SPEECHES & TESTIMONY

Supporting Statement of Commissioner Brian Quintenz Regarding Final Rule: Derivatives Clearing Organization General Provisions and Core Principles

December 18, 2019

I am pleased to support today's final rule that amends the Commissions regulations governing derivatives clearing organizations (DCOs).[1]

Before highlighting aspects of the final rule, I would like to review the importance of central clearing, DCOs, and the Commission's oversight over these institutions. DCOs play a truly crucial role in the futures and swap markets by serving as a central counterparty to every transaction that they clear. When a transaction is cleared, the DCO guarantees performance of the contract until final settlement so that market participants do not bear counterparty credit risk to each other. The DCO sets collateral and daily-mark-to-market requirements, according to rules enforced by the CFTC, and otherwise maintains the financial integrity of cleared transactions, under CFTC-supervision. The CFTC's Division of Clearing and Risk (DCR) *regularly examines DCOs for compliance with the Commission's regulations*; *reviews new DCO rules*; and *assesses how DCOs manage market and liquidity risks.*

Central clearing has long been a hallmark of the futures market, dating back to the 1920s and functioning extremely well since then. Following Congress' 2010 amendments to the Commodity Exchange Act (CEA),[2] CFTC-regulated DCOs began clearing interest rate swaps and credit default swaps pursuant to revised statutory core principles[3] and revised CFTC DCO regulations.[4] Sixteen DCOs, located in the U.S., Canada, the U.K, France, Germany, and Singapore, are currently registered with the Commission to clear a diverse set of derivatives ranging from agricultural, energy, and Bitcoin futures, to overnight index swaps, to foreign exchange options.[5] Every day, these sixteen DCOs settle over $10 billion in daily mark-to-market obligations and hold over $450 billion in initial margin collateral.[6] Financial institutions, commercial end-users, and retail investors rely on the continued success of DCOs in order to ensure the integrity of their risk management transactions. The public also relies on the CFTC to ensure that DCOs are subject to meaningful regulations that prevent undue risk, while also providing DCOs with sufficient discretion to manage aspects of their operations that they are best equipped to handle without unnecessary government intervention. Today's final version of revised regulations for DCOs includes carefully considered enhancements which the Commission believes DCOs can fulfill without incurring overly burdensome compliance costs.

I am proud that the CFTC is one of only a few authorities around the world to have issued DCO rules that are consistent with the internationally-recognized CPMI-IOSCO *Principles for Financial Market Infrastructures* (PFMIs).[7] The Commission was a leader in both the development of the PFMIs as well as adopting rules consistent with the PFMIs, having done so in 2013.[8] The CFTC's rules for DCOs were augmented again in 2016 to include industry-accepted best practices for cybersecurity, business continuity, and disaster recovery.[9]

The amendments set forth in today's final rule include new requirements for: *governance*; *reporting clearing members' positions to the Commission*; *reporting changes in liquidity funding* and *settlement bank arrangements*; *determining initial margin requirements*; *default management procedures; enterprise risk management*; *reviewing haircuts on assets submitted as initial margin*; *exemptions for DCOs clearing only fully-collateralized contracts*; *cross-margining programs*; *transfers of open interest*; and *public disclosures issued in response to an CPMI-IOSCO initiative*.[10]

I would like to highlight some of the provisions of the final rule. Regarding reporting to the Commission, a DCO will be required to report daily the amounts of initial and variation margin for "*individual customer accounts*" held within each futures commission merchant (FCM)-clearing member's overall "*customer account*."[11] Such *individual customer accounts* include individual funds sponsored by an asset manager and an asset manager's separate accounts for institutional investors. DCR can use this information to more precisely assess the risks and exposures of a DCO's clearing members. In adopting this new requirement, the Commission noted that much of this information is already reported, meaning the burden to comply with the revised rule should be minimal. Regarding default management, the final rule requires a DCO to include clearing members in annual tests of its default management plan.[12] Finally, I note that while the proposal would have required a DCO to file a new report with the Commission 30 days in advance of clearing a new product,[13] the final rule eliminates this requirement, noting that both designated contract markets (DCMs) and swap execution facilities (SEFs) already file notices of new product offerings with the Commission under the "*self-certification*" process.

In conclusion, I am pleased that in finalizing these new rules, the Commission has genuinely taken the public's comments into account, reviewing input not only from the DCOs themselves, but also from the market participants that clear their trades at DCOs, including investment funds, futures commission merchants, and other financial institutions. I recognize that commenters raised important issues that are beyond the scope of, or not included in, today's rulemaking concerning the relationship between a DCO and its members. While the Commission will continue to consider the public's views on these issues, the Commission is focused on ensuring DCOs comply with the CEA's core principles. I hope that the DCOs, their members, and their members' customers can continue working in good faith to find constructive solutions to other issues not included here.

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[1] The CFTC's regulations for DCOs are codified in part 39 (17 CFR part 39).

[2] Dodd-Frank Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[3] Sec. 5b of the CEA.

[4] The current version of the CFTC's DCO regulations was promulgated in 2011 (DCO General Provisions and Core Principles, 76 Fed. Reg. 69,334 (Nov. 8, 2011)).

[5] The list of registered DCOs is available on the CFTC's website at,https://sirt.cftc.gov/sirt/sirt.aspx?Topic=ClearingOrganizations

[6] These figures represent daily averages over the past month and concern only products within the Commission's jurisdiction.

[7] The PFMIs are available at, https://www.bis.org/cpmi/info_pfmi.htm

[8] DCOs and International Standards, 78 Fed. Reg. 72,476 (Dec. 2, 2013).

[9] System Safeguards Testing Requirements for DCOs, 81 Fed. Reg. 64,322 (Sept. 19, 2016). In 2016, the Commission also instituted similar requirements for DCMs, SEFs and SDRs (81 Fed. Reg. 64,272 (Sept. 19, 2016)).

[10] Revised and new regulations 39.3(g); 39.10(d); 39.11(c) and (e); 39.13(f), (g)(3), (g)(8), and (i); 39.16(c), 39.19(c); 39.26; and 39.37(c).

[11] Revised regulation 39.19(c)(1)(i).

[12] Revised regulation 39.16(b).

[13] Proposed regulation 39.19(c)(4)(xxvi).