Securities Regulation Daily Wrap Up, TOP STORY—CFTC proposes capital rules for swap dealers and participants, but questions remain, (Dec. 2, 2016)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Brad Rosen, J.D.

The CFTC has unanimously approved proposed rules establishing minimum capital requirements for swap dealers (SDs) and major swap participants (MSPs). The rules, called for by the Dodd-Frank Act enacted in 2010, were long in coming. With margin requirements becoming finalized and implemented over the past few years, the Commission is now taking this opportunity to move the rulemaking process forward and bring further clarity to the swap community on these important issues.

CFTC Chairman Timothy Massad, in a separate statement, observed, "capital requirements for swap dealers are among the most important reforms for the over-the-counter swap markets agreed to by leaders of the G20 nations in 2009." A previous Commission proposal in 2011 which provided for SD and MSP capital requirements had stalled as a result of unresolved margin standards for uncleared swaps globally.

The reproposed rules reflect a flexible and practical approach and take into account the diverse nature of the various participants engaged in swap related activities. Accordingly, the proposed rules allow for the application of three general alternative approaches to determine capital requirements depending on an SD's regulatory status.

First, in the event that an SD is a bank affiliate, the proposal allows for methods permitted by bank regulators. Second, if an SD is a broker-dealer or futures commission merchant, that party may look to either the CFTC or SEC for its net liquid assets requirements. Third, SDs that are primarily engaged in non-financial activities, as well as MSPs, may elect minimum capital requirements based upon the tangible net worth of the entity. Under the proposal, SDs also may use internal models for the purpose of computing their regulatory capital, subject to the prior approval of either the CFTC or the National Futures Association (NFA).

Chairman Massad indicated that this proposal reflects the diversity of swap participants in today's markets while "it supports competition as well as safety and soundness." Although fellow Commissioner J. Christopher Giancarlo voted in favor of the proposed rule, he voiced a number of concerns in his own separate statement which included the following: (1) how do the proposed capital rules affect smaller SDs and how much additional capital may they have to raise; (2) what will the impact of the proposed rule be on new participants; (3) whether reduced capital requirements will apply to SDs that execute swaps only on exchanges and use only proprietary funds; and (4) whether the model review and approval process involving the NFA as envisioned under the proposal will be workable given the complexity of these models, the large number of models to be reviewed, and the practical resource constraints at the NFA.

Both Chairman Massad and Commissioner Giancarlo enthusiastically invited public comment on the proposed rule. The comment period will remain open for 90 days following the publication of the proposal in the Federal Register.

MainStory: TopStory Derivatives DoddFrankAct FinancialIntermediaries Swaps