SPEECHES & TESTIMONY

Opening Statement of Chairman J. Christopher Giancarlo before the Open Commission Meeting

June 4, 2018

Good morning. This meeting will come to order. This is a public meeting of the Commodity Futures Trading Commission (CFTC).

I am pleased to be joined today by my colleagues, Commissioners Brian Quintenz and Rostin Benham in our first public meeting together as a Commission.

These hearings require great preparation. I would like to thank the CFTC staff for their hard work and input.

We are here today to consider one final rule amending the swap data access provisions and two proposed rules amending the Volcker Rule and Swaps Dealer de minimis calculations.

Indemnification Rule

I turn first to the final rule on amendments to the swap data access provisions of Part 49, also formerly known as the swap data repository (SDR) indemnification rule.

Eight years ago, Congress included in the Dodd-Frank Act a requirement that foreign and domestic regulators indemnify SDRs and the Commission for any expenses arising from litigation relating to the information provided by SDRs. Foreign and domestic regulators were unable or unwilling to provide this indemnification hindering the ability to share swaps data. The indemnification requirement also hindered the ability of foreign and domestic regulators to access SDR data to assess risks their regulated entities are assuming, and the impact of such risks on the broader markets.

I am pleased that Congress has since amended the Dodd-Frank Act to take out the indemnification requirement. We therefore can change our regulations accordingly, which we propose to do today.

In addition to the removal of the indemnification requirement, the final rule adds a category of “other regulators” that the Commission may deem to be appropriate to receive access to SDR swap data.

The final rule sets out the process by which appropriateness is determined for those entities that are not already specifically enumerated. This process is a change to current Commission regulations, as it would apply to any such entity, including domestic regulators not enumerated in Commission regulations and foreign regulators.

The statute also now requires a SDR to receive a written agreement from each requesting entity stating that the entity shall abide by the confidentiality requirements described in the CEA prior to sharing information with the requesting entity. Commission regulations currently require the SDR and the requesting regulator to execute a confidentiality agreement, but do not provide a form or details of such an agreement.

The final rule modifies the current Commission regulations by providing a form of confidentiality arrangement, as Appendix B to part 49, and by requiring the confidentiality arrangement to be between the requesting regulator and the Commission. The Commission expects that this will benefit SDRs in that most, if not all, confidentiality arrangements will be exactly the same, and the Commission will be in the place of entering into the confidentiality agreements with regulators.

We received comments from the affected CFTC-registered SDRs on the proposed rule that I believe that we have sufficiently addressed. The final regulations provide long-awaited clarity to the official sector regarding the CFTC’s requirements to determine access to, and safeguard the confidentiality of, transactional information reported to SDRs.

In my experience as a Commissioner and Chairman of the CFTC, I have found, as have other foreign and domestic regulators, that conducting oversight of global derivatives markets can be difficult as a result of the current fragmented financial regulatory structure. In this regard, I expect that the final rule will enable authorities to enhance their oversight of derivatives markets across product and asset classes by marrying up the trading and position data they receive from regulated entities with the data sets obtained directly from SDRs. In so doing, I believe we have made significant progress towards cross-border data sharing and enhancing transparency in the global swaps market.

Because today’s swaps markets are global in scope, utilizing the data and information available in only one jurisdiction does not provide a complete picture of cross border trading activity and systemic risk. To that end, I expect that CFTC staff will seek to facilitate access to SDR data for authorities with which we have a history of regulatory assistance and that similarly seek to facilitate CFTC access to data maintained by trade repositories in their jurisdiction. Such data sharing represents an opportunity for greater cooperation among market and prudential regulators, as well as among foreign and domestic regulators, providing more effective financial market oversight, expanding data driven policymaking, and improving early warning systems to reduce the probability or severity of a financial crisis.

These regulations will have a direct positive impact on the operational readiness of the official sector, providing authorities with critical information to make sound near-term and long-term policy and oversight decisions.

I am particularly pleased that this rule represents a final step in eliminating a major legal impediment to sharing swaps market data with overseas regulators. The Dodd-Frank Act’s original insistence on an indemnification requirement may have been well-intentioned to protect the safety of data held in SDRs, but Congress wisely determined that any such benefit is outweighed by the greater public interest of allowing international regulators to share and access information to carry out the regulatory and supervisory functions necessary to protect the global financial markets.

It is essential that policymakers in other jurisdictions make determinations similar to these before us today concerning current legal barriers to information sharing. Even a law, like the new EU General Data Protection Regulation (GDPR), which has laudable objectives, must not be applied in ways that hinder the sharing and access of information between European and U.S. regulators for regulatory and supervisory purposes. Such a result could have dangerous implications for our global markets. I hope today's action by the CFTC will encourage international regulators and policymakers to take affirmative steps to address other existing legal barriers to information sharing and access.

The Volcker Rule

I turn next to the proposal for amendments to the Volcker rule.

Section 619 of the Dodd-Frank Act added a new section 13 to the Bank Holding Company Act of 1956 (BHC Act) that is commonly known as the Volcker Rule. The new section generally prohibits "banking entities" from engaging in "proprietary trading" for the purpose of selling financial instruments to profit from short-term price movements. Section 13 of the BHC Act also generally prohibits banking entities from acquiring or retaining an ownership interest in, or sponsoring, a hedge fund or a private equity fund ("covered funds").

As we know, the Volcker rule is named for former Federal Reserve Chairman, Paul Volcker. The basic premise of the Volcker Rule is to restrict use of insured bank depositors' money for bank proprietary trading but permit it for market making, hedging and other traditional financial service activities. It is a sound premise, but one that relies on correctly identifying and separating these activities, a task that is far from simple. No other major economy outside of the United States has adopted restrictions similar to the Volcker Rule.

Recognizing that the "devil is in the details," Congress left the finer points of developing Volcker Rule regulations to five agencies: the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Securities and Exchange Commission (SEC), and the CFTC (together, the "Agencies"). The Agencies issued the final rule in December 2013.

We now have four years of experience with the initial version of the Volcker Rule. In that time, concern has grown that US regulators' first pass at the rule was not ideal in several respects. Specifically, the current rule causes confusion as to what is acceptable activity, presumes unacceptable activity in various cases and imposes highly intensive compliance burdens in all cases unfairly benefitting large Wall Street banks over smaller regional ones.

A year and a half ago, I had the opportunity to speak about the rule with Chairman Volcker. Chairman Volcker said that he was proud of the rule that bears his name. But he also said told me that regulators should have come up with something more straightforward than what is currently in place, especially for smaller banks.

The amendments to the Volcker Rule in the proposal before us today address that concern. The proposal seeks to simplify and tailor the Volcker Rule to increase efficiency, right-size firms' compliance obligations, and allow banking entities – especially smaller ones - to more efficiently provide services to clients. It adopts a risk-based approach relying on a set of clearly articulated standards for both prohibited and permitted activities and investments.

The proposal addresses a number of targeted areas of widespread concern. First, it tailors the application of the Volcker Rule to a firm's risk profile and size and scope of trading activities. In particular, it further streamlines compliance obligations for firms with smaller trading operations. These changes reflect the experience of the Agencies that the costs and uncertainty faced by smaller and mid-size firms of complying with the 2013 final rule have been disproportionately high relative to the amount of their typical trading activity.

Second, the draft proposal seeks to streamline and clarify for all banking entities certain definitions and requirements related to the proprietary trading prohibition and limitations on covered fund activities and investments. To this end, and where appropriate, the Agencies have sought to codify, or otherwise address, matters currently covered by staff guidance through responses to Frequently Asked Questions (FAQs). Additionally, the Agencies are seeking in this proposal to reduce reporting, recordkeeping and compliance program complexity where appropriate.

This proposal will provide banking entities and their affiliates, including a number of swap dealers, FCMs and commodity pools subject to CFTC oversight, with greater clarity and certainty about what activities are permitted under the Volcker Rule. For the CFTC, "banking entities" subject to the Volcker Rule include primarily swap dealers and FCMs that are: insured depository institutions, certain foreign banking entities operating in the U.S. and affiliates of either of those two categories. In addition, certain commodity pools that are owned or controlled by any such entity may also be banking entities or covered funds under the Volcker Rule.

Third, this proposal will address the implicit bias against market making in the current version of the Volcker Rule. Last year, I testified to Congress that the 2013 Volcker Rule presumes that some activities are impermissible proprietary trading that really should be permissible market-making. That presumption creates a bias against market activity and healthy trading liquidity – a first order concern for the CFTC as a market regulator. Today's proposal would remove the presumption, and that bias, by allowing banking entities the ability to more effectively and efficiently engage in routine market making. It will benefit CFTC registrants by allowing them to support trading markets more actively without having to prove that each trade was not on the wrong side of this presumption.

So why are these modest changes important? Because, as monitored by the CFTC's Market Intelligence Branch, current market conditions are becoming increasingly volatile as a result of a range of factors, including changes in US monetary policy, strong US economic growth and increased global political risk. In higher volatility markets, such as we saw last week in European sovereign debt, durable trading liquidity and vigorous market making are essential to smooth out trading gaps in price and supply and avoid potential panic.[1] That is why these amendments to the Volcker Rule simplifying legitimate market making activity will enhance market orderliness and resiliency in times of market stress.

As important as are these improvements on their individual merits, equally important is that we and the other Agencies are today re-endorsing as a foundational element of US financial market regulation the Volcker Rule and its prohibition on bank proprietary trading with depositor funds. This fact must not go unrecognized in accounts of the important, but relatively modest amendments, before us today.

Today's proposal is the product of a collaborative effort with the Federal Reserve, FDIC, OCC, and SEC. I thank my fellow regulators for close cooperation, especially my fellow agency Chairman and friend, Martin Gruenberg, who will soon step down. Marty worked with us to make sure today's amendments do not disrupt the "core principles" of Volcker and that its prohibitions on proprietary trading remain "robust."

I also thank CFTC staff for their fine work that resulted in today's proposal. I look forward to reviewing comments from the public.

Swap Dealer de minimis

Finally, I want to turn to the proposal for the swap dealer de minimis definition.

Since becoming Chairman, I have committed to resolving this outstanding issue and giving market participants the regulatory certainty they need. Still, as you know, last year I requested that the Commission postpone a decision on the de minimis threshold for a year. That decision was understandably disappointing to some, including my fellow Commissioners, who said they were then ready to vote on it.

Yet, as I told Congress at the time, I did not just want to address the de minimis threshold; I wanted to get it right.

Today, I believe the staff has had adequate time to analyze the most current and comprehensive trading data and arrive at a recommendation for the best path forward in terms of managing risk to the financial system. The staff has provided Commissioners with full access to the data they have used in their analysis. They have also conducted additional and specific data analyses requested by Commissioners.

The data shows quite clearly that a drop in the de minimis definition from $8 billion to $3 billion would not have an appreciable impact on coverage of the marketplace. In fact, any impact would be less than one percent - an amount that is truly de minimis.

On the other hand, the drop in the threshold would pose unnecessary burdens for non-financial companies that engage in relatively small levels of swap dealing to manage business risk for themselves and their customers. That would likely cause non-financial companies to curtail or terminate risk-hedging activities with their customers, limiting risk-management options for end-users and ultimately consolidating marketplace risk in only a few large, Wall Street swap dealers.

In my travels around the country over the past four years on the Commission, I have met numerous small swaps trading firms that make markets in local markets or in select asset classes. These firms are often housed in small community banks, local energy utilities or commodity trading houses. They all trade below the $8 Billion threshold. Almost all of them say that if the de minimis threshold were to drop to $3 Billion, they would reduce their trading accordingly. They just cannot afford to be registered as swap dealers.

Who are the winners if these small firms reduce their market making activities? Big Wall Street banks. Who are the losers if these small firms reduce their market making activities? Small regional lenders, energy hedgers and Ag producers, who become more dependent on Wall Street trading liquidity. Who is the really big loser? The US economy, which becomes more financially concentrated and less economically diverse.

That is why I think the proposed rule rightly balances the mandate to register swap dealers whose activity is large enough in size and scope to warrant oversight without detrimentally affecting community banks and agricultural co-ops that engage in limited swap dealing activity and do not pose systemic risk. Leaving the threshold at the $8 billion level allows firms to avoid incurring new costs for overhauling their existing procedures for monitoring and maintaining compliance with the threshold. It fosters increased certainty and efficiency in determining swap dealer registration by utilizing a simple objective test with a limited degree of complexity. And it ensures that smaller market makers and the counterparties with which they trade can engage in limited swap dealing without the high costs of registration and compliance as intended by Congress when it established the de minimis dealing exception to begin with.

The changes proposed today will also not count swaps of Insured Depository Institutions (IDIs) made in connection with loans. They would allow, for example, an insured depository institution swap dealer to write a swap with a customer 181 days after entering into a loan without counting it towards the $8 billion threshold. These types of changes will allow small and regional banks to further serve customers' needs without the added burden of unnecessary regulation and associated compliance costs.

This proposal incorporates feedback and input from my two fellow Commissioners and their fine staffs. We now look forward to feedback from the public and market participants. We ask numerous questions about whether any additional exceptions or calculations should be included in the final rule. Three years ago, I raised the question of whether there should be an exclusion from counting cleared swaps towards the registration threshold and that question is asked again. Your response to questions regarding adding other potential components will help the Commission assess whether further adjustments to the de minimis exception may be appropriate in the final rule.

As discussed in the adopting release, staff continues to consult with the SEC and prudential regulators regarding the changes in the proposal in particular some of the questions regarding exclusions. I remain committed to working with Chair Jay Clayton and the SEC in areas where harmonization is necessary and appropriate.

I also remain committed to finalizing this rule before the end of the year. I recognize that market participants need certainty. Today's proposal is a major step forward in doing just that. I applaud staff for this proposal and look forward to feedback.

Thank you.

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[1] (file:///S:/Media/DRAFT%20press%20releases/2018%20Speeches,%20Testimony,%20Events%20etc/giancarlostatement060418.doc#_ftnref1) It was widely reported that last week's extraordinarily high volatility in European sovereign debt markets was exacerbated at least in part by the reluctance of large banking institutions to commit trading capital due to regulatory constraints on use of capital. *See,* Kate Allen & Miles Johnson, *Italian Rout Points to Strains in Post-Crisis Regulatory Structure*, Financial Times, June 1, 2018; and *In Italy, A Hair-Trigger Market*, Riva Gold & Jon Sidreu, Wall Street Journal, June 1, 2018.