U.S. COMMODITY FUTURES TRADING COMMISSION
ENSURING THE INTEGRITY OF THE FUTURES & OPTIONS MARKETS

SPEECHES & TESTIMONY

Statement of Commissioner Mark P. Wetjen, Public Meeting of the Commodity Futures Trading Commission

October 30, 2013

Thank you Chairman Gensler. And my thanks to the professional staff for their hard work on the important final rule we are considering today regarding customer protection.

Customer Protection

The CFTC's core mission is to protect futures and swaps customers from fraud, manipulation, abusive practices and systemic risk. In pursuing this mission, it is vital that the commission unceasingly look to update and improve the protections we have in order to better protect the public and ensure the safety, soundness, and integrity of those operating in the derivatives marketplace.

The final customer protection rule before us today requires important improvements to a range of protections that have been implemented by the commission and industry in recent months. It fills certain remaining regulatory gaps to prevent future failures in the FCM community, and enhances nearly every protection afforded customers of FCMs in the futures and cleared-swaps markets. Customers will benefit from enhancements to FCM risk management programs, modernized audit programs and streamlined measures that will better insulate customers from fellow customer risk.

Residual Interest

The residual-interest provisions have been the most discussed part of the proposal. The commission received a significant number of comment letters in response to that proposal, which would have required FCMs to maintain “at all times” enough residual interest in their segregated accounts to cover all customer margin deficits. That approach was intended to limit fellow-customer risk by ensuring that one customer would in no circumstance be responsible for unwittingly covering another customer’s margin obligations.

Although the proposal offered one permissible construction of the Commodity Exchange Act, it suffered from some practical shortcomings. Those practical shortcomings, in my judgment, are appropriately addressed in the document before us today.

For example, many suggested that the “at all times” requirement under the proposal likely would have imposed significant capital costs on FCMs, which could have led to the unintended effect of limiting access to the derivatives markets. Many contended that this would be too high a price to pay when measured against the corresponding benefit of mitigating fellow-customer risks. The commission has considered these comments and has taken a different approach in today’s release.

The compromise reflected in the final rule is intended to usher in improvements to margin-collection practices over time and to protect access to the markets for a broad cross-section of participants. As a general matter, I strongly support improvements to the residual-interest requirements because of the critical policy objectives they are designed to achieve. First, they will better protect the excess segregation funds of a customer in the event of an FCM bankruptcy. Second, they will encourage FCMs to more actively monitor customer accounts for instances when those accounts are under-margined. And third, they will incentivize FCMs to address those circumstances when an account is under-margined. Together, these enhancements will better protect the safety and soundness of the FCM.

Importantly, the commission has given itself sufficient time to evaluate the FCM community’s progress in implementing the residual-interest policy in the final rule, and to change course if necessary. Indeed, the phased compliance schedule provided in today’s release was a

critical component of getting to this final compromise on residual interest.

That compromise is reasonable and measured. For one year, there will be no change to current practice with respect to the treatment of residual interest. After that year, FCMs will be required to comply with the residual-interest requirement as of the close of business on the day following the margin-deficit calculation. This is a necessary and significant change to current market practice.

Thirty months after today's release is published, commission staff is obligated to conduct a study determining the feasibility, costs and benefits of moving the residual-interest deadline to the completion of the first clearing-settlement cycle following the trade date. The study will be published for public comment, and a public roundtable will be held to solicit the views of market participants.

Finally, after five years, the residual-interest requirement will move up to the first clearing settlement cycle of the day, typically first thing in the morning, should the commission choose not to change course based upon recommendations in the study or in reaction to public feedback at the roundtable.

To be sure, if this end-state were implemented today it would no doubt create a significant cost to FCMs and to market participants. The five-year phase-in period, however, provides the industry an opportunity to streamline margin-collection practices and to take advantage of any technological solutions that may be developed in the meantime.

Equally important, today's release ensures that future residual-interest requirements will not be imposed on the FCM community if the facts on the ground regarding feasibility and cost do not support it. It is important to note that the study and roundtable are not optional but rather mandated by law, which means that the newly updated information will be brought to the commission before the phase-in period would end.

If the commission decides that it is appropriate to change the residual-interest deadline, the commission may act nimbly and implement a new compliance schedule for that deadline by order, without the procedural hurdles of notice and comment. I am confident that if the commission is presented with convincing facts through this process, it will be compelled to respond appropriately.

All stakeholders in today's release – including policymakers, FCMs and their customers – rightly anticipate that new services and technologies will provide solutions to today's compliance challenges. I know that all of us not only welcome those advancements but hope they are brought to market as quickly as practicable. The approach of this rulemaking appropriately incentivizes that outcome.

For that reason, I anticipate that technological solutions will facilitate compliance with residual-interest requirements in the near future for those who could not comply today. I must point out that the comment file to this rule suggests that the vast majority of the marketplace could comply with more abbreviated timelines for margin calls and payments today.

I also anticipate that the flexibility built into this final rule will help avoid the less desirable, alternative methods of compliance suggested by commenters, including self-funding or pre-funding residual interest or margin obligations, as some have predicted. To be more clear, I strongly prefer, and indeed expect, that FCMs will not pursue these options in order to comply with today's release. This judgment is based in part on the rapid advancement in settlement solutions in recent years, as well as the fact that the latter options may not – all things considered – be as commercially viable.

The expense of pre-funding margin accounts was a special concern of the agricultural community raised in their comments. I spent many days with agricultural producers over the last several months, discussing this issue and others. I met with a number of producers in my home state of Iowa who actively use the derivatives markets to hedge their production risks. I have listened to and carefully considered their concerns about the residual-interest requirement. Today's release takes those concerns into account, and I believe that their most-pressing fears will not be realized because of this rule.

Meanwhile, even today producers can make intra-day margin payments to FCMs through banking or credit relationships once a margin call is received. Based on what I have learned over recent months, these types of relationships are at a minimum common in the producer community, and seemingly the norm for larger producers. For those producers who do not currently rely on these services, again, I expect other solutions to payment settlement will be offered, or producers will in time embrace those already available, with marginal added expense to them.

I also would like to clarify that today's release does require FCMs to take a capital charge for failure to meet its residual-interest requirement, but this falls on the FCM at the close of business the day after its residual-interest obligation. Importantly, today's release phases in the timing of this capital-charge obligation until one year after its publication in the federal register, as some commenters suggested.

I would like to thank the staff for their work in putting together this balanced approach. With the concerns about residual interest properly addressed, I am happy to support the final rule as an important step forward in the commission's ongoing efforts to protect customers.

As a final note, I look forward to taking up the Volcker Rule and the position-limits proposal by year-end, along with a number of commission determinations on substituted compliance. As I said at the time we finalized our cross-border guidance, those determinations will benefit from as much transparency as practicable. With that, I look forward to supporting the staff's recommendations on the rule before the commission today.

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