SPEECHES & TESTIMONY

Opening Statement of Commissioner Brian Quintenz, Open Meeting on Final Rule: Indemnification (Amendments to the Swap Data Access Provisions of Part 49 and Certain Other Matters), Proposed Rule: Volcker Rule (Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds), and Proposed Rule: De Minimis Exception (Amendments to Swap Dealer Registration De Minimis Exception)

June 4, 2018

Mr. Chairman, thank you for calling this meeting. It is a great pleasure to participate today with you and my fellow Commissioner in my first open meeting, as well as the first under your Chairmanship. The matters before us today are important and timely.

Proposed Rule: De Minimis Exception (Amendments to Swap Dealer Registration De Minimis Exception)

This rulemaking which governs swap dealer registration is fundamental to the Commission's effective oversight of the swaps market.

Swap dealers are subject to extensive and costly regulatory requirements: registration fees; minimum capital requirements; posting margin for uncleared swaps; IT costs for trade processing, reporting, confirmation, and reconciliation activities; costs to create and send clients daily valuation reports; costs for recordkeeping obligations; third party audit expenses; legal fees to develop and implement business conduct rules and many, many more. If that sounds like a big bill, it is. A prominent economic research firm estimated the present value of the cost for swap dealer registration compliance at $390 million per firm.[1]

Those significant requirements and costs are imposed to advance equally significant policy objectives, such as the reduction of systemic risk, increased counterparty protections, and enhanced market efficiency and integrity. Therefore, the registration threshold, as the trigger mechanism for those costs and objectives, must be appropriately and specifically calibrated to ensure that the correct market group shoulders the burdens of swap dealer regulations because they are best situated to realize the corresponding policy goals of that registration.

I have stated previously, in great detail and with considerable evidence, the importance of appropriately calibrating the de minimis threshold so that entities posing no systemic

risk and with a relatively small market footprint are not regulated under a regime that is more appropriate for the world's largest, most complex financial institutions.[2] If we fail to calibrate this threshold appropriately, firms at the margin will likely reduce their activity to avoid registration as opposed to serving their clients' interests and accepting the burdens of registration. A public policy choice which drives away market participants and reduces market activity is undeniably flawed.

From my first confirmation hearing in 2016 to the present day,[3] including meetings with elected representatives, my second confirmation hearing,[4]interviews with the press,[5] discussions with market participants, and in public remarks at event forums, [6] I have been adamant that notional value is a poor measure of activity and a meaningless measure of risk, and therefore, by itself, is a deficient metric by which to impose large costs and achieve substantial policy objectives.[7] Therefore, I have some reservations about this proposal's continued reliance on a one-size-fits-all notional value test for swap dealer registration.

I still, and will continue to, believe that the criteria for determining swap dealer registration should be more closely correlated to risk. However, if any final rule is going to settle for an activity-based threshold, a notional value metric should at least be combined with additional measures (such as dealing counterparty count and dealing transaction count) to determine what constitutes a de minimis quantity of swap dealing activity. Including additional measures should mitigate instances of "false positives" that could result from the use and deficiencies of any one activity-based metric.[8]

While it would have been my preference that this concept appear in this proposal's rule text as the operative standard, I am very grateful to the Chairman and the Division of Swap Dealer and Intermediary Oversight (DSIO) for including a robust discussion in the preamble on the merits of replacing the current notional value de minimis threshold with a three-prong test. Specifically, the preamble suggests an entity could qualify for the de minimis exception if its dealing activity is below *any* of the following three criteria: (i) a notional threshold, (ii) a proposed dealing counterparty count threshold, or (iii) a proposed dealing transaction count threshold. In other words, an entity would have to surpass all three hurdles collectively in order to lose the de minimis exception's safe harbor.

I have included several questions in the proposal that ask for feedback on this approach, particularly with respect to the dealing counterparty and transaction count thresholds which I believe would provide market participants with additional flexibility to serve their clients' needs without triggering a very costly and burdensome registration process. I thank the staff of DSIO for including my questions in the proposal and welcome market participant's feedback on this potential approach.

I also welcome comments on the Proposed Rule's preamble discussion on accounting for exchange-traded or cleared swaps in an entity's de minimis calculation. Many of the policy goals of swap dealer regulation are accomplished when a swap is exchange-traded and cleared. For example, systemic risk concerns are diminished with respect to cleared swaps: the swaps are standardized, the executing counterparties do not incur counterparty credit risk because they face the clearinghouse and not each other, and each side is required to post margin that helps guarantee performance and prevent unfunded losses from accumulating. Removing such swaps from the de minimis calculation would better align the registration threshold with risk and would also, I believe, encourage additional liquidity on SEFs. I am hopeful that with the benefit of additional industry comment and further Commission analysis, the Commission will either adopt an exclusion for exchange-traded and cleared swaps or adjust their notional weighting in an entity's de minimis calculation.

We must remember, the Commission is not establishing the de minimis exception in a vacuum. Subsequent to the adoption of the swap dealer definition, other regulatory requirements have gone into effect which also advance the goals of swap dealer registration, such as mandatory clearing, SEF trading, reporting swap data to repositories, and margin requirements for uncleared swaps. For example, regardless of whether an entity is registered as a swap dealer, its swap activity is transparent to the Commission because of the swap data and real-time reporting requirements that apply to all market participants.

When the Commission first established the $8 billion de minimis threshold in 2012, it did so without the benefit of swap data.[9] Now almost six years later, staff has conducted a comprehensive analysis of the available swap data collected by Commission-registered SDRs and presented estimates about the impact that lower or higher notional amount thresholds would have on swap dealer registration. Although much work remains to be done to further refine the data, particularly with respect to the non-financial commodity asset class, I commend staff for their hard work, progress, and thoughtful analysis. I believe the data in the Proposed Rule clearly supports maintaining the de minimis threshold at $8 billion or potentially increasing it. For example, at a $20 billion notional threshold, the estimated amount of notional swap activity that would no longer be covered by swap dealer regulation is approximately only 1/100th of 1 percent of the $221 trillion market analyzed. I am interested to hear from commenters about the policy and market implications of maintaining or raising the de minimis threshold.

Finally, I would like to commend the Chairman and DSIO for including many important improvements to the de minimis exception in this proposal which I fully support. For instance, I support an appropriate Insured Depository Institution exemption that will allow for banks to serve their clients' needs. By removing unnecessary timing restrictions and expanding the types of credit extensions that qualify for the exclusion, the proposal should improve the ability of IDIs to help their customers hedge loan-

related risks as the statute intended. I also support the proposed rule's clarification that swaps that hedge financial risks may be excluded from an entity's de minimis count. Market participants should be able to use swaps to manage their financial and physical risks without concern that such activity may trigger swap dealer registration.

I will vote in favor of issuing this proposal to the public for feedback and look forward to hearing from market participants about how these proposed amendments may be further refined or calibrated to increase the efficacy of the de minimis threshold to meet the goals of swap dealer registration.

Proposed Rule: Volcker Rule (Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds)

I support today's proposal to amend the Volcker Rule and efforts to acknowledge core elements of banking entities' trading activities in a manner consistent with the statutory provisions that established the Volcker Rule.

I am pleased that the proposal would revise elements of the prohibition on proprietary trading to provide banking entities, including CFTC-registered swap dealers and futures commission merchants, with greater flexibility in their trading activities and to simplify their compliance with the rule.

Banks and financial intermediaries are in the business of taking risk. When a bank extends a mortgage to a home buyer, it is taking a proprietary risk. When a bank provides working capital to a farmer, it is taking a proprietary risk. When a bank provides a revolving credit facility to a small business, it is taking a proprietary risk. And, in the context of the CFTC's jurisdiction, when a financial firm allows a client to hedge its exposures so that the client can focus on its core competency and better predict its operations, that financial institution is taking a proprietary risk. All of these financial functions provide crucial support to our economy and go to the heart of the complexity of implementing the Volcker Rule – the distinction between taking a proprietary risk that serves clients and a proprietary trade that is generated purely by the financial institution.

This proposal intends to tailor the requirements of the Volcker Rule to focus on entities with relatively large trading operations, and to simplify regulatory requirements by clarifying prohibited and permissible activities. I am particularly pleased that the proposal requests public input regarding key exceptions to the proprietary trading ban, concerning market-making, loan-related swaps, and risk-mitigating hedging.

I would like to highlight that today's proposal serves as an example of effective cooperation among five regulators: the CFTC; the Securities and Exchange Commission; the Federal Reserve Board; the Office of the Comptroller of the Currency; and the Federal Deposit Insurance Corporation. I firmly believe in inter-agency cooperation over areas of joint jurisdiction and applaud the Chairman for his hard work to develop productive and positive relationships with fellow regulators.

Finally, I would like to thank the staff of the Division of Swap Dealer and Intermediary Oversight for their efforts on this matter.

Final Rule: Indemnification (Amendments to the Swap Data Access Provisions of Part 49 and Certain Other Matters)

I would like to thank the staff in our Division of Market Oversight for their work to amend Part 49 of the Commission's Regulations to implement provisions of the Fixing America's Surface Transportation Act of 2015 (Fast Act)[10].

The Fast Act amended provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act)[11] that proved unworkable. Most significantly, the Fast Act repealed the Dodd-Frank Act's requirement that to obtain data from swap data repositories (SDR) registered with the CFTC, domestic and foreign authorities must indemnify the CFTC and SDRs from any claims arising from a SDR's production of information to those authorities. Foreign regulators unfamiliar with the U.S. tort law concept of "indemnification" that is inconsistent with their traditions and legal structures, have opted against requesting any information from SDRs. Domestic regulators have also opted against requesting information from SDRs because of the indemnification requirement. Removing the indemnification requirement will facilitate the sharing of SDR information with domestic and foreign authorities and better enable regulators in the United States and abroad to monitor risk across the global financial system.

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[1] *See* NATIONAL ECONOMIC RESEARCH ASSOCIATES, COST-BENEFIT ANALYSIS OF THE CFTC'S PROPOSED SWAP DEALER DEFINITION 1(Dec. 20, 2011) ("NERA Report*"),*http://www.nera.com/content/dam/nera/publications/archive2/PUB_SwapDealer_1211.pdf. It is difficult to estimate the initial and incremental, ongoing costs of swap dealer regulation. NERA's report regarding the costs of registration for non-financial energy firms remains one of the only comprehensive analyses produced.

[2] Keynote Address of Commissioner Brian Quintenz before the Smart Financial Regulation Roundtable (Nov. 2017), https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz3.

[3] Transcript, "Hearing to Consider Pending CFTC Nominations," Senate Agriculture, Nutrition, and Forestry Committee, September 15, 2016, 2016 WL 4938280 p.12)

[4] Transcript, “Hearing to Consider Pending CFTC Nominations,” Senate Agriculture, Nutrition, and Forestry Committee, July 27, 2017, 2017 WL 3215667 p.14 (“With regard to the de minimis threshold level, I think when this threshold was set originally it was really done without the benefit of a lot of data. I think if there is a scenario where this shortfall reduces from $8 billion to $3 billion. And instead of increasing registration, it would drive participants out of the market or force them to reduce their activity because of the cost that would be imposed upon them.”).

[5] Bain, Benjamin, “CFTC Swaps Dealer Threshold Criticized by Its Newest Republican,” Bloomberg (Oct. 9, 2017); *and* DeFrancesco, Dan, “CFTC’s Quintenz: Dealer Threshold Could Exclude Cleared Swaps - Commissioner Suggests Risks should be Better Considered in De Minimis Reappraisal,” Risk.Net (Oct. 24, 2017)

[6] “Fireside Chat: CFTC Commissioners,” FIA Expo Chicago (Oct 19, 2017) available at:https://expo2017.fia.org/articles/fireside-chat-cftc-commissioners, at 9’30” through 10’25”.

[7] For further discussion, see comment letter to CFTC from Financial Services Roundtable dated January 19, 2016 (“We do not see a benefit to requiring an entity that enters into a small number of swaps with a large notional amount but little exposure to choose between exiting the market or registering as a swap dealer, nor should entities that are taking on very large exposures without crossing a notional threshold, or a trade or counterparty count metric, be unregulated because they have concentrated risk in a small number of trades.”).

[8] *For further discussion, see* letter from Institute of International Bankers dated January 19, 2016.

[9] *See Hearing to Review the 2016 Agenda of the Commodity Futures Trading Commission Before the H. Comm. on Agric.,* 114th Cong. 17 (2016) (response of Timothy Massad, former CFTC Chairman, to question posed by Congressman David Scott (D-GA)),https://agriculture.house.gov/uploadedfiles/114-40_-_98680.pdf.

[10] Public Law 114–94, 129 Stat. 1312 (Dec. 4, 2015).

[11] Public Law 111–203, 124 Stat. 1376 (Jul. 21, 2010).