

CFTC's Massad Outlines Views on SEF Trading

Tim Massad, the chairman of the Commodity Futures Trading Commission, set out his approach to the regulation of swap execution facilities on Nov. 12 in a keynote speech at SEFCON, a conference sponsored by the Wholesale Markets Brokers Association. Massad reiterated his determination to enforce the law and exercise strong oversight, but he also promised to encourage innovation and competition and create the conditions in which the markets can thrive.

"Markets don't develop simply as a result of government directives," Massad said. "We must create a regulatory framework that not only implements the statutory trading mandate but that creates conditions in which participants wish to trade on SEFs."

Massad also revealed that the CFTC is taking a close look at certain execution issues related to SEF trading, in particular whether the practice of "name give-up" is discouraging the use of central limit order books. Vince McGonagle, director of the CFTC's market oversight division, also spoke at the conference and described the CFTC's ongoing review of SEF registrations. McGonagle indicated that CFTC staff are using these reviews to reinforce compliance with the CFTC's core principles for SEFs.

CFTC Eases Trading Requirements for "Package" Trades

The Commodity Futures Trading Commission on Nov. 10 set out a new timetable for when complex transactions involving interest rate and credit default swaps must be traded on swap execution facilities or designated contract markets.

The no-action letter extended a deadline set for mid-November for so-called package transactions, which involve two or more positions executed at the same time. In a Nov. 12 speech, CFTC Chairman Tim Massad described the relief as regulatory

"fine-tuning" that will reduce the burden on SEF participants and provide more time for a "smooth transition" to new requirements.

The CFTC tailored the relief by category of package. For example, packages involving swaps and swaptions will not have to be traded on SEFs or DCMs until February 2015. In addition, this type of package trade will not be subject to the CFTC's trade execution requirements until February 2016. In practical terms, this means SEFs will be able to offer any method of execution for these transactions during this period. Another example is invoice spreads, which typically include Treasury futures or Eurodollar futures. These transactions will not be required to trade on SEFs until November 2015.

SEC Adopts Trading Risk Rules

The SEC on Nov. 19 approved a new set of rules under Regulation Systems Compliance and Integrity that are intended to protect against technology glitches and other systems issues that can disrupt markets. Under Regulation SCI, exchanges, clearinghouses and certain alternative trading systems will be required to have comprehensive policies and procedures in place for their technological systems. The rules also provide a framework for these entities to take appropriate corrective action when systems issues occur, provide notifications and reports to the SEC regarding systems problems and systems changes, inform members and participants about systems issues, conduct business continuity testing, and conduct annual reviews of their automated systems. The rules will become effective on Feb. 3 and entities subject to the rules must comply with the requirements nine months after that.

Fed Official Calls for Action on Clearing Risks

Clearinghouses and regulators need to take action soon to reduce the possibility of a clearinghouse failure and avoid the need

for taxpayer support in the next financial crisis, Federal Reserve Governor Jerome Powell said in a speech on Nov. 6.

"Post-crisis reforms and the rise of central clearing have started us down a path toward greater financial stability," Powell said in the speech, which was given at a banking conference in Chicago. "At the same time, central clearing brings with it a number of complexities that relate to the interaction between CCPs and the rest of the financial system, especially the global systemically important financial institutions that represent many of their largest clearing members."

Powell, a former investment banker who served in the Treasury Department in the early 1990s, spoke in favor of four measures in particular:

- Clearinghouses need to have sufficient resources to withstand liquidity shocks in case of a clearing firm failure.
- Clearinghouses need to provide their members with greater transparency into their risk profiles, including stress test results, margin models, and the sizing of default funds.
- Regulators should strengthen clearinghouse stress testing, disclose the results to clearing members, and consider a standardized approach so that clearing members and regulators can compare results across several clearinghouses.
- Clearinghouses must develop "transparent, actionable, and effective plans" for dealing with financial shocks that do not leave either an explicit or implicit role for the government.

"Given the increasingly prominent role that central clearing will play in the financial system going forward, it is critical that we collectively get central clearing right," Powell said. "To do so, I have argued that it is imperative that we consider central clearing from a system-wide perspective, and that regulators will need to continue to work collaboratively with each other, both domestically and internationally."



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Industry Panel Recommends 2016 Deadline for Mandatory NDF Clearing

A group of market participants have provided the Commodity Futures Trading Commission with several recommendations on how best to implement mandatory clearing for non-deliverable forwards in foreign currencies.

If and when the CFTC decides to proceed with mandatory clearing for NDFs, the group recommended that the agency should implement the requirements in phases between February and August of 2016. The group cautioned, however, that meeting this “challenging but realistic timeline” will require the resolution of a number of critical issues by regulators and market participants.

The group consists of representatives from banks such as Deutsche Bank and J.P. Morgan, trading venues such as EBS and Thomson Reuters, and market infrastructure groups such as CLS, LCH.Clearnet and Traiana. The group was formed as a subcommittee of the CFTC’s Global Markets Advisory Committee, which serves as a forum for providing the CFTC with input on regulatory issues and market developments.

The group urged the CFTC to harmonize

its rules for mandatory NDF clearing with similar rules being developed in Europe by the European Securities and Markets Authority, in particular with respect to timelines, counterparty categories and the currencies and tenors of the products that will be subject to mandatory clearing.

The group warned against moving too quickly to implement mandatory trading of NDFs on swap execution facilities, and emphasized the importance of resolving certain critical issues, such as the handling of package transactions and amending prime brokerage work flows.

CFTC Responds to End-Users’ Concerns

The Commodity Futures Trading Commission on Nov. 3 issued three proposed changes to its regulations in response to concerns raised by end-users. CFTC Chairman Tim Massad said the proposed changes were specifically intended to “fine-tune” three areas of the CFTC’s rules to alleviate the impact of Dodd-Frank on commercial end-users.

“With reforms as significant as these, it is inevitable that there will be a need for some minor adjustments. And that is what we are

doing,” Massad said at the start of the Nov. 3 meeting. “The changes we are proposing today help ensure that as we regulate the potential for excessive risks in these markets, we make sure that the commercial businesses—whether they are farmers, ranchers, manufacturers or others—that rely on these markets to hedge routine risks can continue to do so efficiently and effectively.”

CFTC Commissioners Mark Wetjen and Chris Giancarlo also expressed concern about the impact of Dodd-Frank on futures commission merchants, particularly the smaller and medium-sized FCMs that serve agricultural interests and other end-users.

“Today we have about half the number of FCMs serving farmers than we did just a few years ago,” said Giancarlo. “In the current low interest rate environment and the increased regulatory burdens being placed on them, they are barely breaking even.”

RESIDUAL INTEREST: The CFTC proposed changing its residual interest rule, which was finalized in 2013 as part of the agency’s customer protection enhancements. The proposal clarifies that the CFTC could not move deadline for posting residual interest any earlier than 6:00 p.m. without normal rule-



making procedures, including the publication of proposed rules for public comment. The agency will also conduct a study of the impact and cost of the tighter deadlines for posting residual interest.

“We want to make sure we move deliberately so that the model works best for customers in light of all of their interests, since the deadline will affect how much margin customers have to post and when,” said Massad. “Today’s proposal will make sure that customers have an opportunity to not only review the study but give us input when we consider whether to accelerate the deadline.”

FORWARDS WITH VOLUMETRIC OPTIONS: The agency proposed clarifications to an interpretation regarding whether forward contracts with embedded volumetric options are excluded from rules-covered swap transactions. This is particularly important to participants in the energy sector such as electric utilities. These entities often enter into swaps that provide counterparties with the option to change the amount of the underlying commodity at the expiration of the contract. Market participants have raised concerns that the CFTC’s interpretation is causing confusion and uncertainty as to whether these types of contracts should be treated as physical forwards, which are excluded from the CFTC’s jurisdiction, or as swaps subject to Dodd-Frank rules.

RECORD-KEEPING REQUIREMENTS: The CFTC also proposed a rule codifying certain relief that had already been granted by staff from certain aspects of Rule 1.35 that require market participants to keep text messages and other records in a manner that is

identifiable and searchable by transaction. The CFTC’s amendment would clarify that certain types of records would not have to be linked to a specific transaction. In addition, the rule would clarify that commodity trading advisors would not have to maintain oral communications.

FIA Backs CFTC’s Proposed Residual Interest Amendment

FIA filed a comment letter with the CFTC on Dec. 17 expressing its support for the CFTC’s proposed amendment to its residual interest requirements.

If the amendment is adopted, the CFTC would not be able to accelerate the deadline for depositing residual interest without going through a rule-making process and gathering input from the industry. The current rule allows the deadline to be changed automatically to the time of settlement at the end of 2018.

In its letter, FIA emphasized the importance of giving customers an opportunity to comment on changes to the deadline. FIA said that the current deadline, which is 6:00 p.m. on the business day after the trade date, “strikes the proper balance” between protecting customer funds and alleviating financial and operational burdens on customers and their clearing firms. FIA also said that it anticipates participating in the study that the CFTC will undertake to determine whether it would be practicable to move the deadline earlier.

FIA Updates Customer Protections FAQ

On Nov. 25 FIA issued an updated version of its guide to the rules and regulations

relating to customer fund protections in the U.S. The guide, which was first issued in February 2012, provides futures commission merchants and customers with easy-to-use information about the relevant provisions of the Commodity Exchange Act and the rules of the Commodity Futures Trading Commission. The latest version reflects the CFTC’s implementation of several enhanced customer protection rules as well as the issuance of several no-action letters and interpretations related to customer fund protections. (http://www.futuresindustry.org/downloads/PCF_questions.pdf)

Commodity Firms Worried by Leverage Ratio Impact on Hedging Costs

The Commodity Markets Council, a U.S. trade group that represents grain merchants and other commodity market participants, has warned banking regulators that it is “gravely concerned” about the potential effects of the Basel III supplementary leverage ratio on the costs of trading exchange-traded derivatives.

The CMC said the leverage ratio overstates clearing member leverage exposures because it does not account for the “exposure-reducing effect” of segregated margin held by a clearing member and does not differentiate between cleared and uncleared derivatives.

“We are concerned that the leverage ratio, as currently structured, will increase the cost of using ETDs by more than five times current levels,” the CMC said in a Nov. 24 letter to the Basel Committee on Banking Supervision. The group warned

CFTC Launches Website to Protect Consumers

The Commodity Futures Trading Commission on Nov. 19 launched SmartCheck, an online portal intended to offer investors access to a range of resources to check backgrounds of financial professionals.

Prior to the launch of SmartCheck, consumers had to consult a variety of databases from different government and self-regulatory organizations to conduct a thorough background check of financial professionals. SmartCheck.CFTC.gov brings this information into one portal.

“This campaign provides investors with new interactive tools that include the website as well as a targeted advertising campaign,” said CFTC Chairman Timothy Massad.



Michael Herndon, CFTC consumer outreach officer, and Timothy Massad, CFTC Chairman, unveil SmartCheck website.

that the likely result will be greater volatility in food, energy and other commodity-driven markets.

CFTC Funding Increased by \$35 Million

On Dec. 16, President Obama signed a bill into law that funds the government for the remainder of fiscal 2015, thereby avoiding a government shutdown. The law includes a provision increasing the CFTC's funding level to \$250 million, \$35 million over fiscal 2014 levels. Of that funding, \$50 million is directed to information technology, though \$10 million of that can be reprogrammed for salaries and expenses.

The law also includes two swap-related provisions: An amendment to the "swap push out" provision of the Dodd-Frank Act that limits the requirement to certain structured financial swaps and ensures that the provision applies consistently to U.S. and foreign banks; and a directive to the CFTC to initiate a formal rulemaking before lowering the threshold for swap dealer registration. Current CFTC regulation automatically reduces the threshold from \$8 billion to \$3 billion in aggregate gross notional dealing activities over 12 months after five years' worth of data being reported to swap data repositories.

CFTC Enforcement Head Outlines Shift in Strategy

The CFTC plans to increase its efforts to put people in jail for violating futures laws but also plans to direct some cases to administrative law judges in order to save money, Aitan Goelman, the CFTC's head of enforcement, said in an interview published in the Wall Street Journal on Nov. 9.

The CFTC currently sends contested cases to federal court. Goelman said the main reason for the switch to administrative law judges is that the agency is short on resources. Administrative cases are typically faster and less expensive for agencies to litigate than ones in federal court.

Goelman also said the CFTC plans to pursue more prosecutions of market manipulation and fraud, and spoofing in particular. "We want to put the word out that if you violate the Commodity Exchange Act, you have a real chance of facing time in prison," Goelman told the paper.

CFTC Grants Regulatory Relief

Nov. 7	CFTC provides relief for certain inter-affiliate swap transactions, extending relief from clearing and trading requirements set to expire on Dec. 31, 2014 until Dec. 31, 2015.
Nov. 10	CFTC revises and extends package relief, setting out new phased-in compliance dates for when certain interest rate and credit default swaps must be traded on swap execution facilities or designated contract markets. Under the relief, packages involving swaps and swaptions will not have to be traded on SEFs until February 2015.
Nov. 13	CFTC Grants Relief to futures commission merchants concerning the holding of customer funds to margin foreign futures and options transactions under Rule 30.7. Under the relief, which was granted at the request of FIA, FCMs will be permitted to exclude customer funds deposited with a foreign bank that otherwise qualifies as a depository from calculations that limit the amount of customer margin funds an intermediary is allowed to maintain in certain accounts.
Nov. 14	CFTC extends cross-border relief, providing more time for non-U.S. swap dealers to comply with certain transaction-level requirements under the Commodity Exchange Act.
Nov. 24	CFTC extends relief for swap data reporting requirements for swap dealers and major swap participants established in Australia, Canada, the European Union, Japan and Switzerland.
Nov. 26	CFTC expands clearing relief for non-financial end-users, making it easier for treasury affiliates of non-financial companies to qualify for the end-user exception from mandatory clearing.
Dec. 18	CFTC staff issues letters to four Asian clearinghouses extending previously granted no-action relief for another year.
Dec. 22	CFTC provides guidance on chief compliance officer report requirements and extends the filing deadline by 30 days.
Dec. 23	CFTC extends time-limited no-action relief to Eurex Clearing and its U.S. clearing members. The relief expires the earlier of when Eurex Clearing becomes a registered DCO or Sept. 30, 2015.
Dec. 29	CFTC issues time-limited no-action relief until April 20, 2015 for futures commission merchants from a requirement that they obtain and acknowledgement letter from certain depositories.

U.S. Trade Groups Urge Obama to Improve Access to China's Financial Markets

The Engage China Coalition, a group of financial trade associations that includes FIA, sent a letter to President Barack Obama on Nov. 6 encouraging him to discuss market access reforms at his meeting with Chinese President Xi Jinping in Beijing Nov. 10-12.

The coalition stressed the importance of accelerated reform and modernization of China's financial system, including a "level playing field" for foreign participants in China's financial services marketplace.

The coalition also encouraged Obama to complete negotiations on a bilateral investment treaty, encourage the Chinese authorities to raise the limits on institutional investor

inflows and outflows, and seek regulatory and procedural transparency in China.

CFTC Approves LCH.Clearnet's Updated DCO Registration

On Dec. 16 the CFTC approved LCH.Clearnet Ltd.'s request for an updated registration as a derivatives clearing organization. The clearinghouse asked for an update because of changes in the scope of the products it clears and intends to clear. The updated DCO registration permits LCH.Clearnet Ltd. to provide clearing services for swaps traded on swap execution facilities and designated contract markets. It also expands its ability to offer clearing for futures to include all futures and options on futures across all asset classes. 