

SPEECHES & TESTIMONY

Opening Statement of Chairman Heath P. Tarbert Before the Open Commission Meeting on October 16, 2019

October 16, 2019

Good morning, and thank you for attending today's open meeting of the U.S. Commodity Futures Trading Commission ("CFTC"). We have two important items on the agenda: (1) a proposed rule to extend the compliance date for phase five of the CFTC's margin rule for uncleared swaps ("Margin Rule"),^[1] and (2) a proposed rule regarding the application of the Margin Rule to the European Stability Mechanism ("ESM").

Phase five of the Margin Rule will subject many small entities to initial margin ("IM") documentation and custodial and operational requirements for the first time. In the United States alone, this phase will expand the number of in-scope entities from 40 to over 700 and could require documenting and operationalizing nearly 7,000 initial margin relationships.^[2]

Recognizing the operational complexity of this undertaking, the Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency ("OCC") recently proposed to extend their compliance deadline for "phase five" counterparties by one year.^[3] This follows a Basel Committee on Banking Supervision-International Organization of Securities Commissions ("BCBS-IOSCO") proposal for a similar one-year extension.^[4]

I fully support today's proposal to provide the same relief. Without this extension, market strain and disruption may arise because so many newly in-scope counterparties are engaging the same limited number of entities providing required IM services. Such services include, among other things, IM-related documentation, approval and implementation of risk-based models for IM calculation, and custodial arrangements.

Counterparties unable to operationalize adequate IM arrangements by the September 2020 deadline would be prohibited from entering into uncleared swaps. They would thus be forced to rely on cleared products that may not adequately match their risk management needs, or forego hedging altogether. Allowing such counterparties to be shut out from the uncleared swaps markets could harm liquidity and price discovery in these markets, in addition to impeding sound risk management.^[5]

I do not take this proposed extension lightly, as initial margin is an important guard against counterparty credit risk. However, the extension would affect only three percent of total swaps activity across all phases of IM implementation.^[6] Given that, I believe the proposed extension will mitigate rather than exacerbate risk.

I also support the proposed amendment to Regulation 23.151, which, if adopted by the Commission, will codify the exclusion of the ESM from the Margin Rule. The Margin Rule requires a covered swap dealer or major swap participant ("swap entity") to post and collect initial and variation margin for uncleared swaps that it enters into with (1) another swap entity or (2) a "financial end user."^[7] Sovereign entities, multilateral development banks, the Bank for International Settlements, and similar entities are excluded from the Margin Rule's definition of "financial end user." Despite its similarities to the aforementioned excluded entities, the ESM has not been carved out of the financial end user definition. Like those entities, the ESM is an intergovernmental agency that supports Eurozone economies by making loans, purchasing bonds, and shoring up member banking systems. All 19 Eurozone members are shareholders of the ESM, and all have contributed capital to support its success.^[8]

In 2017, the ESM requested no-action relief to exempt swap entities from the Margin Rule for uncleared swaps entered into with the ESM. The CFTC's staff provided this no-action relief on July 24, 2017,^[9] recognizing the unique and important role that the ESM plays in the European financial system.

I am pleased to support the proposed amendment, which, if adopted, will make permanent the existing no-action relief from the Margin Rule for the ESM. Codifying the ESM's relief from the Margin Rule would make the ESM's existing no-action relief superfluous. Accordingly, CFTC staff today will withdraw the ESM's existing no-action letter and replace it with reissued no-action relief that will expire upon final Commission action on this matter, or by April 14, 2020, whichever comes first.

In a similar light, the CFTC's staff is today providing the ESM with a reissued no-action letter relating to existing no-action relief from the swap clearing requirements of Section 2(h)(1) of the Act.^[10] It is my intention to take up a proposed rulemaking in the coming months that will codify the ESM's relief from these clearing requirements.

The global nature of today's derivatives markets requires that regulators work cooperatively to ensure the success of the G20 reforms, foster economic growth, and promote financial stability. In 2016, for example, the CFTC and the European Commission ("EC") entered into an agreement regarding requirements for dually registered central counterparties, and in doing so, took an important step in achieving cross-border harmonization of derivatives regulation. And just last month, CFTC staff and I met with representatives from the EC, at which time we reaffirmed our mutual commitment to transatlantic cooperation.

The CFTC aims to lead by example, and the proposed rule before the Commission today is an opportunity to demonstrate our commitment to regulatory deference and support for efficient market activity. The CFTC remains committed to working with the EC, the European Securities and Markets Authority, and other stakeholders to maintain well-regulated and efficient markets. The proposed rule relating to the ESM is a step in that direction.^[11] As we go forward, it is important to recognize that deference is a two-way street: the only way to make it work is if it is mutual.

Deference not only facilitates greater cooperation between regulators, but also promotes stability, resiliency, and growth in our global derivatives markets. I will continue to encourage our foreign counterparts to act in a manner that relies on cooperation and deference, so that duplicative or conflicting regulatory regimes do not stifle our markets or raise the prospect of financial stability risks. By working together, we can promote sound and effective regulation without unduly constraining our financial markets.

When I first spoke to the employees of this agency after taking office, I said that action would be the watchword of my chairmanship. We have had an impactful first 90 days, and these proposed rules build on that important work. I look forward to their advancement by the Commission.

Thank you.

^[1] The Margin Rule is contained in Commission Regulations 23.150 through 23.161, 17 C.F.R. § 23.150-23.161 (2019).

^[2] Richard Haynes, Madison Lau, & Bruce Tuckman, Office of the Chief Economist, CFTC, *Initial Margin Phase 5* (Oct. 2018), <https://www.cftc.gov/PressRoom/PressReleases/7834-18>.

[3] BCBS-IOSCO, the FDIC, and the OCC recognize that the margin rules “should be phased in so that the systemic risk reductions and incentive benefits are appropriately balanced against the liquidity, operational, and transition costs associated with implementing the requirements.” *Margin Requirements for Non-Centrally Cleared Derivatives* 23 (July 2019); see also FDIC & OCC, *Margin and Capital Requirements for Covered Swap Entities* (Sept. 17, 2019) (notice of proposed rulemaking). The Federal Reserve has not yet voted on the banking regulators’ proposed extension.

[4] BCBS-IOSCO, *Margin Requirements for Non-Centrally Cleared Derivatives* 23 (July 2019).

[5] *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants* (Oct. 16, 2019) (CFTC notice of proposed rulemaking).

[6] *Id.* (citing Haynes et al., *supra* note 2, at 4-5) (finding that total daily average aggregate notional amount (“AANA”) for entities that would be subject to the one-year extension is approximately three percent of total AANA across all IM phases).

[7] The Margin Rule applies to swap entities that are not supervised by one of the federal banking regulators (e.g., the Federal Reserve, the FDIC, and the OCC).

[8] See ESM website, available at <https://www.esm.europa.eu>.

[9] See CFTC No-Action Letter 17-34 (July 24, 2017), available on the Commission’s website.

[10] See CFTC Letter No. 17-58 (November 7, 2017), available on the Commission’s website.

[11] I also support the technical amendments to Regulation 23.157, which provide additional clarity to market participants.