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Cabinet **News and Views**

Informed analysis for the financial services industry

Turning Towards Tuesday

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In This Issue ...

We will all be closely watching the results of the U.S. midterm elections on Tuesday – and for a lot of reasons. For those of us in the financial services industry, the big question is how the vote will impact Congressional initiatives going forward. Simply put: Will the Democrats be emboldened by a strong showing and look to implement additional elements of their agenda or will a so-called "red wave" by the Republicans enable them to reassert their power and determine the legislative agenda for financial services going forward? Or maybe, as many prognosticators suggest, we end up with split control of the legislative agenda, with Republicans in the majority in the House of Representatives and Democrats in the majority in the Senate. Clearly up in the air, pending Tuesday's results, are future policies on crypto-assets, climate, bank regulatory, and so much more.

While we wait for election results to come in, let's focus on what *is* happening now – the almost-every day developments in the crypto-assets and climate spaces, as well as in consumer banking protection. There was also a significant development in the continued fallout from the Archegos matter. And be sure to read here this week about important developments in the UK surrounding both sustainable disclosure and funds regulation.

I'm always interested in our readers' perspectives. Please feel free to drop me a note here.

Daniel Meade
Editor, *Cabinet News and Views*

CFTC and SEC Issue Guidance on Security-Based Swaps and Fraud in OTC Swap Disclosures

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

On October 21, Commodity Futures Trading Commission ("CFTC") Commissioner Caroline D. Pham issued a concurring statement to the CFTC's amended complaint originally filed on April 27, 2022 in the U.S. District Court for the Southern District of New York against Archegos Capital Management, LP ("Archegos") and certain related individuals. A parallel enforcement action was filed on the same day by the Securities and Exchange Commission ("SEC").

Both the CFTC and the SEC allege that Archegos, through its key representatives, engaged in a fraudulent and manipulative scheme to drive up the valuations of Archegos through swaps and security-based swaps ("SBS"), including total return swaps. The Dodd-Frank Wall Street Reform and Consumer Protection Act assigned oversight of swaps to the CFTC and SBS to the SEC. Archegos' use of these derivatives with numerous counterparties effectively concealed from these counterparties Archegos' true exposure and its available cash position. The market unfavorably turned against Archegos' positions in March 2021, and these counterparties cumulatively lost over $10 billion.

First, this action illustrates that further clarification is necessary to the definitions of a commodity-based swap, or a "swap" (that is subject to CFTC's exclusive jurisdiction), and "SBS" (that, in turn, is subject to SEC's exclusive jurisdiction). Subsequent to the adoption of Dodd-Frank, the agencies issued joint guidance in 2012 (Products Definitions) further delineating the differences between swaps and SBS. However, in the 10 years since the adoption of Products Definitions, further refinement was necessary, and following the Archegos action, the SEC on July 11, 2022 issued FAQs clarifying that: "In the staff's view, the swap based on the shares of an exchange traded fund (ETF) that tracks a broad-based securities index, such as the S&P 500, is a security-based swap." Because the majority of swaps utilized by Archegos were indeed SBS, Commissioner Pham stated that the SEC had primary enforcement responsibility. Nevertheless, some transactions qualified as "swaps" and therefore the CFTC proceeded as well.

Second, the SEC's and the CFTC's joint enforcement actions, as well as the filing of criminal charges by the U.S. Attorney's Office for the Southern District of New York, illustrate the government's willingness to pursue civil and criminal remedies for alleged intentional fraud, particularly where the magnitude of losses caused by the alleged wrongdoing is as large as in the case of Archegos.

Third, this complaint is further significant because this is the first time the CFTC took a broader interpretation of its authorities under §6(c)(1) of the Commodity Exchange Act ("CEA") and §180.1(a)(1)-(3) promulgated thereunder to assert that a swap counterparty, Archegos, is liable for misleading statements with respect to OTC swaps where no disclosures were required by the CEA. One thing is certain:

this is unlikely to be the last instance where the CFTC adapts SEC's traditional enforcement priorities to commodity derivatives markets.

Consumer Financial Protection Bureau Kicks Off Extensive Privacy Rulemaking Process

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

The CFPB took the first step last week to put into place a comprehensive privacy rule that would significantly impact how consumers can manage their financial data.

Just envision a world where you can take all of your transactional data, payment history and the like and transfer that information from one bank to another, so that you have a continuous stream of information available to you, but also available to your new bank. In this kind of world, banks would compete much more with each other to offer better customer service, and consumers can benefit from not having to "start all over again" each time they change financial institutions. The CFPB also believes this freedom to move data is something that will lead to even more innovation in the fintech space. Noting that as many as 100 million consumers have authorized fintech companies to access their accounts at financial institutions to drive a wide variety of services, such as improved savings, money management, new forms of payment and even lending programs, the CFPB seeks to ensure that this kind of sharing of data is protected, authorized and available to everyone. Entities that would need to comply with the rule would include any entity that met the applicable definitions for the following categories – data providers, data recipients or data aggregators.

An important aspect of this kind of comprehensive privacy rule is that it would apply broadly and would impact businesses of all sizes. In other words, whether the bank has millions of customers or thousands, this rule would apply to them. Accordingly, the CFPB is consulting with small businesses through a process that is compliant with the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"). "The Dodd-Frank Act requires the CFPB to comply with SBREFA, which imposes additional procedural requirements for rulemakings, including [a] consultative process, when a rule is expected to have a significant economic impact on a substantial number of small entities." In particular, small businesses of concern for the SBREFA process extend to a host of nondepository financial institutions and entities outside of the financial industry, such as entities that use consumer information to underwrite loans, to offer budget or personal financial management services, or facilitate payments, and would be impacted by the privacy rule. In addition, the CFPB identified all of the following types of entities as potentially being impacted as well: "those involved in NonDepository Credit Intermediation, Activities Related to Credit Intermediation, and Securities and Commodity Contracts Intermediation and Brokerage[, as well as . . .] Software Publishers; Data Processing, Hosting, and Related Services; Payroll Services; Custom Computer Programming Services; and Credit Bureaus."

One of the documents put forth by the CFPB explains the SBREFA process and includes an outline of what the comprehensive privacy rule would look like, so that the panels of small businesses being convened can provide initial input on the

rule's structure, even before the CFPB drafts a proposed rule. The outline includes 149 questions for the SBREFA panels to address and upon which to provide perspectives.

The proposed initial scope of the privacy rule would apply only to asset accounts (as defined in Regulation E and including consumer deposit accounts and prepaid cards) and credit card accounts (as defined in Regulation Z), and covered data providers would only be financial institutions that provide those accounts directly or indirectly. The initial limited scope is intended to give the greatest benefit to consumers as possible, as quickly as possible. The CFPB intends to expand the privacy rule scope in subsequent rulemaking processes. Operational considerations covered by the CFPB include defining proper authorization processes for consumers to allow the data to be moved, defining exactly what categories of data would be required to be made available to move by the data providers, and identifying secure methods for accomplishing the move of the data.

While the 71-page outline is intended to be utilized for the SBREFA process, the CFPB has identified that other interested stakeholders may provide feedback until January 25, 2023 to this email address: Financial_Data_Rights_SBREFA@cfpb.gov. To facilitate comments from non-SBREFA interested parties, the CFPB prepared an alternate High Level Summary and Discussion Guide document that is focused solely on the privacy rule itself.

FDIC Chair Speaks on Unbanked and Underbanked Survey

By **Daniel Meade**
Partner | Financial Regulation

Martin Gruenberg, Acting Chair of the Federal Deposit Insurance Corporation, gave remarks yesterday to the National Association of Affordable Housing Lenders ("NAAHL").

In the speech, Acting Chair Gruenberg praised NAAHL's work on housing affordability as "vital to ensuring that all Americans can share in and contribute to their communities." He also noted the importance that NAAHL's work continue as there still are disparities in home ownership statistics between white and minority households.

He then turned to the 2021 National Survey of Unbanked and Underbanked Households, released by the FDIC on October 25, noting that "before families can achieve sustainable homeownership, they need to develop sound financial capabilities, including acquiring perhaps the most elementary financial asset of all, a relationship with an insured depository institution."

Mr. Gruenberg stated that "[w]hile the results reveal that substantial progress has been made, they also demonstrate that much work remains to ensure all Americans have meaningful access to and can benefit from a banking relationship." He went on to note that "4.5 percent of households were unbanked in 2021, meaning they did not have an account at an insured depository. To place this figure in perspective, in 2011, 8.2 percent of households were unbanked. Put another way, the gains over the last ten years have resulted in almost 5 million additional households with banking relationships. Those households would be expected to be comprised of 9.6 million adults and 2.3 million children."

Mr. Gruenberg said that much of the increase in households with a banking relationship are likely due to what he termed "bankable moments," such as receipt of economic impact payments during the pandemic, or starting a new job. He also praised the work of the American Bankers Association and the Independent Community Bankers in their "Bank On" efforts.

Mr. Gruenberg concluded by reiterating that the recent survey results are encouraging, but that there remains much work to do.

FCA Publishes Consultation Paper on UK Sustainability Disclosure Requirements

By Michael Newell
Partner | Financial Services

The UK Financial Services Authority ("FCA") has published its long-awaited consultation paper in relation to the proposed UK Sustainability Disclosure Requirements ("SDR") and investment labels regime, which is designed to tackle greenwashing and retain trust in sustainable products (and is largely a tailored response to the EU's Sustainable Finance Disclosure Regulation and Taxonomy).

The FCA's proposals build from the early views set out in its Discussion Paper on Sustainability Disclosure Requirements and investment labels (DP21/4), published last November, focusing on the following core areas: sustainable investment labels, qualifying criteria that firms must meet to use a label, product- and entity-level disclosures, and naming and marketing rules. The FCA notes that the proposals in this consultation paper are a starting point for a regime that will expand and evolve over time.

The FCA's proposals cover the following main areas:

- Sustainable investment labels to help consumers navigate the investment product landscape and enhance consumer trust.
- Consumer-facing disclosures to help consumers understand the key sustainability-related features of a product.
- Detailed disclosures targeted at a wider audience (for example, institutional investors and consumers seeking more information):

  – pre-contractual disclosures (for example, in the fund prospectus), covering the sustainability-related features of investment products;

  – ongoing sustainability-related performance information, including key sustainability-related performance indicators and metrics, in a sustainability product report;

  – a sustainability entity report covering how firms are managing sustainability-related risks and opportunities.
- Naming and marketing rules restricting the use of certain sustainability-related terms in product names and marketing materials unless the product uses a sustainable investment label.
- Requirements for distributors to ensure that product-level information (including the labels) is made available to consumers.
- A general "anti-greenwashing" rule applied to all regulated firms that reiterates existing rules to clarify that sustainability-related claims must be

clear, fair and not misleading.

The FCA has been mindful of other international requirements in pulling together its proposals, and Annex 1 of the document contains a mapping exercise against current SEC and EU SFDR requirements.

EU Publishes Final Text of ELTIF Regime

By Michael Newell
Partner | Financial Services

The EU has published its final text for the proposed revision of the European Long-Term Investment Fund ("ELTIF") regime by means of the European Long-Term Investment Funds Regulation.

The ELTIF regime was originally introduced in 2015 to create a product allowing retail access to alternative investment classes including private credit, private equity and infrastructure but has seen only a modest number of launches as a result of several restrictive features of the regime (such as prohibitions on co-investments that did not allow asset managers to include ELTIFs in their private market product lines). It is hoped that the updating of the ELTIF framework will lead to a significant increase of investment into the EU economy at a time when traditional sources of financing are becoming more challenging for businesses to access.

The agreement will significantly upgrade the ELTIF product by:

- Splitting up retail and professional ELTIFs to cater to these investor bases that have different regulatory requirements and allow institutional-only products.
- Simplifying access to ELTIFs by retail investors while maintaining strong diversification suitability and disclosure protections.
- Introducing greater flexibility regarding eligible assets for the ELTIF by expanding the universe to an increased range of corporate and real estate investments.
- Introducing a framework for master-feeder ELTIFs and fund-of-funds structures.
- Allowing ELTIFs to use prudent levels of borrowing to expand their investment potential.
- Allowing ELTIFs to co-invest with other funds and/or accounts managed by the same investment manager.

Central Banks Should Consider Climate and Biodiversity Shocks When Stress Testing Financial Institutions

By **Jason M. Halper**
Partner | Global Litigation

Sylvie Goulard, Deputy Governor of the Banque de France, the French central bank, stated in a speech on October 24 that central banks need to take more aggressive action regarding nature-related risk. She posited that "monetary assessments of ecosystem services have many limitations," in part because of their complexity and also because "shocks" in one sector can have significant impacts on other sectors. As a result, she proposed that "the best risk mitigation strategy is to do everything in our power, early enough, to ensure that we remain within planetary boundaries." She proposed that central banks incorporate climate and biodiversity impacts into their decision-making as an aspect of their "non-monetary portfolios;" integrating nature-related concerns into central banks' monetary operations, as the European Central Bank has begun to do for climate change, and implement nature-related stress testing exercises that address both climate and biodiversity shocks for banks and financial institutions to improve global financial stability.

Goulard concluded her speech by stating: "The task ahead looks like an uphill battle: academic economic departments, policy makers, central bankers and supervisors remain far behind the curve when it comes to acknowledging that our socioeconomic systems need to operate a radical transformation. We know that those who dare to question the status quo face strong pushback or even reputational risks for their careers. They may be considered 'activists' or 'dreamers.' However, we have no choice but to restore nature as much as possible, as quickly as possible and finance can play a role in this task. The magnitude of the change required makes it difficult but also promising. No generation on earth for the past 12,000 years had such a responsibility to keep the world alive."

Taking the Temperature: Just as BlackRock's CEO has stated that "climate risk is investment risk," Goulard appears to be saying that nature risk is financial stability risk. What is more, she opines that governments and companies will be hard-pressed to understand the full range of impacts resulting from climate-related biodiversity change. That, in turn, threatens the stability of global financial systems and the companies that operate within those systems. Financial regulators around the world, including in the United States, have weighed in on climate-related issues confronting financial institutions, but less so specifically regarding biodiversity. For instance, the Federal Reserve Board recently announced that six of the largest U.S. banks "will participate in a pilot climate scenario analysis exercise designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks" (and that there would be no "capital or supervisory implications from the pilot"). We expect regulators increasingly to focus on nature-related climate change impacts as another aspect of risk to financial stability resulting from global warming.

(This article originally appeared in "Cadwalader Climate," a new twice-weekly newsletter on the ESG market.)

A Big Thank You

A big "thank you" to the more than 500 industry leaders who participated at last week's 2022 Cadwalader Finance Forum in Charlotte. And a special acknowledgment to the nearly 50 speakers – both industry experts and Cadwalader attorneys – whose perspectives made the Forum so valuable for all attendees. See our full list of speakers here.