SPEECHES & TESTIMONY

Opening Statement of Chairman J. Christopher Giancarlo before the Energy and Environmental Markets Advisory Committee

April 17, 2019

A warm welcome to all of the EEMAC members, presenters and participants, both here and on the telephone. It is good to have you all with us.

As a former Chair of EEMAC, I am particularly pleased to see the important work of this committee continuing under the very capable hands of Commissioner Berkovitz.

In my brief remarks today, I want to focus on two issues.

Supplementary Leverage Ratio

The first is the Supplementary Leverage Ratio ("SLR").

The SLR is a global capital requirement for banks. It is size-based rather than risk-based and is designed to restrain bank balance sheet activity (namely lending). It requires large U.S. banks to set aside roughly five percent of assets for loss absorption. This is intended to supplement risk-based capital requirements like the Common Equity Tier 1 Ratio. Banks that hold clearing customer client margin in the form of cash through their affiliate futures commission merchant ("FCM") clearing services must also set aside the requisite five percent SLR

Unfortunately, the SLR is being applied to an entirely different activity – swaps clearing – that is itself intended to steer risk away from bank balance sheets. Applying the SLR to clearing customer margin reflects a flawed understanding of central counterparty ("CCP") clearing.

The current implementation of the SLR is biased against derivatives. It does not take into account the fact that outstanding derivative contracts in a portfolio can offset each other and thus reduce the potential risk exposure. It incorrectly treats the notional size of a derivative contract as representative of the total potential risk of that contract. It ignores the exposure-reducing effect of margin for clearing firms.

This Commission fully supports U.S. and global swaps reform efforts to move customer margin off the balance sheets of bank FCMs and into CCPs. Yet applying a capital charge against that customer margin works against the swaps clearing mandate by treating FCMs as having retained balance sheet exposure.

This Commission has consistently advocated for adjustments to the SLR in its current form. Back in 2016, Chairman Massad, Commissioner Sharon Bowen and I called for reworking the SLR formulation to reduce its disincentives to the use of derivatives and central clearing.

I am pleased that the Commission continues to speak in a bipartisan voice regarding the SLR.

Importance of Energy Derivatives

The second issue I want to touch on has to do with the importance of derivatives for the energy markets.

Last year I had the good fortune to visit West Texas. For those of you who do not know, West Texas is the epicenter of a stunning accomplishment of American exceptionalism – the shale revolution. This is one of the greatest economic success stories the world has ever seen. Because of it, the United States has become one of the world's largest energy producers.[1] This has changed, not just the structure of global energy markets, but global geo-politics as well.

As I explained in my remarks in West Texas, our newfound energy independence is the result of a unique combination of factors, especially American entrepreneurship and free enterprise.[2] One key factor was the role that financial hedges and commodity derivatives played in enabling the industry and its financial backers to withstand the cartel squeeze by Russia and the Organization of the Petroleum Exporting Countries ("OPEC").

Without the ability to efficiently hedge depressed energy prices and variable costs of production, America's shale producers may well have succumbed to OPEC's concerted efforts and failed to secure our country's growing energy independence. Instead, American shale producers not only survived, but became more efficient, more productive, and more innovative than their overseas competitors. They are a shining example of the ability of American free market capitalism to benefit future generations of Americans.

I look forward to your discussion of the topics on the agenda today, particularly the availability of clearing and other services in the energy derivatives markets. As we confront the challenges ahead, we will look to the thoughtful discussions of advisory committees like yours.

And, again, thank you Commissioner Berkovitz for organizing this meeting.

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[1] *See* Osamu Tsukimori, *U.S. to Overtake Russia as Top Oil Producer by 2019 at latest: IEA*, Reuters, Feb. 26, 2018, available at: https://www.reuters.com/article/us-energy-iea/u-s-to-overtake-russia-as-worlds-biggest-oil-producer-by-2019-latest-iea-idUSKCN1GB0C6.
[2] Remarks of CFTC Chairman J. Christopher Giancarlo at the West Texas Legislative Summit, Angelo State University, San Angelo, Texas (Aug. 2, 2018), available at: https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo51.