet the requirements to be a "Qualified Professional Asset Manager," or "QPAM," including related to the amount of client assets under management and its capitalization, and must satisfy the relevant conditions of the exemption. The DOL proposed multiple changes to the conditions in Section I ("General Exemption") of the QPAM Exemption and the requirements to be a QPAM. A significant portion of the amendments relate to the disqualifying conduct provisions of exemption, although the DOL is proposing multiple other revisions.

In the press release with the proposed amendments, the DOL noted in proposing these amendments that since the QPAM Exemption was granted in 1984, "substantial changes have occurred in the financial services industry ... [including] industry consolidation and the increasing global reach of financial services firms in their affiliations and investment strategies...."

According to a senior DOL official, "modernizing changes are overdue."

The DOL's proposed changes to the QPAM Exemption include (in summary) the following:

(a) Amending the QPAM Exemption, which currently provides that the exemption ceases to be available to a QPAM for 10 years if the QPAM or an affiliate (within the meaning of the exemption) is convicted of certain felonies listed in the QPAM Exemption or crimes listed in Section 411 of ERISA, to make it clear that the exemption applies also to foreign crimes "substantially equivalent" to the listed U.S. federal or state crimes;

(b) Amending the QPAM Exemption to add additional types of conduct that would result in loss of the exemption. The prohibited additional conduct includes any conduct forming the basis for a non-prosecution or deferred prosecution agreement that, if successfully prosecuted, would have constituted a disqualifying crime, engaging in a systematic pattern or practice of violating the conditions of the QPAM Exemption in connection with otherwise non-exempt prohibited

transactions and providing materially misleading information to the DOL in connection with the conditions of the QPAM Exemption;

(c) Adding new provisions (1) requiring the inclusion of certain provisions in a written management agreement relating to what happens in connection with a disqualification of a QPAM (*e.g.*, addressing manager termination and indemnification) and (2) providing for a one-year wind-down period following a manager becoming ineligible to use the QPAM Exemption as a result of engaging in disqualifying conduct;

(d) Requiring a QPAM to notify the DOL that it is relying on the QPAM Exemption and subjecting the QPAM to new recordkeeping standards designed to demonstrate compliance with the QPAM Exemption;

(e) Amending the definition of a “Qualified Professional Asset Manager” to update the assets under management and capitalization requirements; and

(f) Amending Section I(c) of the QPAM Exemption, which requires that the QPAM generally negotiate the terms of, and make the decision to enter into, a covered transaction, to make what the DOL characterizes as clarifying changes to the independence and control the QPAM must possess.

Comments and requests for a public hearing on this proposed amendment must be submitted to the DOL on or before September 26, 2022.

FDIC Makes Clear That It Does Not Insure Crypto Exchanges

By **Daniel Meade**
Partner | Financial Regulation

Last week, the Federal Deposit Insurance Corporation ("FDIC") was part of two releases clarifying that only insured banks and thrifts enjoy FDIC insurance, notwithstanding what some non-banks may say in their marketing materials. The first release, together with the Federal Reserve Board ("FRB"), is a cease-and-desist letter to Voyager Digital (the "Joint C&D Letter"). The second is an FDIC Advisory to FDIC-Insured Institutions Regarding FDIC Deposit Insurance and Dealings with Crypto Companies.

The Joint C&D Letter

In the Joint C&D Letter, the FDIC and FRB ordered Voyager to stop making statements that "suggest in any way, expressly or implicitly, that (1) Voyager is insured by the FDIC; (2) customers who invested with the Voyager cryptocurrency platform would receive FDIC insurance coverage for all funds provided to, held by, on, or with Voyager, without reference to the insured depository institution account; or (3) the FDIC would insure customers against the failure of Voyager itself, from Voyager's websites…" This letter follows Voyager's suspension of trading on its platform and filing for Chapter 11 bankruptcy.

The Joint C&D Letter noted that Voyager did put some customer money in deposits at an insured New York State member bank (hence, the involvement of the FRB) and that Voyager's statements were possibly misleading to consumers because, while dollars deposited in the insured depository institution partner of Voyager would enjoy FDIC insurance, and thus protection in the event of the bank's failure, that insurance does not mean Voyager itself is FDIC insured.

The Advisory

The FDIC's Advisory followed a similar theme as the Joint C&D Letter in that it is important that any non-bank financial companies, such as crypto exchanges that partner with insured depository institutions, do not cause consumer confusion when offering non-bank services but also partners with an insured bank or thrift. The FDIC's advisory seems to suggest that the FDIC expects an affirmative duty on the part of the insured bank that partners with non-bank financial providers to monitor their non-bank customers for what might be false or misleading statements, stating "… insured banks should confirm and monitor that these companies do not misrepresent the availability of deposit insurance in order to measure and control risks to the bank, and should take appropriate action to address such misrepresentations." Some banks were likely doing that already, but for some, this might be an additional risk management process they would need to add.

Both the Joint C&D Letter and the Advisory follow the somewhat recent disruptions in the crypto stablecoin markets, as well as the FDIC finalizing amendments to its rules regarding misrepresentation of insured status in June. The

announcement last week makes clear that the FDIC and the other federal bank regulators will be on the lookout for marketing from non-bank financial providers, especially crypto exchanges and wallets, that may be viewed as misleading by implying that FDIC insurance applies to funds or investments where it does not.

Changes to UK Financial Promotion Rules

By **Michael Sholem**
Partner | Financial Regulation

On August 1, the UK's Financial Conduct Authority ("FCA") published a policy statement on strengthening its financial promotion rules for high-risk investments and firms approving financial promotions (the "policy statement").

In its policy statement, the FCA summarises feedback on its January 2022 consultation paper and sets out its final policy and rules designed to strengthen the regime for the promotion of high-risk investments ("HRIs"). The FCA has previously provided examples of HRIs, such as cryptoassets, structured products, land banking schemes, contracts for difference and mini-bonds (sometimes called high interest return bonds). Currently, the final rules apply only to those HRIs that are already subject to marketing restrictions. The policy statement also contains the final rules and non-Handbook guidance for firms when communicating or approving financial promotions. The final rules are set out in the Financial Promotions and High-Risk Investments Instrument 2022 (FCA 2022/33), which is contained in Appendix 1 to the policy statement and was made by the FCA Board on July 29. The rules relating to risk warnings for financial promotions of HRIs take effect from December 1, 2022. All other rules take effect from February 1, 2023.

Respondents generally agreed with the FCA's proposals in its January 2022 consultation paper. In particular, they supported the behavioral testing the FCA conducted for the consumer journey proposals. Furthermore, there was support for the proposed changes to strengthen the role of authorized firms communicating and approving financial promotions. After considering the feedback, the FCA made several "targeted changes" to their proposals to avoid negative unintended consequences that were identified by respondents.

In the policy statement, the FCA notes that since the consultation paper in January, its work has become even more important due to current high inflation rates resulting in negative real returns for many mainstream investments. The FCA expects this to push consumers into HRIs in search of greater returns. Furthermore, the FCA's policy statement notes that the publication of consumer duty rules and guidance in July also strengthened financial promotion rules and set a baseline for firms promoting HRIs.

Back in January, the Treasury confirmed its intention to legislate to bring certain cryptoassets into the scope of the financial promotion regime. The FCA confirmed that it will make final rules on the promotion of qualifying cryptoassets once the relevant legislation has been made. These will most likely follow the same approach as those for other HRIs as the FCA considers cryptoassets, when used as a speculative investment, to be high-risk.

Capital Relief Trades Webinar Series, Part 4: CRT Structuring in the United Kingdom and EU

Cadwalader's financial services team will host the fourth and final installment of its webinar series on capital relief trades on Wednesday, August 4 from 1-2 p.m. EDT.

Part 4, titled "CRT Structuring in the United Kingdom and EU," will feature Cadwalader partner Nick Shiren and special counsel Assia Damianova, who will examine relevant UK and EU considerations for capital relief trades, including:

- Applicable rules - capital requirements regulation and the EU bank capital rules
- Securitization regulation and how to report and retain risk
- Impact of EMIR
- Examples of structuring issues in European deals

You can register here.

In addition, you can access webinar replays of Parts 1-3 here:

- Part 1: CRT Overview and Regulatory Capital Basics
- Part 2: Unpacking Regulation Q: CRT Structuring
- Part 3: U.S. Legal and Regulatory Considerations