

91st Annual Convention - Four Seasons Resort, Santa Barbara, CA – May 13-15, 2015

DSG Update: House Ag Hearing on the CFTC's 2015 Agenda

February 13, 2015



HOUSE AG COMMITTEE HEARING ON THE CFTC: 2015 AGENDA FOR THE CFTC

OVERVIEW

For questions please contact [Kwon Park](#) at (202) 547-3035.

Yesterday, the House Agriculture Committee held a hearing on the 2015 Agenda for the Commodity Futures Trading Commission (CFTC or Commission). CFTC Chairman Massad was the sole witness.

Please see below for more information:

[CFTC Chairman Massad Opening Statement](#)

Key Takeaways

- Massad expressed concerns over the supplemental leverage ratio (SLR) requiring futures commission merchants to hold more capital, and that he is working with the prudential regulators to address those concerns.
- Massad said the cybersecurity is a big priority for the CFTC, and the Commission must ensure centralized counterparties (CCPs) and others are ready with a good framework in place to prevent cyber attacks.
- Massad indicated that the CFTC must propose a rule that allows commercial participants to engage in legitimate *bona fide hedging* practices, and that the Commission will take its time to ensure the rule is finalized correctly (with no specific timeframe).
- Massad stated that the Commission is working out an arrangement for CCP equivalence determination with Europe, and even if the problem is not resolved by June (when the increased capital charges kick in), European staff have suggested that the capital charge deadline may be extended further.
- Massad proactively raised that registration of high-frequency trading firms is under consideration by the Commission, but noted is not a priority nor something the Commission will act on soon.

SUMMARY

Opening Statement and Testimony

Chairman Conaway (R-TX):

- The Congress and the CFTC made mistakes in Dodd-Frank rulemaking and implementation, so steps must be taken to ensure that rules do not burden end users.
- Conaway laid out four priorities for the House Ag Committee:
 - Examining the swaps market under new regulations;
 - Implementing a position limits rule that the Commission finds necessary to prevent excessive speculation, while making sure that the *bona fide hedging* definition and anticipatory hedging definition are broad enough for commercial firms to continue business practices;
 - Building trust and mutual respect with international regulators to finish executing rules that work cross-border; and
 - Collecting and analyzing data collected under Dodd-Frank, which is critical to well-functioning swaps markets.
- The House Ag Committee will act on CFTC Reauthorization this year and focus on how to tailor and refine the law so it works for all market participants.

Ranking Member Peterson (D-MN):

- The Committee's top priority is to reauthorize the CFTC.

Chairman Massad:

- Massad laid out the Commission's priorities for 2015:
 - Fine-tune CFTC regulations to allow commercial end users to use derivatives markets effectively and efficiently;
 - Implement swaps reforms to bring more transparency into the markets, enhance further trading on swap execution facilities (SEFs), and finalize rules on position limits and margin for uncleared swaps;
 - Enforcement of market manipulation, high-frequency trading (HFT) and other sophisticated trading practices;
 - Harmonize rules internationally; and
 - Examine cybersecurity issues at CCPs and exchanges, and assess automated trading impacts on derivatives markets.

Discussion

Basel III and Leverage Ratio

Lucas (R-OK): The SLR requires futures commission merchants (FCMs) to hold more capital for cleared trades – is this a legitimate concern? *Massad:* The Commission is very concerned this could have a negative effect on mandated clearing. When customer margin is legally segregated and not available to a bank for any other purpose, it should be treated differently in leverage ratio calculations.

Swap Execution Facilities

Conaway: Dodd-Frank allows swap trades to be executed through “any means of interstate commerce,” but current swaps regulation allows only two types of execution – is the CFTC taking any steps to revise this? Does Commissioner Giancarlo’s [SEF White Paper](#) provide any useful suggestions? *Massad:* I am not in favor starting all over but open to fine tuning our rules to enhance SEF trading. Commissioner Giancarlo’s suggestion to license swaps traders is interesting.

CCP Risk and Cybersecurity

Peterson: People are worried about the concentration of risk in CCPs - what is the CFTC doing about that? *Massad:* Mandating clearing of standardized products is better to monitor and mitigate risk, but it does not eliminate it. The CFTC performs daily surveillance on clearing member positions to ensure resources are available in a waterfall event, and focuses on margin models to identify risks taken on. Cyber attacks are a big concern and the CFTC must ensure CCPs have a good framework in place to prevent cyber attacks.

Neugebauer (R-TX): Is private market participation needed to prevent cyber attacks and data breaches? *Massad:* The CFTC wrote its core principles focused on cybersecurity to make sure board of directors are implementing and enforcing policies, and responding to weaknesses. The CFTC does not conduct independent testing because of insufficient resources.

Plaskett (D-VI): Is cybersecurity a CFTC priority? *Massad:* Yes.

Ashford (D-NE): Are farmers at risk if an exchange or CCP is subject to cyber attacks? *Massad:* The CFTC wants to prevent the loss of confidential information. When it comes to critical infrastructure, we want to prevent glitches or trading stops that could impact farmers managing commercial risks.

Costa (D-CA): What do you want to accomplish before your term is up? How protected is the CFTC from data privacy and cyber attacks? *Massad:* I want to increase agency resources and ensure that there is robust surveillance and enforcement. The agency has good policies to protect information within the CFTC, but concerned about cyber attacks elsewhere.

Adams (D-NC): How will you bring down CCP operating costs? *Massad:* The Commission mandated clearing of standardized products to address and monitor risks, and surveillance allows us to do that. Costs are driven by number of factors - clearing members say costs are affected by the low interest rate environment. The agency wants to balance our regulatory goals versus costs to the industry.

Enforcement

Peterson: Does the CFTC want criminal authority? *Massad:* The Commission takes criminal enforcement very seriously and refers cases (when necessary) to the Department of Justice and state regulators.

Scott (D-VA) and McGovern (D-MA): People should go to jail for misconduct as it is the best deterrent, and crooks should not look at penalties as a cost of doing business.

Position Limits and Bona Fide Hedging (BFH)

Neugebauer: The cotton industry informed me that the position limits proposal does not adequately define BFH and limits their ability to manage commercial risks – what is the CFTC doing to fix this? *Massad:* The CFTC must propose a rule that allows commercial participants to engage in BFH, but defining BFH is complicated as trading strategies are complex. We will take our time to get the rule correct.

Scott (R-GA): BFH worked prior to the CFTC proposals – where does the desire to change the rule come from? *Massad:* The rule is congressionally mandated. Defining BFH and writing a rule to reflect Congressional intent is complex, so the Commission is taking time to get it correct.

Davis (R-IL): The conditional limit provision concerns me because it gives preference to some market participants – why is the Commission implementing policy that has negative impacts on agribusiness end users that rely on hedging? *Massad:* Conditional limits are one aspect of the rule that is very complicated – the Commission is taking comments and has not made a decision on what to do.

Allen (R-GA): Will the Commission allow historical commercial practices (that have worked) and not currently recognized as BFH to continue? *Massad:* The CFTC is committed to implementing a position limits rule that curbs excessive speculation and allows for BFH.

Adams: What data has been analyzed in implementing position limits and when will the Commission act on a rule? *Massad:* The Commission has been as data driven as possible. No specific timetable on a final rule.

Swap Dealer *De Minimis* Level

Scott (R-GA): When does the *de minimis* level triggering swap dealer registration automatically drop? Should this rule be addressed in CFTC Reauthorization? *Massad:* The level drops in 2017. I don't think the rule should be addressed in Reauthorization. Any important decision should be based on good data and analysis, and we are required to conduct a study on the current level. The Commissioners will look at the study and any decision will be based on good analysis and data.

Allen: Several commodities companies have expressed concern that they would be forced out of business of offering swaps to their consumers if the *de minimis* level is lowered to \$3 billion. If these companies stop offering swaps, wouldn't that further consolidate the swap business into a handful of Wall Street banks – was that intended by Dodd-Frank? *Massad:* Dodd-Frank gave us direction to create a real framework that regulates swap dealers, and we have done that. The CFTC is conducting a study of this issue and all of the Commissioners will be focused on taking in that data. Any decision we make will be informed by that analysis.

Budget

Scott (D-VA) and McGovern: The CFTC needs more funding.

Thompson (D-CA): Are there responsibilities Congress mandated to the CFTC that have outlived their usefulness and should be eliminated with Reauthorization? *Massad:* The CFTC is conducting a regulatory review to identify regulations that have outlived its usefulness and support the idea to amend or eliminate them if identified.

DelBene (D-WA): Would it help if Reauthorization categorized how the CFTC spends its funding? *Massad:* Any additional funding would help - our main concern is to get the budget up.

Emmer (R-MN): What does the particular functional activities allocation of \$43M entail? *Massad:* Particular functional activities include enforcement and surveillance functions and the technology budget is for IT infrastructure and staff.

Aguilar (D-CA): What are key priorities with funding from the President's budget request? Do you favor expanding the CFTC's geographic footprint? *Massad:* Surveillance, enforcement, and data collection and analysis are key priorities. No, the CFTC does not need to expand its geographical scope.

Cross Border Regulatory Harmonization

Conaway: Are the swaps market fragmented (internationally) and is it a problem? *Massad:* Swap trading rules vary in different jurisdictions and it will take time to harmonize rules internationally. The Commission is making good progress in harmonizing the margin rule for uncleared swaps. To harmonize standards domestically and internationally, good data must be collected and analyzed, but it takes additional resources to do so.

Scott (D-VA): When international agreements happen, how do you enforce rules internationally? *Massad:* The European Union (EU) and CFTC are working toward formalizing arrangements for CCP equivalence. In swap trading, Europe's rules are not in effect until 2017, so the CFTC will look to enhance SEF rules in the meantime.

Lucas: What is the timeline to get international conflicts resolved - is this impacting liquidity and creating fragmentation in the market? *Massad:* We want to minimize fragmentation and the loss of liquidity, but this is an unusual situation since the swaps market was never regulated and everyone is still writing their rules.

Emmer: Why is June is a critical month for CCPs? *Massad:* Capital charges on European FCMs clearing at US CCPs increase in June – expect an extension if agreement has not been reached.

Costa: What is the status of swaps rules and CCP equivalence determinations? *Massad:* I believe Europe and the CFTC can work something out on CCP equivalence – the US has a framework in place that works very well.

CFTC Reauthorization

McGovern: Any advice on CFTC Reauthorization? *Massad:* Some provisions related to commercial end users have been addressed through Commission actions. The proposal to change our decision making process poses a concern. The real issue is the lack of resources, not so much legislative changes.

DelBene: An amendment in the House bill last year proposed that courts uphold the CFTC's assessment of its costs and benefits analysis – is this useful? *Massad:* The Commission does a very robust analysis in its costs and benefits analysis – it is important not to get too specific in the bill's language as it may make it more difficult to fine-tune our rules.

Recordkeeping and Reporting Rules

Davis: Thank you for the no-action relief to Southwest Airlines (SWA) on the real time reporting (RTR) rule - are any other market participants facing the same challenges? *Massad:* I will check with staff to see if anyone else has the same problem. The goal of transparency should not make it harder for companies that engage in legitimate hedging practices. The CFTC must balance transparency in illiquid markets versus the ability to hedge legitimate business risks.

Thompson: What does the CFTC plan to do with all the data collected? *Massad:* The agency is taking steps practically to harmonize reporting standards and looking at changes to our rules to better understand the data. To analyze this data, the Commission needs more resources to invest in technology.

Crawford (R-AR): How have the international data sharing provisions impacted the CFTC negatively? *Massad:* Currently, certain data cannot be shared internationally due to the indemnity provision.

High-Frequency Trading (HFT) and Hedge Funds

Plaskett: Should there be more regulations for hedge funds and asset managers to incentivize other groups to participate in the derivative markets? *Massad:* There are many funds today engaged in trading in our (derivative) markets such as electronic HFT firms. These proprietary trading firms do not fall into a registration category because they trade for their own account and do not deal with customer funds, but transmit many messages that should be examined. Registration of HFT firms is something we are thinking about, but probably not something we are acting on anytime soon. This is not a current CFTC priority.

Public Utility Companies

LaMalfa (R-CA): Since the CFTC revised its rule on public utility companies, have swaps and futures sellers returned to market? Would codifying this rule be useful? *Massad:* I am not hearing any complaints so I think the rule change is addressing market needs. Regulatory agencies are given the legal framework to implement and revise rules as needed – codifying the regulation would make it harder to respond to market changes.

Drop in Oil Prices

Grisham (D-NM): The oil price drops have jeopardized the ability to invest in infrastructure in my state – The Bank for International Settlements published a report claiming the drop in oil prices could have been caused by swap dealers reluctance to provide liquidity in oil hedges to certain companies – is the CFTC conducting further investigations? *Massad:* Although there is direct evidence pointing to supply and demand as well as a dramatic change and increase in shale production, staff continues to investigate this.

Volcker Rule

Rouzer (R-NC): With market makers needing answers to comply with the July deadline, when will regulators respond? *Massad:* The Commission is working with the other regulators and it is critical that the rules look similar.

Smartcheck Program

Davis: What is the estimated cost of the smartcheck program and does it help protect consumers? *Massad:* Smartcheck costs a couple of million dollars and the campaign grew out of precious metal scams against retirees.

Transpacific Partnership (TPP)

Aguiar: Can the TPP help with international harmonization efforts? *Massad:* No.

Insurance Products for Futures Customers

Thompson: Could an insurance product for futures customers become an effective risk management tool? *Massad:* This sounds similar to the Securities Investor Protection Corporation (SIPC) – I will get back to you on this.