

SPEECHES & TESTIMONY

Opening Statement of Commissioner Brian Quintenz before the Open Commission Meeting on March 25, 2019

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Open Meeting on Interim Final Rule Regarding Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants in Light of Brexit; and Final Rule Regarding the De Minimis Exception to the Swap Dealer Definition – Swaps Entered into by Insured Depository Institutions in Connection with Loans to Customers

Mr. Chairman, thank you for calling this meeting. Today's rules are of great significance to both the global and domestic swap markets. The first provides the markets with much needed regulatory certainty in light of a forthcoming Brexit. The second amends the de minimis exception from swap dealer registration for insured depository institutions (IDIs) to ensure that Main Street banks will be able to continue to serve the needs of their small and medium-sized commercial clients without registering as a swap dealer. Of course, this rulemaking addresses only one of the many potential improvements contemplated by the June 2018 proposal that should ultimately be finalized by the Commission.^[1]

Interim Final Rule Regarding Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants in Light of Brexit

I support today's interim final rule providing relief from the Commission's uncleared margin requirements^[2] for legacy swaps transferred to counterparties outside of the UK, in the case of a British exit from the European Union in the absence of a withdrawal agreement ("No-deal Brexit").

I believe the rule will provide necessary legal certainty to market participants as they consider how they will respond to the possibility of a No-deal Brexit. I believe it is correct for the rule to exempt a legacy swap from the Commission's uncleared margin requirements if the swap is amended due to a No-deal Brexit. When the Commission issued margin regulations for uncleared swaps in 2016, the Commission adopted a compliance timetable such that swaps entered into prior to a particular compliance date would not be subject to the new margin requirements.^[3] An event such as a No-deal Brexit, one that is outside of counterparties' control, should not cause counterparties to bear the costs and operational challenges of margining a swap that the Commission had previously exempted. I note that last year, the Commission similarly granted relief to a legacy swap that is amended to comply with the "Qualified Financial Contracts" rules issued by the U.S. prudential regulators in 2017.^[4]

I would like to thank the CFTC staff for having coordinated with the U.S. prudential regulators on this matter to ensure that their interim final rule^[5] and ours are consistent. I look forward to supporting any future efforts by the CFTC to assist derivatives market participants address complications arising from Brexit.

Final Rule Regarding the De Minimis Exception to the Swap Dealer Definition – Swaps Entered into by Insured Depository Institutions in Connection with Loans to Customers

I support today's final rule to amend the de minimis exception to swap dealer registration to include IDI loan-related factors. The amendments facilitate IDIs' provision of hedging swaps to end-user borrowers trying to mitigate the myriad risks – interest rate, currency, commodity price – facing their businesses in connection with their loans. When Congress adopted the definition of "swap dealer" in the Commodity Exchange Act, it recognized that small and medium-sized banks play a critical role in providing credit and risk mitigation services to end-user borrowers.^[6]

In my view, today's amendments further Congressional intent, better align the Commission's swap dealer registration framework with the risk mitigation needs of bank customers, and more accurately reflect current market practices between IDIs and their borrowers. By amending the de minimis exception from swap dealer registration, the Commission is providing small and regional banks with greater flexibility to serve their customers' needs and greater regulatory clarity about the types of de minimis swap dealing activity they can engage in without triggering registration. I am also pleased that the amendments today were completed with full coordination with the Securities and Exchange Commission.^[7]

Today's amendments also contain important limitations that prevent IDIs from entering into an unlimited amount of swap dealing transactions with customers without needing to register as a swap dealer. The swap must have a direct relationship with the origination of the loan with the IDI. For example, the rate or term underlying the swap must be related to a financial term of the loan or the swap must be permissible under the IDI's loan underwriting criteria and commercially appropriate to hedge risks incidental to the borrower's business. These conditions inherently limit the amount of swap dealing activity IDIs can engage in with customers and still qualify for the de minimis exception. Moreover, the preamble of today's rule makes absolutely clear that if an IDI entered into a swap with an end-user for the end-user's speculative purposes, that transaction would not qualify for the de minimis exception.

These amendments are absolutely essential to helping to rationalize the de minimis threshold and ensure that end-users and Main Street businesses don't suffer from an overly prescriptive, punitive, and far-reaching regulatory regime that was only meant to target the largest financial entities.^[8] The Commission's no-action letter to a Main Street bank this past August demonstrates the need to remedy the inadequacies of the current de minimis regime to ensure that legitimate client hedging activity is not artificially constrained.^[9] Since that time, the Commission has received similar requests for no-action relief from other banks in order to meet their customers' needs. These needs are especially acute in light of a rising interest rate environment. Many businesses who have received credit over the last several years may not have felt a need to hedge their interest rates given that rates were low and stable. However, in a rising rate environment, banks should have the flexibility to offer their customers hedging services on those prior extensions of credit without artificially falling into a swap dealer registration regime. I believe that today's final rule appropriately addresses these concerns.

However, as I said at the outset, today's amendments are but one of many improvements to the de minimis threshold contemplated by the June 2018 proposal which must be finalized. As I have said repeatedly, notional value is a poor measure of activity and a meaningless measure of risk. Identifying a de minimis quantity of a meaningless number will always still yield another meaningless number. By itself, notional value is an incredibly deficient registration metric by which to impose large costs and achieve substantial policy objectives, but yet it is the one that the CFTC has repeatedly and inexplicably embraced in this context.

I am supportive of the Office of the Chief Economist's (OCE) efforts to rationalize notional amounts into an entity-netted notional (ENNs) measurement that more accurately reflects an entity's swap activity from both a size and risk perspective. In February 2019, OCE issued a report converting the gross notional amounts of the IRS, FX, and CDS markets into ENNs.^[10] That study found that, when measured with ENNs, the notional amounts of the IRS, FX, and CDS markets considered went from \$225 trillion, \$57 trillion, and \$5.5 trillion, respectively, to \$15.4 trillion, \$17 trillion, and \$2 trillion, respectively. In other words, the entire market of those three swap asset classes shrunk from \$290 trillion to \$34 trillion. When measured against this adjusted (and smaller) market size, the current \$8 billion de minimis threshold still only constitutes .0002 – two ten-thousandths – of that figure.

Given the irrationality of arguing over de minimis quantities to the ten-thousandth increment, I believe the Commission has plenty of flexibility to make further adjustments to this exception that would be consistent with Congress' intent to exempt a de minimis quantity of swap dealing activity. I would note that the Commission, in its vote on the November 2018 final rule, only rejected reducing the de minimis threshold to \$3 billion and did not state at any point that amounts greater than \$8 billion exceeded a "de minimis quantity of swap dealing." If the rule had taken that view, I would have voted against it. Additionally, the November 2018 rule specifically contemplated further Commission action on additional amendments to the de minimis exception, nullifying any after-the-fact attempt to recast that vote as the Commission's final say on the matter.^[11]

Lastly, I am encouraged that, following the Chairman's specific and public direction, staff continues to study both additional adjustments to notional value that would better account for differences between various products, and alternative risk-based registration metrics that could better align the criteria of the de minimis threshold with the costs of swap dealer regulation, particularly the largest costs tied to mitigating systemic risk such as capital and margin requirements.^[12] The results of this staff report will be critical to the Commission's continued consideration of a more risk-sensitive swap dealer registration threshold.

I would like to commend DSIO staff for their hard work on finalizing these amendments and their ongoing, tireless efforts to produce data analyses the Commission can use to further inform necessary improvements to our swap dealer registration regime.

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- [1] De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 27444 (June 12, 2018).
- [2] Commission regulations 23.150-23.161 (17 CFR 23.150-23.161).
- [3] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636, 674-677 (Jan. 6, 2016) (new regulation 23.161).
- [4] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 83 Fed. Reg. 60,341, 60,344 (Nov. 26, 2018) (new regulation 23.161(d)).
- [5] Margin and Capital Requirements for Covered Swap Entities, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corp., Farm Credit Administration, and the Federal Housing Finance Agency, March 15, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190315a.htm>.
- [6] 156 CONG. REC. S5922 (daily ed. July 15, 2010)(statement of Sen. Lincoln)("In addition, we made it clear that a bank that originates a loan with a customer and offers a swap in connection with that loan shouldn't be viewed as a swap dealer.").
- [7] Joint Statement from Chairmen Giancarlo and Clayton on the IDI Exception to the Swap Dealer Definition (Dec. 13, 2018), <https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement121318> (citing the Commissions' interpretation that the Dodd-Frank Act does not require a joint rulemaking between the two agencies with respect to the de minimis exception to the swap dealer definition).
- [8] *Hearing to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act Before the H. Comm. on Agric. and the Subcomm. on General Farm Commodities and Risk Management, 112th CONG. 14* (Feb. 10, 2011), <https://archives-agriculture.house.gov/sites/republicans.agriculture.house.gov/files/transcripts/112/112-1.pdf>.
- [9] CFTC Staff No-Action Letter 18-20 (August 28, 2018), <https://www.cftc.gov/PressRoom/PressReleases/7775-18>.
- [10] ENNs for Corporate and Sovereign CDS and FX Swaps, Office of the Chief Economist (Feb. 2019), <https://www.cftc.gov/sites/default/files/files/ENNs%20for%20Corporate%20CDS%20and%20FX%20Derivatives%20-%20ADA.pdf>.
- [11] De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 56666, 56677, 56679, 56681 (Nov. 13, 2018) (noting that data analysis indicates that increasing the de minimis threshold up to \$100 billion "may have a limited adverse effect on the systemic risk and market efficiency policy considerations of SD regulation. Additionally, a higher threshold could enhance the benefits associated with a de minimis exception, for example by allowing entities to increase ancillary dealing activity").
- [12] Statement of Chairman J. Christopher Giancarlo Regarding the Final Rule on Swap Dealer De Minimis Calculation, (Nov. 5, 2018), <https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110518>.