

Meeting Minutes

Federal Reserve Bank of New York

33 Liberty Street

13th Floor

Thursday, April 4, 2019

8:30 a.m. – 10:00 a.m.

Present: Syed Riaz Ali, James Brown, David Buchalter, Martha Burke, Chinedu Ezetah (by phone), Terence Filewych, Jill Hurwitz, Glade Jacobsen, Robert Klein, Matthew Lillvis, Nancy Rigby, Jeffrey Saxon, Lisa Shemie, David Trapani, Frank Weigand, and Bryan Woodard

Federal Reserve Bank of New York (“FRBNY”) participants: Christina Getz, Michael Nelson, Thomas Noone, Janine Tramontana, Shawei Wang

Other participants: Victoria Cumings (Global Financial Markets Association (“GFMA”), by phone), David Felsenthal (Clifford Chance), Leslie Payton Jacobs (Emerging Markets Traders Association (“EMTA”), by phone), Benjamin Peacock (Clifford Chance), Yousuf Siddiqui (JPMorgan Chase, by phone), Greg Todd (Bank of America, by phone), Alex van Voorhees (Bank of America, by phone), Stephen Winer (JPMorgan Chase, by phone)

FX prosecutions update

FMLG Chair Michael Nelson introduced David Felsenthal and Benjamin Peacock from the law firm Clifford Chance. They continued discussions from prior meetings about *United States v. Johnson* and *United States v. Bogucki*. Mr. Felsenthal and Mr. Peacock identified several facts that distinguish the two cases. They highlighted, for example, counterparty testimony in *Bogucki* about market expectations of dishonest conduct, which led parties not to trust one another. The District Court concluded on the basis of this testimony that the misrepresentations of one party to another in an “arm’s length” transaction could not have been material. Mr. Felsenthal and Mr. Peacock also noted the importance of the confidentiality agreement in *Johnson*, which the government relied on to support a misappropriation theory of wire fraud. The jury in that case may have concluded that the agreement established a fiduciary-like relationship, notwithstanding a standard “arm’s length” provision in the governing master agreement published by the International Swap Dealers Association (“ISDA”). Mr. Peacock also

addressed other potential applications of the Federal wire fraud statute, 18 U.S.C. § 1343, to foreign exchange transactions, including the misappropriation of information in violation of a duty of confidence owed by an employee to an employer, as in *Carpenter v. United States*, a landmark insider trading case.

Members asked questions about a variety of issues, including the potential use of the Commodity Futures Trading Commission’s (“CFTC”) anti-fraud regulation, 17 C.F.R. § 23.410, in enforcement actions and criminal prosecutions; potential criminal liability for wire fraud resulting from statements in pitch materials, such as advertising “best execution;” and the evidence that might be required to distinguish an unlawful intent to manipulate a price from a legitimate trade may collaterally affect a price. Members also discussed the role of the FX Global Code as a deterrent to misconduct.

Fintech initiatives

Syed Ali introduced two colleagues from JPMorgan Chase—Yousuf Siddiqui and Stephen Winer—who discussed their firm’s recent public announcement regarding JPM Coin. The presentation included an overview of public and private applications of block chain technology and digital tokens, and a high-level summary of the development and potential applications of JPM Coin.

Members discussed the benefits of block chain technology from a business perspective, including greater efficiency for settlement and other back office operations, and the legal questions that could attend the internal application of block chain technology, including record keeping requirements. Members also discussed the different ways that regulators have treated tokenized assets and liabilities under their respective rules.

Recent volatility in the Turkish Lira

Victoria Cumings from GFMA and Leslie Payton Jacobs from EMTA joined the meeting by phone to discuss lessons learned from recent volatility in the Turkish Lira, focusing on operational challenges in liquidity crunches and settlement fails. As of the meeting, they did not foresee any risks to other currencies resulting from the Lira’s unusual volatility because its causes were specific to Turkey’s domestic politics and economy.

Manufactured defaults and ISDA definitions

Glade Jacobsen reported that ISDA had amended its credit derivatives definitions to address “narrowly tailored credit events,” which also go by the name “manufactured defaults.” Mr. Jacobsen reviewed the facts of a high-profile controversy involving Hovnanian Enterprises

and the Blackstone Group, in which a loan to the former carried a condition of defaulting on a pre-existing debt, which benefitted the latter through credit default swaps (“CDS”). The transaction drew criticism from the CFTC and many market participants because the default was not a result of financial distress, and therefore went against an industry norm governing the legitimate use of CDS. ISDA’s new definitions make clear that a failure to pay must result from a deterioration of the creditworthiness or financial condition of the referenced entity. ISDA expects to publish additional guidance in the future.

Members discussed what future work on manufactured defaults might entail, and the degree of subjectivity that would be acceptable in determining the cause of a payment default.

Australian consultation on enforcing industry codes

Nancy Rigby briefed members on proposal from Australia’s Treasury to implement a recommendation from the Royal Commission that certain provisions of financial sector industry codes be made enforceable by the Australian Securities and Investments Commission. The Royal Commission’s recommendation appeared in a February 2019 report entitled “Restoring Trust in Australia’s Financial System.”

According to the Treasury’s proposal, the regulator would treat a breach of an applicable code provision as if it were a violation of law. The proposal set out criteria for identifying which industry codes, and which provisions of those codes, should be treated as enforceable promises. The criteria would not cover the FX Global Code. Instead, they focus on industry codes exclusive to Australia’s financial sector.

Members discussed how the change in enforceability would affect internal compliance and audit functions, how other regulators might treat industry codes within existing regulatory frameworks, and how the creation of third-party rights may affect the willingness of market participants to adopt industry codes.

ISDA novation protocol update

FMLG Treasurer Martha Burke gave an update on work of the GFMA’s Global Foreign Exchange Division on ISDA’s novation protocol, including a debate about continuing with the requirement that each fund adhere to the protocol, rather than a higher-level corporate entity.

CFTC external business conduct obligations

Lisa Shemie reported that the CFTC had granted the “no action” relief that the FMLG requested in a recent letter regarding the applicability of an exception to a disclosure rule for

certain offsetting transactions that mirror transactions occurring on a swap execution facility, particularly in the context of foreign exchange prime brokerage. The CFTC’s “no action” letter is available on its public website.

Quadrilateral update

FMLG Secretary Thomas Noone asked members to finalize their proposals for presentations at the upcoming Quadrilateral meeting and to confirm their attendance.

Administrative matters

Ms. Burke gave a brief update on the group’s finances.

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