SPEECHES & TESTIMONY

Statement of Commissioner Dawn D. Stump for the CFTC Open Meeting, July 11, 2019

Open Meeting on: 1) Proposed Rule – Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations; and 2) Supplemental Proposal – Exemption from Derivatives Clearing Organization Registration

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Overview

In responding to the financial crisis, both the Group of 20 Nations (G-20) and the U.S. Congress recognized that the derivatives markets are global and in doing so provided for international coordination and a practical application of regulatory deference. I want to commend the Chairman for his leadership in reminding us of the global commitments made in 2009 and the subsequent efforts Congress made to encourage global regulatory harmonization. Specifically, the G-20 leaders stated the clear responsibility we have "to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage."[1] More directly related to the subjects before us today, Congress, in the Dodd-Frank Act, amended the Commodity Exchange Act to provide: "The Commission may exempt, conditionally or unconditionally, a derivatives clearing organization from registration … for the clearing of swaps if the Commission determines that the derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by… the appropriate government authorities in the home country of the organization."[2]

I believe deference to comparable regulatory regimes is essential. Historically, such deference has been the guiding principle of the CFTC's approach to regulating cross-border derivatives. We cannot effectively supervise central counterparties (CCPs) in every corner of the world. We can, however, evaluate the regulatory requirements in a CCP's home country to determine if they are sufficiently commensurate to our own. We will never have the exact same rules around the globe. We should rather strive to minimize the frequency and impact of duplicative regulatory oversight while also demanding high comparable standards, just as Congress intended.

Had we previously established a more comprehensive structure for those comparably-regulated, foreign CCPs seeking to offer swaps clearing to U.S. customers, then CCPs wishing to seek an exemption would have been able to do so under a regime that Congress provided for in the Dodd-Frank Act. Alternatively, those that wanted to register as a DCO would have done so voluntarily in response to a business rationale

demanded by their clearing members and customers. However, by not having previously established an exemption process, the CFTC left only one path for customer clearing on non-U.S. DCOs, which resulted in compelling several non-U.S. CCPs to become dually registered with both their home country regulator and the CFTC.

As a result, relationships with our global regulatory counterparts became strained, and there have been many unfortunate consequences such that now we must provide new ground rules. So today, we are advancing an overdue conversation on applying international regulatory deference through the establishment of a test to identify non-U.S. CCPs that pose substantial risk to the U.S. financial system. To be clear, neither of the proposals we are considering today would be available to DCOs that pose such risk. I fear that this point may be lost or confused by the fact that we are presenting these as two separate rulemakings. While I would have preferred a single rulemaking to alleviate any confusion, I want to make clear that we are simply proposing two regulatory options, each of which is only available to those DCOs that do NOT pose substantial risk to the U.S. financial system under the proposed test. I encourage commenters to provide input on the proposals as if they are a single package, particularly where the request for comments in one proposal may be relevant or more applicable to consideration of the other proposal.

These proposals are a step towards achieving the goals established in 2009 – an effort I wholeheartedly support. However, I have concerns that these proposals may be a bit too rigid to pragmatically facilitate increased swaps clearing by U.S. customers, as we are committed to do by the original G-20 and Congressional directives. Under the Alternative Compliance proposal, non-U.S. DCOs can permit customer access only if a futures commission merchant (FCM) is directly facilitating the clearing while the other available option -- provided for in the Exempt DCO proposal -- completely disallows the FCM from being involved in customer clearing. While I recognize that the blunt nature of these bright line distinctions makes it easier to regulate, I worry that it may not be workable in practice. I support putting these proposals out for public comment in hopes that those who participate in these markets and who are expected to apply the new swap clearing mandates will be able to lend their voices to the discussion. However, I anticipate that the elements left unaddressed in these proposals, which are detailed in the requests for comments, may require a re-proposal at some future date. Nonetheless, if that is to occur we will be well served to have that discussion with the benefit of public comments.

Registration with Alternative Compliance for Non-U.S. DCOs

This proposal is designed to more clearly spell out how we would provide regulatory oversight for those clearinghouses that do not pose substantial risk to the U.S. financial system and that may obtain Alternative Compliance by demonstrating fulfillment of statutorily-established core principles.

Unfortunately, the proposal fails to address, and in my opinion may even worsen, a challenge of great concern to this Commission – the increased strain on our registered FCMs. Under the Alternative Compliance proposal, any non-U.S. DCO seeking to apply the regime would be required to do so ONLY through clearing members that are FCMs,

and may not do so through an affiliate of the FCM in the home country that is already acting as a clearing member of the DCO. This is the status quo, and frankly it often makes very little economic sense for both the FCM and its affiliate to be capitalizing a clearinghouse simultaneously. Consideration should be given to the efficiency of utilizing an affiliated entity, which would allow this to be a business decision between FCMs and their customers, rather than a regulatory impediment to sustaining FCMs that play a critical role in cleared derivatives markets.

It is costly for an FCM to join any clearinghouse and may be especially uneconomic if the FCM only has a few customers who wish to access a particular non-U.S. DCO. It may make more sense to structure the arrangement with the assistance of a non-U.S. affiliate, already actively participating as a member of the DCO. To do otherwise limits U.S. customer choice and access to clearing of the product in a foreign jurisdiction, which seems at odds with the reform agenda of encouraging clearing – mandated or not.

To be clear, two affiliated entities may each be subjected to risk mutualization obligations at the same CCP, and unfortunately, this proposal does not discuss how we might address this duplicative burden. Rather, we are requesting comment in the separate Exempt DCO proposal about how this problem might be addressed through an affiliate guarantee arrangement such that an FCM could potentially participate as a "special" member whose obligations to the DCO could be guaranteed by its non-FCM affiliate acting as a "traditional" member of the DCO. I hope commenters will consider and discuss this concept in the context of the proposed Alternative Compliance regime where it is more applicable to CFTC-registered FCMs at non-U.S., CFTC-registered DCOs. I hope that commenters will also provide other potential solutions to help alleviate undue burdens on FCMs and their customers in the context of the Alternative Compliance proposal.

As a Commission, I believe we are all concerned about the consolidation these clearing service providers are already experiencing and the constraint on the availability of clearing services for market participants. I hope we will be able to avoid policies that unnecessarily challenge the economics of, or otherwise impede, operating as an FCM. Otherwise, we might find that our mandate to increase swaps clearing is futile: Simply put, the clearinghouses don't work without clearing members and so we must seek to preserve both.

Exemption from DCO Registration

The CFTC implemented the clearing elements of the G-20 principles before other regulatory jurisdictions, and in that context determined that any non-U.S. CCP wishing to clear swap products for U.S. customers must become a fully registered DCO. Today, we can re-assess based on fellow international regulatory authorities having now implemented their own comparable reforms, thus aligning many of our regulatory principles, just as the G-20 envisioned. Notably, in authorizing the CFTC to implement these G-20 principles, Congress recognized that consistency, not duplication, is the goal and therefore provided authority in the Dodd-Frank Act to exempt, conditionally or unconditionally, a non-U.S. CCP from registration as a DCO if the CFTC determines

that the entity is subject to comparable, comprehensive supervision and regulation by its home country authorities. Certainly, individual CCPs around the world should be able to seek registration with the CFTC to clear swaps for U.S. customers if they determine that is appropriate based on their individual commercial interests and the demands of their clearing members and end users; but, it is time to revisit the policy rationale of compelled DCO registration for comparably and comprehensively regulated non-U.S. CCPs.

Under this proposal, non-U.S. CCPs that do not pose substantial risk to the U.S. financial system will have another option for offering swap clearing services to U.S. customers in that they may request an exemption from registration, as provided by the Dodd-Frank Act. I appreciate that this may raise concerns by some, and I welcome public input on how best to address any such concerns. However, I would be remiss if I failed to point out that the G-20 leaders recognized in 2009 that we should not ignore the global nature of derivatives markets, a fact even more relevant today as U.S. persons increasingly need access to clearinghouses around the world. Contributing to this increased demand is the fact that during the past decade international regulatory bodies, including the CFTC and pursuant to the G-20 principles, have expanded the obligations for market participants to utilize clearing. It is not fair that we mandate and encourage the adoption of derivatives clearing and then limit access to, or severely hamper efficient operation of, such clearing services.

While I am therefore pleased to see this exemption process advancing, I maintain reservations about the lack of optionality for registered FCMs to engage in clearing services for their customers at an Exempt DCO. Once our agency has determined that an Exempt DCO is subject to regulation that is comprehensive and comparable to our own, then the arrangement by which a U.S. person may access the Exempt DCO should be a business decision between the customer and their preferred clearing member, which may well be an FCM. I very much want to hear from commenters on how we might accomplish this going forward. We have extensive history in allowing such arrangements for U.S. futures clients of CFTC-registered FCMs to access non-U.S. DCOs. I am certain that the public input will assist us in determining how a clearing structure that works for futures customers might sensibly be extended to swaps customers.

I would remind commenters that only sophisticated market participants qualify as eligible contract participants able to enter into swaps (other than on a designated contract market). We need to assist these qualified U.S. market participants and their clearing members not only by providing access, but by pragmatically preserving their ability to enter into prudent business arrangements that they deem most appropriate for their operations and business needs. While prohibiting FCM participation on Exempt DCOs, as we are proposing today, is designed for simplicity, the realities of clearing arrangements and the bankruptcy treatment that applies to them are complex. I fear that ignoring that fact may render the Exempt DCO option with less appeal than I believe it is due and that Congress contemplated. I am confident that the tremendous institutional knowledge at this agency, coupled with public input, will enable us to design a workable solution, but it may not be the bright line test envisioned by this proposal.

Closing

At the beginning of this year I penned an opinion piece in the Financial Times[3] in which I attempted to appeal to our international regulatory partners to recommit to a coordinated approach, ensuring that our alliance remains strong rather than fractured. Regulatory conflicts are at odds with our shared mission and do a disservice to global market participants. I am committed to advancing a coordinated approach, and I believe the proposals we are putting forward today are a first step in that process. There is, however, more work to be done both in the way of the CFTC extending deference to other jurisdictions and vice versa. I hope our international regulatory partners will also take the opportunity to reset and recognize that our shared interest of advancing derivatives clearing is best achieved by respecting each jurisdiction's successful implementation of the principles agreed to ten years ago. Otherwise, it might unfortunately become challenging to advance the concept of deference under consideration today to the next stage of the process.

Finally, I would like to express my sincere thanks to the staff of the Division of Clearing & Risk and the rest of the team that have worked so hard on the proposals that we are considering today. The interplay between these proposals has presented particular challenges, and I am most appreciative of staff's diligence and responsiveness in addressing our comments and questions.