Remarks of Commissioner Rostin Behnam before the Commodity Futures Trading Commission's International Regulators Meeting, Boca Raton, Florida

March 13, 2018

Introduction

Thank you for the kind introduction. It is a pleasure to be with you today. Before I begin, just a quick housekeeping note that the views contained in this speech are my own and do not represent the views of the Commission. Before I dive into the main topic of my remarks this afternoon, I want to spend some time sharing some key points from my first six months at the CFTC, and my vision for the next six months and beyond.

I delivered my first public remarks as a Commissioner in November at Georgetown University. I announced that during my first year as a Commissioner, I would spend as much time as possible on a listening tour, visiting market participants and stakeholders in order to get a better sense of what's working and what's not working. Given the broad swath of CFTC stakeholders, this listening tour has taken me to New York (several times), New Jersey, California, Iowa, Illinois, and Kansas. And I look forward to many more visits in the next six months so that I can fully digest and analyze the full spectrum of issues, concerns, and comments.

At the same speech delivered at Georgetown, I asserted that the CFTC is at an inflection point. Nearly ten years to the day since Bear Stearns collapsed, and nearly eight years since the passage of Dodd-Frank, the CFTC has largely completed its congressionally mandated, post-crisis financial reforms. Ahead of many of its domestic and international counterparts, I suggested in the speech that the CFTC must continue to move *forward*, swiftly finalizing any incomplete rules, and only consider narrow, surgical tweaks to existing rules as a measure to correct unintended consequences.

Given the sometimes aggressive rhetoric in Washington these days to roll-back regulations, I argued that the CFTC must continue to demonstrate its leadership by not rolling back or watering down *any* key financial reforms. With that in mind, I will continue to extend my desire and willingness to work with Chairman Giancarlo as he considers Project Kiss and Swaps Reform 2.0 in the weeks and months ahead. I will also continue to focus on what I believe are cornerstones of good regulatory behavior: accountability and transparency. Working with all stakeholders, both domestically and internationally, I am confident that the CFTC can be a forward thinking 21st century regulator that maintains strong, robust rules of the road for market participants, while protecting the public from fraud and manipulation.

Turning to the next few months, I will be squarely focused on the Market Risk Advisory Committee (MRAC). As sponsor of this advisory committee, I am currently laying the groundwork for renewing the committee's charter, reconstituting its membership, and setting an agenda for 2018. Having already met once this year, regarding a very hot topic: bitcoin, I believe the MRAC, as it is more commonly known, is ripe for many more important, cutting edge discussions. I believe it's time for the CFTC to follow the lead of our fellow regulators in the prudential space and focus on operational risk—the risk that remains after determining financing and systemic risk, and includes risks resulting from breakdowns in internal procedures, personnel, and systems. It includes fintech risks such as service disruptions, data compromise, and cybersecurity. It also includes risks from outsourcing and use of third-party products and vendors. And, it includes fraud and other personnel misconduct. Of course, the MRAC will continue to focus on central counterparties (CCPs), expanding its focus from default risks to cover related credit and liquidity risks. There are certainly many important issues to discuss within this space considering above all else, that the CFTC and its markets deal in risk; and I look forward to input from all interested stakeholders, including regulators, to better inform the MRAC's roadmap ahead.

Deference is the Cornerstone of the CFTC's Cross-Border Supervision

Deference: The CFTC's Cross-Border Approach

The CFTC has a long history of regulatory deference to overseas regulators in the futures and swaps markets. What do we mean by deference? Deference is an essential regulatory tool that not only alleviates practical budgetary constraints; but, also respects the strength of deserving foreign counterparts, and encourages the fundamentals of working *together* towards a cohesive cross-border regulatory framework that supports strong, robust, and transparent regulations. If a home country authority implements a comprehensive regulatory and supervisory framework that is comparable to our regulations and laws, then that home country authority should maintain primary oversight over its domestic entities to which other foreign regulators should defer. A solid, outcomes-based comparability assessment of the consistency of the home regulator's relevant regulations and supervisory programs is the foundation of such deference.1 An example of this approach is the Part 30 exemption regime for foreign futures which the CFTC established in 1987.2 This program permits non-U.S. intermediaries to trade directly with U.S. persons that wish to transact in foreign futures on the basis of compliance with the regulations of their home jurisdictions. Part 30 was a pioneering program that used comparability determinations in order to facilitate cross border harmonization. Today firms all over the world, including Asia, the U.K., and the European Union (EU) have access to U.S. customers without having to register with the CFTC through the use of this program.

Another example of our approach is the 2016 CFTC and European Commission equivalence determination. On February 10, 2016, the CFTC and the European Commission issued a joint statement agreeing to support a common approach to regulation and supervision of cross-border CCPs.3 This agreement was not an afterthought. It took three years of extensive negotiations to put in place. Shortly thereafter, as part of our agreement, on March 15, 2016, the European Commission announced it would treat U.S.-registered clearinghouses as equivalent for purposes of recognition under the European Market Infrastructure Regulation (EMIR).4 Currently, there are five U.S.-registered derivatives clearing organizations (DCOs) that have received recognition under EMIR.5 Immediately after the European Commission's decision, on March 16, 2016, the Commission reciprocated and approved a substituted compliance framework for EU-based clearinghouses registered with the CFTC.6 Under the framework, EU-based CCPs may comply with certain CFTC requirements for financial resources, risk management, settlement procedures, and default rules and procedures by complying with corresponding requirements under EMIR.7 Four European-based DCOs currently enjoy the benefit of the CFTC's substituted compliance determination.8

European Commission Proposal to Amend EMIR

Our 2016 agreement is a successful testament to the cross-border regulation of CCPs. Our global markets are more efficient because of this agreement; there are less regulatory and supervisory burdens for our clearinghouses and less market fragmentation. However, last year, in the wake of Brexit, the European Commission proposed legislation to amend EMIR which would create a new European Framework to regulate and supervise CCPs.9 The proposal would expand the regulatory and supervisory authority of the European Securities and Markets Authority (ESMA) over both EU and third-country CCPs, alter the framework for the recognition of third-country CCPs, and provide the European Central Bank (ECB) and other EU central banks with direct oversight authority over both EU and third-country CCPs. It would, in effect, make EU authorities primary supervisors of third-country CCPs.

The proposal sets forth a new two-tier system for classifying and regulating third-country CCPs that operate in the EU. Under this proposal, all currently recognized CCPs will need to be reassessed as either "Tier 1" or "Tier 2" CCPs by ESMA. Tier 1 CCPs would be considered "non-systemically important," and would continue to be able to operate under any existing recognition determination. Tier 2 CCPs would be considered "systemically important," and would be subject to additional EU regulatory and supervisory requirements. Third-country CCPs in Tier 2 would be allowed to meet the additional EU requirements by following their home country rules to the degree that their home country regime is determined to be consistent with EMIR. If the home country rules of the third-country CCP are not consistent, then the CCP would be required to adopt and implement the EU requirements. Tier 2 CCPs would also be

subject to the oversight of the ECB, which may require Tier 2 CCPs to adhere to additional requirements with respect to liquidity, segregation, and collateral.

The potential results are that the two U.S. CCPs that have been designated as systemically important by the U.S. Financial Stability Oversight Council (FSOC), CME and ICE Clear Credit, could be deemed Tier 2 CCPs and would be subject to additional regulatory and supervisory burdens beyond the equivalence conditions in the CFTC and European Commission equivalence determination. Moreover, if a Tier 2 CCP is deemed to be substantially systemically important to the EU by ESMA, such that even full compliance with EU requirements would not sufficiently reduce risks, ESMA may deny recognition and ask the European Commission to impose a location requirement for either the whole CCP or certain clearing services (i.e., only IRS products). LCH.Clearnet Ltd., which is based in London and regulated by the Bank of England and the CFTC, could be forced to relocate some or all of its euro-denominated clearing contracts to the EU under the proposal.

Our European colleagues suggest that the European Commission's proposed legislation is a mirror copy of the CFTC regime.[10] That is simply not the case. The proposed legislation contemplates a regime in the EU that would differ fundamentally in application and in substance from that of the CFTC. For instance, consider the cross-border application of the CFTC's requirements to third-country CCPs and the cross-border application of EMIR to such CCPs. For third-country CCPs, the CFTC requirements apply to the U.S. side of the business only. In contrast, EMIR would apply to a third-country CCP's entire business.

With respect to the designation of "systemically important," I note that such a designation in the U.S. by the FSOC has been limited to U.S.-domiciled CCPs. Under the proposal, ESMA could designate a third-country CCP as systemically important; thereby, increasing the third-country CCP's regulatory and supervisory burdens. The proposal also authorizes ESMA to conduct onsite inspections of a third-country CCP and provides ESMA with the discretion to invite the relevant third-country regulator of the CCP to participate. In contrast, while the CFTC reserves the right to examine CFTC-registered CCPs based outside of the United States, to date, the CFTC has not conducted onsite examinations of a non-U.S. based DCO on the continental EU. Moreover, the CFTC would not conduct an inspection or examination without the participation of the third-country regulator. For example, when the CFTC recently examined LCH.Clearnet Ltd., we did so in conjunction with the Bank of England, its primary regulator.

Concerns over how the European Commission's Legislative Proposal would impact U.S. Clearinghouses

The European Commission's proposed legislation would be detrimental to recognized U.S. CCPs. The proposal would likely subject recognized U.S. CCPs to overlapping regulation and duplicative supervision without due deference to existing CFTC regulation and supervision of those U.S. CCPs— due deference that was agreed upon in the 2016 CFTC and European Commission equivalence agreement. Moreover, this proposal would apply EMIR to all aspects of a third-country CCP's business. This would be quite problematic for U.S. CCPs as there are aspects of EMIR that are inconsistent with the CFTC's regulatory framework. For instance, under the CFTC's regulatory framework for swaps, customer collateral provided for swaps is required to be segregated from a futures commission merchant's own property pursuant to the legally segregated and operationally commingled segregation model (known as "LSOC"). This is in contrast to EMIR which requires that individual segregation be offered to clients for swaps. Recognized U.S. CCPs would not be able to offer individual segregation to their U.S. clients because individual segregation is inconsistent with the U.S. Bankruptcy Code. Consequently, this nuanced difference in regulation has direct and detrimental effects, among other things, on a recognized U.S. CCP's ability to comply with U.S. law.

Moreover, I have serious concerns that a Tier 2 designation could result in the reopening and reconsideration of the 2016 CFTC and European Commission equivalence agreement and create uncertainty regarding the ability of EU market participants to continue to access third-country CCPs. As I previously mentioned, this agreement was the result of three years of negotiations. In the two years since the equivalence agreement, there have been no material changes to the CFTC's regulatory

or supervisory regime, and our recognized U.S. CCPs have not materially increased their EU-based activities. Therefore, reopening the agreement is unnecessary and can lead to a significant disruption of U.S. CCPs doing business in the EU and financial markets more generally.

Further, the proposal sets no limits on the ECB's supervision of third-country CCPs. Under the CFTC's regulatory and supervisory framework, the role of the Federal Reserve Board, the U.S. central bank, is limited to consultation with the CFTC regarding examinations and material rule filings of systemically-important U.S. CCPs. The Federal Reserve Board does not set policy or impose any additional requirements on CCPs. Moreover, the Federal Reserve Board has no role in the oversight of non-U.S. based CCPs registered with the CFTC. Therefore, this proposal is highly disconcerting.

If the proposed legislation becomes law, it is likely that the costs to clear through recognized U.S. CCPs will increase for all market participants. Such increases have the potential to de-incentivize central clearing and could lead to downstream effects such as fractured liquidity and increased systemic risk, which would affect the stability of the financial markets.

I echo Chairman Giancarlo's sentiment that any change to our existing 2016 agreement is unacceptable.[11] My position is that U.S. CCPs must continue to be primarily regulated by U.S. regulators. CFTC regulation and supervision of its CCPs is strong, transparent, and exhaustive. As a result, there is no reasonable basis for the EU to have concurrent oversight over U.S. CCPs.

Looking Forward: What is the Fix?

The European Commission should abide by its commitment to the 2016 equivalence agreement, and provide the CFTC assurances in the legislation that recognized U.S. CCPs will be treated in accordance with the 2016 equivalence determination. This position is fully supported by key members of the U.S. Congress[12] and by the U.S. Administration.

Conclusion

I have heard repeatedly that a sovereign nation has the right to amend its rules and the right to renegotiate agreements. I agree, however, our CCPs will not be collateral damage in the ongoing Brexit battle between the U.K. and the EU. No matter what happens in that battle, U.S. markets will be open for business, will continue to thrive, and will provide the efficiencies of resiliency that market participants deserve.

Thank you for the opportunity to speak to you today.

1 *See also* IOSCO Task Force on Cross-Border Regulation, Final Report (Sep. 2015) (advocating for an outcomes-based approach).

2 17 CFR Part 30.

3 The U.S. Commodity Futures Trading Commission and the European Commission: Common Approach for Transatlantic CCPs (Feb. 10, 2016), *available at* http://www.cftc.gov/PressRoom/PressReleases/cftc_euapproach021016.

4 Commission Implementing Decision No. 2016/377 of 15 March 2016, 2016 O.J. (L70), 32 (EU); *see also* European Commission adopts equivalence decision for CCPs in USA (Mar. 15, 2016), *available at* http://europa.eu/rapid/press-release_IP-16-807_en.htm.

5 CME Inc., ICE Clear Credit LLC, ICE Clear U.S. Inc., Minneapolis Grain Exchange Inc., and Nodal Clear LLC have received recognition under EMIR which permits them to provide clearing services for European market participants.

6 Comparability Determination for the European Union; Dually-Registered Derivatives Clearing Organizations and Central Counterparties, 81 Fed. Reg. 15260, Mar. 22, 2016; *see also* CFTC Approves Substituted Compliance Framework in Follow-up to the Recent Equivalence Agreement between the US and the EU (Mar. 16, 2016), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7342-16.

7 Under the CFTC's substituted compliance framework for dually-registered DCOs and EU CCPs, the CFTC issued no action relief from certain CFTC requirements that are "not comparable" with EMIR requirements and thus, are not applied to EU-based DCOs in order to facilitate cross-border regulatory coordination with the EU. The relief covers CFTC requirements related to: the agency clearing model, LSOC (Part 22), gross margining for initial margin, collection of initial margin at a level that is greater 100% of the DCO's initial margin requirement, prohibition against setting a minimum capital requirement of more than $50 million, straight-through-processing of swaps, clearing members maintenance of written risk management policies and procedures, submission of quarterly financial reports to CFTC, and the submission of annual audited year-end financial statements in accordance with U.S. GAAP. *See* CFTC Letter No. 16-26 (Mar. 16, 2016).

8 These DCOs are Eurex Clearing AG, ICE Clear Europe Ltd., LCH.Clearnet Ltd., and LCH.Clearnet SA.

9 *Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorization of CCPs and requirements for the recognition of third-country CCPs*, COM (2017) 331 final (June 13, 2017); *see also* Commission proposes more robust supervision of central counterparties (CCPs) (June 13, 2017), *available at* http://europa.eu/rapid/press-release_IP-17-1568_en.htm.

10 EU policy makers have also made such statements to the press. *See* Neil Roland and John Rega, *CFTC's Giancarlo to voice concerns about EU bill in Europe visit*, MLex, Feb. 16, 2018; Jim Brunsden and Philip Stafford, *What is London's Euro Clearing Market and Why is Brussels Worried?*, Fin. Times, June 13, 2017.

11 Testimony of Chairman J. Christopher Giancarlo before the U.S. Senate Comm. on Agric., Nutrition, and Forestry, Feb. 15, 2018, *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo38.

12 Letter from Senators Pat Roberts and Debbie Stabenow, Chairman and Ranking Member, Comm. on Agric., Nutrition and Forestry, U.S. Senate (Jan. 8, 2018), *available at* https://www.agriculture.senate.gov/imo/media/doc/01-08-18%20CFTC%20EUROPEAN%20CLEARING%20LETTER.pdf.

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