



# Project KISS: Important Issues for Commodity Markets

**FIA Webinar**  
**July 19, 2017**

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# What is Project KISS?

- Executive Order 13777 (Feb. 24, 2017)
  - Agencies to establish Regulatory Reform Officer and a Regulatory Reform Task Force
- CFTC, as an independent agency, is not bound by EO 13777
- Acting Chairman Giancarlo announced Project KISS in March 2017 as an
  - “agency-wide internal review of the CFTC rules, regulations and practices to identify those areas that can be simplified to make them less burdensome and less costly.” (CFTC Press Release, May 3, 2017)
- Federal Register published notice of Project KISS as a “Request for Information” on May 9, 2017 (with correction on May 24, 2017)
  - Deadline for comments: September 30, 2017

# What does CFTC hope to receive from Project KISS?

- Open question – what does the CFTC want to learn about?
- Full efficiency review of rules, regulations and practices towards simplicity and reductions in burdens or costs ...
  - Spirit of EO 13777
  - Consistent with statements of “simplifying and modernizing the Commission’s rules”
- Or something narrower?
  - Subtle language:
    - “In support of these efforts, the Commission has approved the solicitations of suggestion from the public regarding how the Commission’s existing rules, regulations, or practices could be applied in a simpler, less burdensome and less costly manner?”
  - Explicit limitations:
    - Not looking for suggestions about rules to revoke, suspend, annul, withdraw, limit, amend, modify, condition or repeal.
    - Not a forum for requests for exemptive, no-action or interpretative relief.

## What does CFTC hope to receive from Project KISS

- Strict Reading: proposals for operational or, possibly, interpretational changes
- Pragmatic Reading: proposals for changes to CFTC rules or guidance with the following criteria (not exhaustive):
  - Helpful ideas
  - Litmus test – increase simplicity or reduce burdens or costs
  - Within CFTC’s powers – cannot ignore CEA mandates
  - No loss in CFTC efficacy
  - Discreet – would not require the CFTC to drop an entire rule
  - Practical – based on operational concerns, and not representing policy shifts
  - Reasonable – sensible regardless of politics

# Other Relevant Considerations for Project KISS

- Project KISS likely is not a forum to:
  - Renegotiate the Dodd-Frank Act requirements
  - Revisit complex interpretative questions (*e.g.*, embedded commodity trade options)
- CFTC does not have all 5 commissioners and faces resource constraints
  - Certain fantastic ideas may simply be too difficult to implement
- Too many asks may dilute the force of any individual idea
- Regulatory developments outside the US may shape the CFTC's views
  - Rules in non-US jurisdictions may color the timing and content of US rules

# Commodity Markets and Project KISS

- Chance to revisit some of the unintended consequences to commodity derivative markets from the application by Congress and the CFTC of regulatory models better suited for financial asset classes
  - Commodity markets have unique characteristics
  - Lots of bilateral trading among peers
  - Derivatives are often ancillary business activities
  - Real costs borne by a market not well connected to the 2007/2008 financial crisis
- High number of commercial end users = significant relief from minor changes
- Direct tie to “real economy” concerns



# Technical Note

- 5 Project KISS Initiatives
  - Registration
    - Covers the initiation and continuation of becoming regulated by the CFTC as registered clearing, trading, data repository, and intermediary entities
  - Reporting
    - Pertains to all reporting requirements, including swap data and recordkeeping
  - Clearing
    - Pertains to clearing services with respect to futures contracts, options on futures contracts, or swaps
  - Executing
    - Relates to marketplace transactions of futures and swaps
  - Miscellaneous
    - Anything not related to the four topics described above

# General Comments

- The CFTC should improve the existing rules and guidance before engaging in rulemaking in new areas, absent instruction from Congress
  - The CFTC and Staff covered a lot of ground since the enactment of the Dodd-Frank Act
    - Efforts among separate rulemaking teams lead to sometimes incongruous or duplicative terms
  - Logical step to do a comprehensive review and improve the CFTC's entire rule set
  - This approach would assign a lower priority to rulemakings like Reg AT, which are potentially additive to the body of CFTC rules (both in complexity and burden) but are not statutorily driven

# General Comments

- The CFTC should continue the perceived trend of increased deference to exchanges, allowing them to monitor and police their markets efficiently
  - Increases in speed and fairness in resolving trade practice violations
    - Less concern that every inquiry involves DMO and Division of Enforcement
    - Exchanges have more latitude to scale remedies (e.g., use of warning letters)
  - Reduced costs to market participants if exchange inquiries can be handled without the need to “lawyer up” every time
  - Return to cooperative approach to markets
    - Presumption that most market participants share a common interest in a fair market.

# General Comments

- The CFTC should focus its efforts in the near term on cross-border issues, including (a) styling US rules about extraterritoriality and (b) dovetailing with non-US law and regulation
- One subject area where the CFTC can make significant gains in simplification and reductions in burdens and costs
  - Example of where financial institution concepts overshadowed commercial firm organizational concepts
- Recommendations:
  - Abandon proposed “Foreign Consolidated Subsidiary” concept and revert to prior extraterritoriality guidance
    - Clarifications on definitions of “Guaranteed Affiliate” and “Conduit Affiliate”
  - Further determinations for Substituted Compliance and “Essentially Identical” regimes

# General Comments

- To the maximum extent practicable, principles-based rules and regulations should be adopted in favor of overly prescriptive rules.
- CFTC regulations should (i) reflect current marketplace operations and technology and (ii) provide market participants with the flexibility to operate in the ordinary course of their business.
- Staff interpretations should be based on published precedent.
- Enforcement should not be a vehicle to advance policy or new interpretations of historic rules and practices.
- Cost-benefit analyses should account for costs to market (*e.g.*, loss of liquidity) and costs indirectly borne by market participants (*e.g.*, the cost of the swap dealer capital requirements that are passed through to end-users).

# Suggestions on Registration

- General Comment: There are substantial costs associated with (a) registration and related compliance costs (+ capital and margin) and (b) business constraints or changes along with compliance measures to remain unregistered.
  - Commercial firms typically do not bear such costs as logical outgrowths of their core businesses
- Specific Comments:
  - Swap Dealer *de minimis* level should stay fixed
    - push “drop date” back to December 2019 (or later) because of the 12-month look-back
    - explicitly include mitigation of financial risk in definition of “hedging”
    - when converting from commodity units, continue to let firms calculate notional amounts in accordance with their historical practices
  - Reg AT would be both complex and costly by adding a new category of registrants.

# Suggestions on Reporting

- Overlap with DMO review initiative for CFTC Parts 43, 45 and 49
  - Announced July 10, 2017, comments due by August 21, 2017
- SDR Reporting
  - Require the standardization of swap data fields and requirements across all SDRs.
  - Remove redundancy in the reporting requirements (*i.e.*, eliminate confirmation reporting since primary economic terms (“PET”) data is reported).
  - Eliminate valuation data reporting for end users given it serves questionable regulatory benefit to the CFTC.

# Suggestions on Reporting

- **OCR Reporting**
  - Because Question Nos. 12, 14, 17, 18 and 19 on new Form 40 result in unwarranted costs borne by commercial end users and have questionable regulatory value to the CFTC, they should be eliminated.
  - The CFTC should revert to the Legacy Form 40
    - It was sufficient for the CFTC’s oversight function and less costly for commercial firms to manage.
  - If the CFTC retains new Forms 40 and 102, the CFTC should clarify that one representative from a trader, perhaps a desk head or manager, may be identified as a “natural person controller.”



# Suggestions on Clearing and Execution

- Commodity swaps should not be subjected to mandatory clearing or mandatory trade execution requirements
- “Financial Entity” Definition
  - CEA 2(h)(7)(C)(i)(VIII)
    - “a person predominantly engaged in activities that are in the business of banking or in activities that are financial in nature, as defined in section 4(K) of the Bank Holding Company Act of 1956.”
  - The CFTC interpretation of the definition, *solely for purposes of applying the CEA to its markets*, should not entirely defer to Banking law (again importing financial market concepts into commodity markets) to define activity that is “financial in nature”
    - Exclude physical commodity trading
    - Clarify that “financial assets” do not include receivables from physical commodity sales

# Suggestions on Clearing and Execution

- “Financial End User” Definition
  - This is a similar definition, but used for margin purposes
  - Interpretational difficulty with clause (xi) of definition
    - “An entity, person, or arrangement that is, or holds itself out as being, an entity, person, or arrangement that raises money from investors, accepts money from clients, or uses its own money primarily for investing or trading or facilitating the investing or trading in loans, securities, swaps, funds, or other assets;”
  - CFTC could
    - remove concept of a firm investing its own funds resulting in that firm being a “financial end user”
    - clarify that the definition considers only investments in financial assets or assets not in the use of a commercial enterprise, not just any type of asset

## Other Suggestions

- Recordkeeping
  - The CFTC should confirm that firms do not need to keep emails and IMs with swap transaction terms under Part 45 if they are followed by a final, written transaction record (*e.g.*, confirm).
  - The CFTC should apply its final rule on Rule 1.35 retroactively to records in existence on and before the date the final rule was published in the *Federal Register*.
  - Eliminate unregistered “members” from Rule 1.35.
- Position Limits
  - Big issue for the commodity markets
  - Maybe be silent on subject for Project KISS



Questions?

## Disclaimer

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