

SPEECHES & TESTIMONY

Objection of Commissioner Brian Quintenz to No-Action Relief from Certain Conditions of the Floor Trader Provision

June 27, 2019

Today's no-action letter brings to mind the old adage, "Anything worth doing, is worth doing right."

I have long argued for the policy implicit in today's floor trader no-action letter – that exchange-traded and cleared swaps should not be considered when determining whether a firm must register as a swap dealer. However, I firmly believe that the floor trader exception is a dangerous vehicle, and that no-action relief is a poor process, by which to achieve this substantial and justified policy outcome.^[1]

From my first confirmation hearing to the present day – in meetings with elected representatives and market participants, at my second confirmation hearing, through interviews with the press and public remarks, and in my consideration of the de minimis rulemakings that have come before me at the Commission – I have been adamant that the Commission must rationalize the poorly devised de minimis exception for swap dealer registration. In my view, an appropriate de minimis exception should incorporate factors correlated to risk, which would better align the registration threshold with the costs of swap dealer regulation and more accurately identify the entities warranting Commission oversight due to the interconnectedness, complexity, and systemic implications of their swap dealing activity.

As part of this right-sizing of the de minimis threshold, I have consistently advocated for removing exchange-traded and cleared swaps from an entity's swap dealer analysis. I have long noted that many of the policy goals of swap dealer regulation – including the reduction of systemic risk – are accomplished when a swap is exchange-traded and cleared, making it unnecessary to include those swaps in an entity's de minimis calculation.

Unfortunately, today the Commission is choosing an end-run around appropriately revising what constitutes a "de minimis quantity" of dealing activity by instead further distorting an archaic floor trader regulatory concept to lure unregistered entities into a "swap dealer light" registration scheme. Notably, the floor trader exception from swap dealer registration targeted by today's no-action relief only applies to proprietary trading firms that have historically never been required to register with the Commission. These firms, which risk their own capital and do not have customers or investors, can participate freely in the futures markets without registering with the CFTC.

Any proprietary trading firm that takes advantage of this revised floor trader exception should remember that no-action relief can be withdrawn at any time and with little notice. Further, I am also highly concerned that the current, streamlined regulatory obligations for floor traders will, in a similar way to the evolution of many government regulatory regimes, proliferate over time into a burdensome, byzantine, costly, and inappropriate set of requirements.

Even if I had agreed that the floor trader exception was the appropriate tool to address this policy issue, today's no-action letter subverts the Commission's rule-writing and deliberative process. This letter's broad applicability effectively changes the criteria for the floor trader exception without time limit, without a vote by the Commission, and without notice and comment. As a frequent and vocal critic of the CFTC's prior expansive and misguided use of no-action letters, it is unfortunate to see the Commission again embracing that approach.

If the CFTC views cleared and exchange-traded swaps as non-dealing activity (as today's no-action letter seems to indicate), the Commission should revise its regulations through a new rulemaking that allows all market participants – not just proprietary trading firms – to appropriately exclude such swaps from their dealing threshold. A new rulemaking should also propose including a risk-sensitive factor within the de minimis exception, like entity-netted notionals (ENNs), to more accurately measure an entity's swap dealing activity from a size and risk perspective.

The need to revisit aspects of swap dealer registration is hardly surprising. The Commission's regulatory framework for the swap market has greatly evolved from its state six years ago when the swap dealer definition, along with all of its exclusions and exceptions, was adopted jointly with the Securities and Exchange Commission (SEC). It is only common sense that the Commission, in light of data and experience, would need to re-examine and adjust elements of the swap dealer regulatory regime to keep pace with a dynamic, evolving marketplace. I believe the Commission has the flexibility to make further adjustments to its de minimis exception to address many of these issues. I would also support and welcome a joint rulemaking with the SEC where necessary to broadly reconsider the deficiencies of the current swap dealer registration framework.

I recognize that making such adjustments through rulemaking would require more time and effort – both on the part of the Commission and on the part of market participants. But, as I noted at the beginning, if it is worth doing, it is worth doing right. A rulemaking would provide the market with long-term regulatory certainty, ensure that all firms have the benefit of a rationalized registration scheme, and prevent squeezing currently unregistered firms into a registration category so that they can perform a low-risk and highly valuable market function of adding liquidity to the swaps marketplace. In my view, that would truly be a great day for the Commission, market intermediaries, and end-users. Unfortunately, today is not one of those days.

I have recorded my objection to this no-action letter with the Secretariat.

[1] Rule 1.3 provides that registered floor traders need not consider cleared swaps executed on or subject to the rules of a designated contract market or swap execution facility when determining whether the floor trader is a swap dealer, if certain conditions are met (hereinafter, the “floor trader exception”).