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Coming Down the Homestretch

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In This Issue ...

The December sprint to year-end has begun.

Most of the talk these days is on closing out '22 on a positive note, especially with some promising economic signs, and heading into '23 with confidence.

The "living wills" reports from the FRB and the FDIC will certainly help, as the eight G-SIBs came through the regulatory exercise generally unscathed. On the other hand, continued uncertainty around crypto assets will likely be a big theme in the months to come.

Speaking of '23, the new year marks the beginning of the end for LIBOR, but there's still much to come before June 30 when LIBOR goes away for good. My colleague Lary Stromfeld, who has been advising the Federal Reserve Board's Alternative Reference Rates Committee (ARRC) and a number of major financial institutions, provides an important LIBOR update in this week's issue. Lary will have much more to say on LIBOR in the coming weeks, so stay tuned.

Hope you find this week's issue helpful.

Daniel Meade
Editor, *Cabinet News and Views*

Rule 15c2-11 Update: The SEC Provides Temporary Relief for Fixed Income Rule 144A Securities Until January 4, 2025

By **Michael S. Gambro**
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The SEC's Division of Trading and Markets issued a new no-action letter yesterday that removes the requirement that Rule 144A information be made publicly available prior to a broker-dealer publishing a quotation or submitting a quotation for publication on a fixed income Rule 144A security.

The new no-action letter completely replaces the December 16, 2021 no-action letter that would have phased in the application of Rule 15c2-11 for fixed income securities, including the requirement, that would have commenced on January 4, 2023, for brokers and dealers to determine that Rule 144A information is publicly available prior to publishing a quotation or submitting a quotation for publication on a fixed income Rule 144A security. The new no-action letter also eliminates the requirement, that would have commenced on January 5, 2024, for there to be a direct website link, on the quotation medium on which the quote is being made, to the Rule 144A information about the fixed income security.

The new no-action letter requires that the broker or dealer have a reasonable belief that the issuer will provide the Rule 144A information prior to a Rule 144A transaction, upon request, which effectively aligns the application of Rule 15c2-11 to brokers and dealers with the requirements of Rule 144A.

Finally, the new no-action letter continues to state that, for purposes of the letter, the SEC would consider the Information Requirement discussed in Section II.D of the Rule 144A Adopting Release, Release No. 33-6862 (April 30, 1990), to be consistent with Rule 15c2-11.

Notwithstanding the advocacy of various trade associations and others, the new no-action letter expressly states, without further explanation or rationale, that the relief provided by the letter is temporary and will expire on January 4, 2025. There will accordingly be a need to revisit with the SEC and its staff the issues that compliance with Rule 15c2-11 would raise for Rule 144A fixed income securities.

Finally, the no-action letter states that the SEC staff will not recommend enforcement action for quotations on fixed income securities that are foreign sovereign debt or debt securities guaranteed by a foreign government. This part of the no-action letter does not appear to be subject to expiration on January 4, 2025.

Here is a hyperlink to the new 15c2-11 no-action letter.

FRB and FDIC Provide Resolution Plan Feedback to Eight U.S. G-SIBs

By **Daniel Meade**
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Last week, the Federal Reserve Board ("FRB") and the Federal Deposit Insurance Corporation ("FDIC") released their feedback to the eight global systemically important banking institutions ("G-SIBs") headquartered in the United States on their resolution plans, more commonly called living wills. The eight U.S. G-SIBs are Bank of America Corporation ("BofA"), Bank of New York Mellon Corporation ("BNYMellon"), Citigroup Inc. ("Citi"), The Goldman Sachs Group ("GS"), JPMorgan Chase & Co. ("JPMC"), Morgan Stanley ("MS"), State Street Corporation ("State Street"), and Wells Fargo & Company ("Wells Fargo").

None of the eight institutions' resolution plans were found to be "not credible." In other words, all eight institutions "passed" their 2021 targeted resolution plans. Additionally, the six institutions that were found to have shortcomings in their 2019 plans (BofA, BNYMellon, Citi, MS, State Street, and Wells Fargo) related to their ability to produce reliable data in stressed conditions were deemed to have adequately addressed those shortcomings in their 2021 resolution plans. However, the FRB and the FDIC found that one institution, Citi, had a shortcoming related to data quality that was the subject of consent orders with the FRB and the OCC in 2020. As the FRB and the FDIC explained in their press releases, "a shortcoming is a weakness that raises questions about the feasibility of the plan ... but is not as severe as a deficiency."

If there is a theme in this year's feedback, it is data integrity. Going forward, the FRB and the FDIC noted in all eight feedback letters that they would expect ongoing improvements to "governance mechanisms, liquidity, and capital" including "liquidity resolution capabilities to reflect further actual stress conditions." All eight feedback letters paid particular attention to each institution's resolution liquidity execution need ("RLEN"), and the data needed to integrate RLEN needs with general liquidity risk management. The FRB and the FDIC noted that "the Agencies are considering conducting focused evaluations during the review of the [institutions'] 2023 Full Plan of whether the firm's reliability of data, data accuracy, and BAU data capabilities are adequate to support its resolutions strategies and plans and ... the firm's policies and expected practices for moving liquidity at various points along the stress continuum."

Senator Wyden Seeks Information from Crypto Exchanges Regarding Their Financial Stability and Customer Protections in the Event of Bankruptcy

By **Rachel Rodman**
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On November 29, U.S. Senator Ron Wyden (D-OR), Chairman of the Senate Finance Committee, sent requests for information to the CEOs of six of the largest crypto exchanges. The requests seek information about the safeguards each exchange has put in place to protect customers' assets in the event they file for bankruptcy or otherwise experience financial distress.

Chairman Wyden's inquiry comes on the heels of bankruptcy filings by FTX, one of the largest crypto exchanges, and several other crypto platforms. His requests note that FTX's bankruptcy, in particular, has reportedly left close to one million customers facing significant losses of their assets.

Media reports have also suggested that insufficient controls may have caused or contributed to FTX's collapse. To that end, Chairman Wyden is seeking information from the exchanges about their implementation of safeguards designed to protect customer assets, including, but not limited to:

- Segregation of customer assets from institutional assets;
- Restrictions on the use of customer assets for purposes other than those specifically disclosed to customers;
- Controls designed to ensure adequate liquidity in the event of increased customer withdrawals;
- Policies and procedures designed to prevent potential market manipulation, including wash trades;
- Policies and procedures designed to prevent the misappropriation of customer data by officers, employees and affiliated entities engaged in institutional or personal trading; and
- Support for industry initiatives and/or legislation to create protections for customers, such as an industry-funded insurance fund.

Chairman Wyden is also seeking information from the exchanges about their financial condition, including their current balance sheets and audited financials, as well as information about any insurance policies carried by the exchanges that could benefit customers in the event of bankruptcy, theft or hack.

Chairman Wyden has previously expressed concern that strict regulation of crypto assets could unnecessarily hamper innovation. His inquiry suggests that Members

of Congress who previously supported lighter regulation for crypto assets may be spurred into action by recent events.

FCA Seeks Feedback on 'Synthetic' USD LIBOR

By Lary Stromfeld
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On November 23, the UK's Financial Conduct Authority ("FCA") released its further consultation to require the administrator of LIBOR to publish a synthetic version of 1-, 3-, and 6-month U.S. dollar LIBOR settings for a temporary period until end-September 2024. Overnight and 12-month USD LIBOR settings will cease permanently at end-June 2023.

The FCA seeks views on its proposal to base synthetic USD LIBOR on CME's Term SOFR rate plus the fixed ISDA spread for the corresponding LIBOR setting. The FCA emphasized that the synthetic rate would not be "representative" of market conditions that the original LIBOR settings were intended to measure.

The FCA also made clear that its primary purpose in requiring the publication of synthetic USD LIBOR is to facilitate an orderly transition of legacy contracts that are governed by UK or other non-U.S. law and that have no realistic prospect of being amended by the time LIBOR is no longer published in its current form at end-June 2023.

The consultation includes an extensive discussion of the potential interaction between synthetic USD LIBOR and the U.S. Adjustable Interest Rate (LIBOR) Act. The FCA noted that the LIBOR Act covers legacy USD LIBOR contracts governed by U.S. law that contain no, or unworkable, fallbacks. On the other hand, it noted that contracts that have workable non-LIBOR fallbacks (such as the Prime Rate) are generally not covered by the LIBOR Act. Some contracts in this latter category (such as cash products and derivatives that adopted the fallback language published by the ARRC and ISDA, respectively) may trigger their non-LIBOR fallback rate when LIBOR is no longer *representative*. Synthetic USD LIBOR will not be representative. However, other contracts may fall back only when LIBOR is no longer *available* or *published*, in which case they might use a synthetic USD LIBOR setting for as long as it is published (and then fall back to their non-LIBOR rate), subject to interpretation of the contract language.

Essentially acknowledging that its jurisdiction is limited to "supervised entities" and contracts within the scope of the UK Benchmark Regulation, the FCA chose not to place restrictions on other entities' use of synthetic LIBOR in contracts governed by U.S. law. In short, it is up to these contract parties to determine whether they are permitted to use a non-representative synthetic USD LIBOR rate that continues to be published after June 30, 2023.

Ultimately, the economic differences between a contract that uses synthetic USD LIBOR and a contract that is subject to the LIBOR Act should be mitigated by the fact that both are expected to be based on the CME Term SOFR plus the fixed ISDA spread adjustment. This result is driven by regulators' desire to aim for "international consistency." The SOFR-based rates applicable under the LIBOR Act

will be determined by final rules expected to be published by the Federal Reserve shortly.

The deadline for feedback on the FCA consultation is January 6, 2023. The FCA's final decision is expected to be announced in late Q1/early Q2 2023.

EU Consultation on ESG Fund Names and SFDR Q&As

By **Michael Newell**
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On 18 November, the European Securities and Markets Authority ("ESMA") published a consultation paper containing draft guidelines on funds' names using ESG or sustainability-related terms. The deadline for comments on the consultation paper is 20 February 2023. This consultation follows the consultation issued on 15 November by the joint European supervisory authorities (including ESMA) in relation to greenwashing (see our news item in the 23 November issue of *Cabinet News and Views*), and is seen as part of this initiative.

ESMA is proposing to publish guidelines (a draft of which is attached to the consultation paper) in relation to appropriate names for investment funds marketed to EEA investors (note that this does not just apply to EEA-domiciled funds) in an ESG or sustainable-investment related context. ESMA notes that investors are increasingly attracted to such strategies and wishes to ensure that investment funds that purport to have such characteristics in their name do indeed meet EU regulatory and disclosure standards relating to ESG and sustainability.

In this context, ESMA notes that the name of the investment fund is usually the first thing a potential investor sees and, notwithstanding the expectation that investors should look beyond the name and do their due diligence on the product, the name can still have a significant impact on their investment decision.

These guidelines are intended to complement ESMA's previous, principles-based guidance on fund names with ESG and sustainability-related terms that were set out in a supervisory briefing on the sustainability risks and disclosures in the area of investment management on May 31, 2022 (ESMA34-45-1427). The draft guidelines propose quantitative thresholds and other criteria relating to particular terminology relating to ESG and sustainability, including terms derived from "ESG" and "sustainability" (*e.g.*, "climate change" or "biodiversity"), "impact investing" or "transition." The proposals being consulted on include questions of quantitative thresholds, such as having minimum investment percentages for particular types of investment and whether or not benchmarks or synthetic replication should be treated in the same manner as other funds.

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Meanwhile, on 17 November, the European commission published a set of detailed Q&As in relation to the delegated regulation made under the sustainable finance disclosure regulation ("SFDR")(EU2019/2088). This Q&A covers topics including how to calculate the current values or investments in portfolios for the purposes of principal adverse indicator ("PAI") and taxonomy-aligned disclosures. There are also more specific Q&A in relation to PAI disclosures and taxonomy-aligned investment disclosures, as well as Q&A relating to specific financial products and multi option products.