

2024 Derivatives Year in Preview

February 22, 2024

As we move deeper into 2024, we see many potential regulatory and market developments on the horizon that may have a significant effect on participants in the derivatives market. This **Sidley Update** enumerates some of those potential developments, the key trends we think will influence the derivatives market in 2024 and their potential impact on market participants.

Part 1 — Regulatory Trends

Securities and Exchange Commission (SEC) Rulemakings

Shortened 13D/G filing deadlines

Type of Action	Key Dates	Affected Clients	Projected Effect
Amendment to Rule	February 5, 2024 (effective date for Schedule 13D rule changes)	13D and 13G filers	Shortened filing deadlines
	September 30, 2024 (effective date for Schedule 13G rule changes)		Increased frequency of amendment filing obligation

The SEC has adopted shortened filing deadlines for Schedule 13D and 13G, which take effect in 2024. Specifically, effective February 5, 2024, the initial Schedule 13D filing deadline was shortened to five business days (compared with 10 calendar days) and amendments to Schedule 13D are due within two business days (replacing the vague “prompt” deadline). Effective September 30, 2024, the new Schedule 13G deadlines take effect, including, among other things, reducing 10 calendar day deadlines to five, replacing “prompt” deadlines with deadlines of two business days, and increasing the annual amendment filing obligation to a quarterly obligation.

Sidley Insight news update: <https://www.sidley.com/en/insights/newsupdates/2023/10/sec-shortens-filing-deadlines-for-schedules-13d-g>.

Rule 13f-2

Type of Action	Key Dates	Affected Firms	Projected Effect
Final Rule	January 2, 2025 (compliance date)	Institutional Investment Managers	Extensive reporting requirements
	April 2025 (SEC to publish short sale information)		Requirement to monitor short sale activity and perform onerous calculations to determine net trading activity

The SEC has adopted Rule 13f-2, which requires institutional investment managers¹ to report extensive information on certain “large” short positions and short sale activity within 14 calendar days after each calendar month. Institutional investment managers will need to monitor daily their short sale activity in equity securities to calculate whether their “gross short position” exceeds certain thresholds and will be required to perform onerous calculations to determine, and report, the “net” trading activity for each equity security in which the gross short position exceeds the applicable threshold. The compliance date for Rule 13f-2 and Form SHO is January 2, 2025, and the SEC will begin publishing aggregated short sale information in April 2025.

Sidley Insight news update: <https://www.sidley.com/en/insights/newsupdates/2023/10/get-shorty-the-sequel-sec-implements-new-disclosure-of-short-positions>.

Treasury Clearing Rules

Type of Action	Key Dates	Affected Clients	Projected Effect
Final Rule	December 13, 2023 (adopted)	Participants in the market for repos on U.S. Treasury securities (USTs)	Will require virtually all market participants to submit repurchase and reverse repurchase transactions in USTs for central clearing
	March 31, 2025 (Compliance Date Package 1)		
	June 30, 2026 (Compliance Date Package 2)		

The SEC has adopted a final rule that will require central clearing of most repurchase and reverse repurchase transactions involving USTs. Since the Government Securities Division of Fixed Income Clearing Corporation (FICC) is the only clearing agency that centrally clears UST transactions today, the final rule requires FICC to adopt written policies and procedures reasonably designed to require direct participants to submit all “eligible secondary market transactions” in USTs. The final rule also amends FICC’s margining requirements by requiring it to calculate, collect, and hold margin separately for proprietary UST positions of its direct participant members and customers of these direct participants.

Many of the details related to implementation will be made clear as FICC prepares and presents its proposals to accommodate the final rule. Some of the issues we are watching here: (i) whether

¹ The term “institutional investment manager” is defined in Section 13(f)(6)(A) of the Exchange Act (15 USC § 78m(f)(6)(A)) to include “any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person.” The SEC noted this typically can include broker-dealers, investment advisers, banks, insurance companies, pension funds, and corporations.

implementation will require clients who currently clear USTs to repaper their existing documentation and (ii) the impact, if any, this may have on customer counterparty risk to both the clearinghouse and its sponsoring member, particularly as it relates to “fellow customer risk.”

Sidley Insight news update: <https://www.sidley.com/en/insights/newsupdates/2023/12/us-sec-adopts-rules-requiring-central-clearing-in-the-us-treasury-market>.

Commodity Futures Trading Commission (CFTC) Rulemakings

Disclosure and investor qualification

Type of Action	Key Dates	Affected Firms	Projected Impact
Proposed Rule	December 11, 2023 (comment period ended)	CPOs and CTAs relying on 4.7 compliance exemption	Increased disclosure, reporting, and recordkeeping requirements
	TBD whether and when CFTC issues final rule		Increased thresholds for investors to qualify as QEPs

The CFTC has proposed amendments to Regulation 4.7 that, if adopted, would create substantial new disclosure, reporting, and recordkeeping obligations for commodity pool operators (CPOs) and commodity trading advisors (CTA) relying on the Regulation 4.7 compliance exemptions and increase the monetary thresholds that individual investors would need to satisfy to qualify as “qualified eligible persons” (QEPs).

A substantial number of institutional investment managers currently rely on Regulation 4.7, which provides CPOs and CTAs that meet certain conditions an exemption from many disclosure, reporting, and recordkeeping requirements otherwise applicable to such firms. All participants in commodity pools operated under Regulation 4.7 must be QEPs, and all managed account clients of CTAs relying on Regulation 4.7 must be QEPs. Given the nature of the investor base for institutional investment managers, the proposed changes to the QEP monetary thresholds would have a limited impact.

A number of industry groups submitted comments, largely supporting the proposed changes in the QEP thresholds but opposing the proposed new disclosure and other compliance obligations. Notably, the National Futures Association (NFA), the self-regulatory organization that conducts day-to-day oversight of registered CPOs and CTAs, submitted comments opposing both the proposed QEP changes and the proposed disclosure, reporting, and recordkeeping requirements. NFA’s opposition makes it less likely that the CFTC will adopt the proposal in 2024.

Sidley Insight news update: <https://www.sidley.com/en/insights/newsupdates/2023/10/cftc-proposes-first-major-changes-to-rule-4-point-7-in-over-30-years>.

Swap Dealer (SD) and Futures Commission Merchant (FCM) Compliance

Type of Action	Key Dates	Affected Firms	Projected Effect
Proposed Rule	February 13, 2024 (comment period ended).	SDs and major swap participants (MSPs)	Simplified process for swap dealers to meet financial reporting requirements and related calculations

The CFTC is proposing to (i) amend the capital and financial reporting requirements for FCMs, SDs, and MSPs and (ii) codify certain staff no-action letters related to capital calculations under the tangible net worth

capital approach and alternative financial reporting for bank SDs. According to the CFTC, the proposed amendments are intended to make it easier for SDs to comply with certain CFTC compliance requirements. The CFTC may adopt a version of the proposal later in 2024.

Type of Action	Key Dates	Affected Firms	Projected Effect
Proposed Rule	January 17, 2024 (comment period ended)	FCMs and clearinghouses	Holding funds at FCMs could lead to potential credit risk
		Customers of FCMs (indirect)	

The CFTC proposed to revamp substantially a number of its rules regarding the investment of customer funds by FCMs and clearinghouses, FCM capital charges related to such investments, and related regulations. To the extent the CFTC adopts portions of the proposed rule changes, market participants will need to carefully consider how the changes may affect their credit risks associated with holding funds at their FCMs.

Carbon Markets

Type of Action	Key Dates	Affected Firms	Projected Effect
Proposed Guidance	December 4, 2023 (Proposed Guidance approved)	CFTC-regulated designated contract markets (DCMs)	Will establish standards for listing and trading of voluntary carbon credit derivatives products
	February 16, 2024 (comment period ended)		

The CFTC approved proposed guidance and requested public comment regarding the listing for trading of voluntary carbon credit derivative contracts. The guidance sets out factors that CFTC-regulated designated contract markets should analyze in connection with product design and listing, with the goal of helping to advance the standardization of such products in a manner that promotes transparency and liquidity. This proposed guidance and request for comment follow the CFTC's information gathering process on the voluntary carbon market that included two public meetings and a request for information "to better inform the Commission on how, consistent with its statutory authority, to address climate related financial risk as pertinent to the derivatives markets and underlying commodities markets."

Regulation of exchanges and clearing organizations

Type of Action	Key Dates	Affected Firms	Projected Impact
Proposed Rule	February 16, 2024 (comment period ended)	Exchanges, clearing organizations	Burdensome daily reconciliations of customer and clearinghouse funds
		FCMs and their customers (indirect)	Potentially improved risk to a clearinghouse or exchange in a liquidity crisis

The CFTC is proposing to require clearinghouses to conduct daily calculation and reconciliation of customer and clearing member funds against the amounts actually held by the clearinghouse. Such reconciliations could be onerous for clearinghouses. It is not clear whether the CFTC will adopt the requirements as proposed, but if it does, the new regulations may affect clearing organizations in 2024 and beyond.

Other Regulatory Issues to Watch

European Market Infrastructures Regulation (EMIR) Refit Reporting Changes

Type of Action	Key Dates	Affected Firms	Projected Impact
Amendment to Regulation	April 29, 2024 (EU implementation date)	Counterparties established in the UK/EU that report under EMIR (direct)	New EMIR reporting requirements
	September 30, 2024 (UK implementation date)	Non-UK/EU counterparties that trade with reporting counterparties (indirect)	Requirement to update existing reports for outstanding derivatives trades
	October 26, 2024 (EU deadline to update existing reports)		Non-UK/EU counterparties may need to provide additional data to reporting counterparties
	March 31, 2025 (UK deadline to update existing reports)		

EMIR is an EU regulation designed to provide transparency and reduce risk in the over-the-counter derivatives market. EMIR was amended by EMIR Refit following a review in 2019. EMIR applies directly to counterparties established in the EU (EU EMIR) and, following Brexit, to counterparties established in the UK, having been onshored into UK legislation in 2021 (UK EMIR). In 2024, reporting changes mandated under EMIR Refit are coming into force.

EU and UK reporting entities will need to ensure that all reporting of derivatives trades complies with the new EMIR Refit requirements. Reporting entities will also be obligated to update reports for outstanding derivatives trades to comply with the new requirements within six months of the relevant implementation date. As with EMIR in its current form, EMIR Refit will not impose direct reporting obligations on non-UK or non-EU entities.

The new rules may require modifications to reporting systems and new internal procedures. For example, under the new EMIR Refit requirements, reporting counterparties must

- i. submit reports using a standardised XML template
- ii. notify regulatory authorities of reporting issues, errors, and omissions
- iii. use Unique Product Identifier codes to report certain derivatives trades

The EMIR Refit reporting requirements are different under EU EMIR and UK EMIR, so counterparties with dual obligations will need to understand two sets of rules. Some of the key differences between the rules are set out below.

	EU EMIR	UK EMIR
Increase in Number of Reportable Fields	From 129 to 203	From 129 to 204
Misreporting Notification Obligation	The EU obligation, applying European Securities and Markets Authority (ESMA) guidelines, is metric-based. Counterparties must notify NCAs of (i) misreporting caused by flaws, (ii) any reporting obstacles, and (iii) any significant issue resulting in reporting errors.	The UK obligation is less prescriptive. Counterparties must notify the Financial Conduct Authority (FCA) of any material errors or omissions in reporting.
Source of Guidance	ESMA Final Report	FCA Policy Statement

Sidley Insight news update: <https://www.sidley.com/en/insights/newsupdates/2024/02/2024-european-market-infrastructure-regulation-refit>.

Part 2 — Market and Transactional Trends

Regulatory Developments in the Crypto Markets and a Potential Crypto Thaw?

After a flurry of investment and transactional interest in digital assets during 2021-summer of 2022, we began a period many in the industry have described as a “crypto winter.” In recent months we have seen a number of significant regulatory developments that may spur new activity and product development in the digital assets markets. An overview of some of these regulatory developments and their potential market impacts are discussed briefly below.

Approval of Bitcoin ETPs. The SEC has now approved a number of exchange-traded products (ETPs) that obtain underlying exposure by investing in the spot bitcoin market. With such approvals, it is likely that a larger market will develop for derivatives referencing the ETPs. For example, market participants may find it useful to trade options on shares of the ETPs (proposals to list and trade such products have already been filed with the SEC). An option on a share of an ETP is generally viewed as being a securities option, regulated by the SEC, because the ETP share is itself a security. However, the CFTC has in the past issued exemptive relief to provide comfort that it would not assert jurisdiction over options on shares of commodity-based ETPs, where the ETPs obtain their exposure via investments in the cash/spot market, as opposed to the derivatives markets. It is not clear whether the CFTC will propose similar relief in 2024 with respect to derivatives on ETPs that obtain exposure to bitcoin through investments in the spot/cash markets.

Extension of Customer Protections to Nonintermediated Markets. The CFTC is proposing to extend certain protections that currently apply only to customer funds deposited with an FCM to persons who access exchanges without going through an FCM, for example in cryptocurrency derivatives markets that are nonintermediated. The comprehensive regime under the Commodity Exchange Act (CEA) and the regulations of the CFTC that protect customer funds, including through segregation requirements, currently applies only to funds deposited by a customer with an FCM. CFTC-regulated markets have traditionally required an FCM to stand between customers and the clearinghouses for the exchanges.

However, there are now several disintermediated markets in which market participants can trade on the exchanges and access the clearinghouses directly. Although this may not be widely appreciated by market participants, persons who trade in this manner are not “customers” and do not receive all of the protections that would be afforded to them if they were customers. The CFTC’s proposal would extend most of the customer protections, including segregation requirements, to these market participants. This would represent a substantial change in market structure for CFTC-regulated markets.

CFTC Digital Asset Enforcement. Nearly half of the CFTC’s enforcement actions in FY 2023 involved conduct related to digital assets.² Although CFTC Chair Rostin Behnam later called the statistic “alarming [...] for an agency that does not have authority over this cash digital asset market,”³ indications are that CFTC will continue to police digital asset markets. The CFTC closed 2023 by settling charges against the world’s largest digital asset exchange and its founder for various violations of the CEA.⁴ Speaking at a press conference alongside Attorney General Merrick Garland and Treasury Secretary Janet Yellen regarding the settlement, Chair Behnam stated that the action “solidifies the CFTC’s reputation as the proven leader in the civil enforcement space when it comes to digital assets.”⁵

Looking ahead, decentralized finance (DeFi) products and services may be subject to increasing scrutiny by the CFTC. In September of 2023, the CFTC announced settled enforcement orders against

² CFTC Release No. 8822-23, CFTC Releases FY 2023 Enforcement Results (Nov. 7, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8822-23>.

³ The Block, CFTC Chair Rostin Behnam says Congress needs to play a more pivotal role in how agencies regulate crypto (Nov. 8, 2023), <https://www.theblock.co/post/262219/cftc-chair-rostin-behnam-says-congress-needs-to-play-a-more-pivotal-role-in-how-agencies-regulate-crypto>.

⁴ *CFTC v. Zhao et al.*, No. 1:23-cv-01887 (N.D. Ill. Dec. 14, 2023).

⁵ CFTC Chair Rostin Behnam, Statement of Chairman Rostin Behnam Regarding Binance and its Founder (Nov. 21, 2023), <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement11213>.

developers of three DeFi trading protocols for illegally operating without CFTC registration,⁶ and earlier this year the CFTC's Digital Assets and Blockchain Technology Subcommittee released a report "intended to help inform ongoing policy debates in the U.S. Congress, state legislatures, and regulators including the CFTC," examining both risks and benefits of DeFi technology.⁷

Private Credit Markets and Derivatives Transactions

Private credit is an investment strategy that has grown in recent years. We also see growing interest in certain derivatives instruments by private credit fund managers. Most frequently, we see credit managers using interest rate hedges, foreign currency hedges, and total return swaps on debt instruments. Some of the key issues for private credit fund managers to consider when entering into these transactions:

- i. *The central clearing mandate.* In the United States, most interest rate swaps are subject to the clearing mandate. This means that a private fund that wishes to enter into interest rate hedge transactions will probably not be able to use any existing International Swaps and Derivatives Association Master Agreements for these trades. Since private funds are not eligible for the regulatory "end user exception" from the clearing mandate, in all likelihood they will need to enter into a futures customer agreement and related annex to transact in cleared interest rate swap transactions.
- ii. *Meeting collateral requirements.* It is market practice (and in many cases a legal requirement) that a private fund post variation margin daily to its swap counterparties. Funds that originate loans may not have the liquidity required to meet these daily margin requirements. Private funds can address this issue in a number of ways, including by limiting trading to FX transactions that do not require daily posting of variation margin.

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⁶ CFTC Release No. 8774-23, CFTC Issues Orders Against Operators of Three DeFi Protocols for Offering Illegal Digital Asset Derivatives Trading (Sept. 7, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8774-23>.

⁷ CFTC Commissioner Christy Goldsmith Romero, Statement of Commissioner Christy Goldsmith Romero on CFTC's Digital Assets and Blockchain Technology Subcommittee Release of Decentralized Finance Report (Jan. 8, 2024), <https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement010824b>.

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