

# Public Statements & Remarks

## Statement of Commissioner Caroline D. Pham in Support of Proposed Order and Request for Comment on Comparability Determination for EU Nonbank Swap Dealer Capital and Financial Reporting Requirements

June 07, 2023

In order to implement Title VII of the Dodd-Frank Act and create a comprehensive regulatory framework for over-the-counter (OTC) derivatives markets, the Commodity Futures Trading Commission (Commission or CFTC) promulgated rules for the registration of swap dealers in 2012.[1] Since that time, the Commission has issued dozens of rules for the oversight of swap dealers and their activities.[2] Because swaps markets are global and involve cross-border transactions, and both U.S. and non-U.S. swap dealers must register with the CFTC, the Commission has also made 12 comparability determinations in order to provide for substituted compliance for non-U.S. swap dealers with home jurisdiction regulations that are comparable and comprehensive.[3]

I support the Commission's proposed order and request for comment on a comparability determination for European Union (EU) nonbank swap dealer capital and financial reporting requirements. I would like to first deeply thank the staff of the Market Participants Division (MPD) for their hard work on these incredibly technical and detailed requirements, involving many hours of engagement with the European Central Bank (ECB), Autorité de contrôle prudentiel et de résolution (ACPR), and CFTC registrants. This proposal is the staff's third proposed capital adequacy and financial reporting comparability determination in the past year, after Japan[4] and Mexico[5], with the UK to be addressed next.

I want to remind you that this decidedly unglamorous work by CFTC staff creates the underpinnings of global markets that enable governments, central banks and commercial banks, asset managers and investors, and companies to manage the risks inherent in international flows of capital that fuel economic growth and prosperity in both developed and developing economies. I commend these MPD staff members for their dedication and work on this proposal: Amanda Olear, Tom Smith, Rafael Martinez, Liliya Bozhanova, Joo Hong, and Justin McPhee.

## **Conditions for Notice Requirements**

I especially thank the staff for addressing my comments on the prior capital and financial reporting comparability determination proposals, by providing more clarity on the conditions for notice requirements for certain defined events such as undercapitalization or breaches of capital levels. Generally, the proposal states that written notice to the CFTC and the National Futures Association (NFA) is required within 24 hours of when the firm “knows or should have known” of the defined event.

I am pleased that this proposal solves the guessing game and now makes clear that the “should have known” part of the timing standard for the filing of the proposed notice is “intended to cover facts and circumstances that should reasonably lead the firm to believe” that the defined event has occurred. This additional clarity will allow EU nonbank swap dealers to implement reasonably designed notification processes to comply with the proposed conditions.

In addition, I thank the staff for providing more clarity in response to my feedback on conditions for written notice within 24 hours to the CFTC and NFA if an EU nonbank swap dealer fails to maintain current books and records. I am pleased that this proposal now makes clear that the proposed notice requirement applies to books and records with respect to the EU nonbank swap dealer’s financial condition and financial reporting requirements, such as “current ledgers or other similar records” regarding asset, liability, income, expense, and capital accounts “in accordance with the accounting principles accepted by the relevant competent authorities.”

Without this substantive clarification, the proposed notice requirement could have been so overbroad as to require 24 hours’ written notice to the CFTC and NFA for *any* failure to maintain books and records. The Commission could have been inundated by a nonstop deluge of written notices for recordkeeping lapses, no matter how immaterial.

## **Market Fragmentation and Good Practices for Cross-Border Regulation**

The importance of substituted compliance and these comparability determinations for global swaps markets cannot be overstated. As noted by the International Organization of Securities Commissions (IOSCO) in its 2019 report on *Market Fragmentation and Cross-Border Regulation*[6] under the Japanese Presidency of the G20, unintended market fragmentation[7] can be harmful to wholesale securities and derivatives markets.

Despite its flaws and inauspicious beginnings[8], the CFTC's 2013 Cross-Border Guidance is the foundation for today's \$600 trillion notional swaps markets[9] that spans the globe from one financial markets trading hub to another—New York, to London, Paris, Frankfurt, Tokyo, Hong Kong, Singapore, and beyond. The Commission and its staff have labored for the past 10 years to improve upon the Cross-Border Guidance and promote international regulatory harmonization through substituted compliance comparability determinations, rulemakings, guidance, advisories, and no-action letters. These efforts have helped to address features and indicators of market fragmentation set forth in the IOSCO 2019 report:

- Multiple liquidity pools in market sectors or for instruments of the same economic value which reduces depth and may reduce firms' abilities to diversify or hedge their risks and result in similar assets quoted at significantly different prices
- Reduction in cross-border flows that would otherwise occur to meet demand
- Increased costs to firms in both risks and fees
- Potential scope for regulatory arbitrage or hindrance of effective market oversight

I am pleased that the Commission is finishing what it started back in 2012 by taking these steps to complete comparability determinations necessary to providing a substituted compliance regime over the whole of the CFTC's swaps regulation. As I have stated before, global collaboration and coordination are critical to promoting regulatory cohesion and financial stability, and mitigating market fragmentation and systemic risk.[10]

I continue to believe that the CFTC should take an outcomes-based approach to substituted compliance that promotes efficient global markets and preserves access for U.S. persons to other markets. In particular, I encourage the Commission, its staff, and our regulatory counterparts around the world to adhere to the recommendations in IOSCO's 2020 report on *Good Practices on Processes for Deference*, which was developed to provide solutions to the challenges and drivers of market fragmentation.[11]

As set forth in the IOSCO 2020 report, such processes for deference[12] are typically outcomes-based; risk-sensitive; transparent; cooperative; and sufficiently flexible.

## **Conclusion**

When used appropriately, substituted compliance can take a balanced approach to achieving these key objectives: (1) facilitating market access to foreign market participants seeking to conduct business on a cross-border basis; (2) maintaining appropriate levels of market participant protection; and (3) managing systemic risks.[13] I commend the staff for striking the appropriate balance in this proposed order and request for comment on a comparability determination for EU nonbank swap dealer capital and financial reporting requirements. I encourage the public to comment on this, and to especially note any areas where the proposed conditions may be unnecessarily burdensome, create operational complexity, or present implementation challenges.

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[1] See Registration of Swap Dealers and Major Swap Participants (Final Rule), 77 Fed. Reg. 2613 (Jan. 19, 2012), <https://www.cftc.gov/sites/default/files/idc/groups/public/@Irfederalregister/documents/file/2012-792a.pdf> (<https://www.cftc.gov/sites/default/files/idc/groups/public/@Irfederalregister/documents/file/2012-792a.pdf>).

[2] These rules range from business conduct standards to thresholds for registration with the CFTC. See, e.g., Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties (Final Rule), 77 Fed. Reg. 9734 (Feb. 17, 2012).

[3] See generally, 7 U.S.C. 2(i). The Commission created the comparable and comprehensive standard for substituted compliance determinations. See Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (Proposed Rule), 77 Fed. Reg. 41214, 41230 (July 12, 2012). The comparable standard is now in CFTC regulations 23.23 for swap dealer registration, 23.160 for margin, and 23.106 for capital. See 17 CFR 23.23, 23.160, and 23.106. The CFTC maintains its list of comparability determinations for substituted compliance purposes at

<https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm>

(<https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm>).

[4] Commissioner Pham “Concurring Statement of Commissioner Caroline D. Pham Regarding Proposed Swap Dealer Capital and Financial Reporting Comparability Determination” (July 27, 2022).

[5] Commissioner Pham “Concurring Statement of Commissioner Caroline D. Pham Regarding Proposed Order and Request for Comment on an Application for a Capital Comparability Determination” (Nov. 10, 2022).

[6] IOSCO Report “Market Fragmentation & Cross Border Regulation” (June 2019),

<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD629.pdf>

(<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD629.pdf>).

[7] Both the Financial Stability Board and IOSCO have defined “market fragmentation” as “global markets that break into segments, either geographically or by type of products or participants.” *Id.* at 6-9.

[8] Commissioner O’Malia “Statement of Dissent by Commissioner Scott D. O’Malia, Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations and Related Exemptive Order”

(July 12, 2013), <https://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement071213b>

(<https://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement071213b>).

[9] See Bank for International Settlements “OTC derivatives statistics at end-June 2022” (Nov. 30, 2022),

[https://www.bis.org/publ/otc\\_hy2211.pdf](https://www.bis.org/publ/otc_hy2211.pdf) ([https://www.bis.org/publ/otc\\_hy2211.pdf](https://www.bis.org/publ/otc_hy2211.pdf)).

[10] Commissioner Pham “Opening Statement of Commissioner Caroline D. Pham before the Global Markets Advisory Committee” (Feb. 13, 2023),

<https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement021323>

(<https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement021323>).

[11] IOSCO Report, “Good Practices on Processes for Deference” (June 2020),

<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD659.pdf>

(<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD659.pdf>).

[12] IOSCO uses “deference” as an “overarching concept to describe the reliance that authorities place on one another when carrying out regulation or supervision of participants operating cross-border.” *Id.* at 1. The CFTC’s use of substituted compliance for swaps regulation is an example of regulatory deference mechanisms.

[13] These considerations for regulatory authorities were recognized by IOSCO in its 2015 *Report on Cross-Border Regulation*. See IOSCO Report, “IOSCO Task Force on Cross-Border Regulation Final Report” (Sept. 2015), <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD507.pdf> (<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD507.pdf>).

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