Public Statements & Remarks

Statement of Commissioner Dawn D. Stump Regarding Joint Final Rule: Customer Margin Rules Relating to Security Futures

October 22, 2020

I am pleased to be a part of today's Joint Open Meeting of the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC). I commend:

- Chairmen Tarbert and Clayton for holding this Meeting to provide transparency into our work in jointly addressing issues of mutual interest to both our agencies;
- Commissioner Quintenz at the CFTC and Commissioner Peirce at the SEC for laying the groundwork for this Joint Meeting through their efforts to harmonize the regulatory regimes of the agencies, as these harmonization efforts benefit not only those we regulate, but also the public we all serve; and
- The staff of the agencies for putting before us a Joint Final Rule that will lower the margin level for an unhedged security futures position from 20% to 15%, which I firmly believe is sound public policy.

And yet, while I don't want to rain on today's parade, I nevertheless feel compelled to express a few regrets.

I regret, for example, that the Commissions did not take the common-sense step of reducing the security futures margin level from 20% to 15% years ago. After all, OneChicago, the only U.S. exchange that made a long-term effort to develop a market for security futures, asked us to take this step 12 years ago in 2008. And the self-regulatory organization rules establishing a 15% margin level for unhedged security futures held in a securities portfolio margin account (with which the action we are taking will align) have been in effect for at least 10 years since 2010. I appreciate that the global financial crisis and the ensuing regulatory focus on swaps and other reforms diverted attention from security futures. But it is nonetheless disappointing that it took the Commissions a decade to take the step we take today–and even more disappointing given that OneChicago did not survive to see it, as it discontinued all trading operations about a month ago on September 21.

I also regret that the adopting release does not recognize the unique circumstances presented by the recent exit of OneChicago and the fact that no U.S. exchange currently lists security futures for trading, and thus issues opinions on hypothetical questions that I do not believe we should be addressing here. By way of background, when the Commissions proposed to reduce the margin level of an unhedged security futures position from 20% to 15%, we also requested comment on whether there are any other risk-based margin methodologies that could be used to prescribe margin requirements for security futures.[1] In response, OneChicago urged the Commissions to permit the use of risk-based margin models for security futures–similar to what is done for other futures contracts. I am in complete agreement that we should not adopt such a sweeping change to the manner in which margin is calculated for security futures based solely on the response to a single request for comment in a proposal designed to address a wholly different type of margin calculation rule.

Unfortunately, though, the adopting release goes further, and rejects OneChicago's arguments regarding the Commissions' authority to adopt risk-based margining for security futures. Some of these arguments are fact–based, and thus a future change in facts could yield a different conclusion, which is appropriate.[2] But the adopting release also rejects OneChicago's interpretive arguments that the Commissions can adopt risk–based margining for security futures even absent a change in factual circumstances.[3] I think that is unfortunate, for three reasons.

First, I do not believe that we should be offering advisory opinions on interpretive questions that, in light of the demise of OneChicago, no CFTC- or SEC–registered exchange is currently asking. In my view, these hypothetical questions are not material given the circumstances before us, and should therefore be left to future CFTC and SEC Commissioners, to be decided in the context of a live request to list and trade security futures.

Second, risk-based margining for security futures is permitted in Europe, and while factors other than margin requirements may influence demand for security futures, its rejection in the adopting release creates a potential competitive disadvantage for U.S. exchanges vs. their international counterparts. The Commodity Exchange Act (CEA) specifies that one of its purposes is "to promote responsible innovation and fair competition among boards of trade, other markets and market participants."[4] The interpretation in the adopting release fails to fulfill that purpose.

Third, it should be remembered that the trading of security futures on U.S. exchanges before the year 2000 was prohibited due to jurisdictional disputes over the treatment of products that have attributes of both SEC–regulated securities and CFTC–regulated derivatives. In the Commodity Futures Modernization Act of 2000 (CFMA), Congress repealed that prohibition and permitted security futures to trade on U.S. exchanges pursuant to a framework of joint regulation by the CFTC and the SEC.[5] Yet, the rejection of risk-based margining in the adopting release risks stifling the very security futures market that the CFMA intended to promote.

Nevertheless, it is my sincere hope that while the reduction in margin level for an unhedged security futures position from 20% to 15% may have come too late for OneChicago, it will incentivize another U.S. exchange to launch security futures. And in that event, it is my further hope that the Commissions will bring an open mind to any interpretive arguments the exchange may advance if it requests recognition of risk-based margining for its contracts.

In the meantime, I support the Joint Final Rule that is before us.

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[1] Customer Margin Rules Relating to Security Futures, 84 Fed. Reg. 36434, 36441 (July 26, 2019). The proposing release also asked commenters, if their answer to this question was yes, to "please identify the margin methodologies and explain how they would meet the comparability standards under the [Securities] Exchange Act [of 1934]." *Id.*

[2] The Securities Exchange Act of 1934 (Exchange Act) provides that margin levels for security futures must, among other things, be: i) *consistent with* the margin requirements for *comparable* options traded on any exchange registered pursuant to Section 6(a) of the Exchange Act; and ii) *not lower than* the lowest level of margin, exclusive of premium, required for any *comparable* exchange-traded options. *See* Sections 7(c)(2)(B)(iii)(I)-(II) of the Exchange Act (emphasis added). The adopting release concludes that risk-based margining for security futures is inappropriate, in part, because it would substantially deviate from how margin requirements are calculated for exchange-traded equity options at this time. If risk-based margining were permitted for such equity options in the future, then risk-based margining for security futures might follow, too.

[3] OneChicago's interpretive arguments included that: i) the Commissions' reading of Sections 7(c)(2)(B)(iii)(I)-(II) of the Exchange Act as focusing on margin levels is incorrect; and ii) security futures contracts are not "comparable" to equity options and, therefore, the "consistent with" and "not lower than" margin restrictions in Sections 7(c)(2)(B)(iii)(I)-(II) of the Exchange Act do not apply.

[4] CEA Section 3(b), 7 U.S.C. § 5(b) (emphasis added).

[5] Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763 (2000).

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