FIA's Roadmap to Smarter Regulation & Healthier Markets

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About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry.

FIA's mission is to:

- *support open, transparent and competitive markets,*
- *protect and enhance the integrity of the financial system, and*
- *promote high standards of professional conduct.*

As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.

EXECUTIVE SUMMARY

The cleared derivatives markets play an important role in our economy by allowing farmers, manufacturers and commodity firms to hedge risk, discover prices and grow their businesses. Since the passage of the Dodd-Frank Act, considerable progress has been made on implementing regulatory and structural changes to the over-the-counter (OTC) derivatives markets. Today an overwhelming majority of these products are centrally cleared on regulated clearinghouses and a growing number are traded on regulated venues, bringing more transparency and oversight to these markets than ever before. On the whole, FIA supports the goals of these changes to make the derivatives markets safer. However, it is becoming clear that the unintended consequences and costs of these rules are having an adverse impact on the health of the markets and making it more challenging for market participants to access these products.

FIA makes the following recommendations to promote a smarter and simpler regulatory framework for the cleared derivatives markets. Importantly, these recommendations aim to keep the market and its participants safe while allowing for responsible growth and innovation.

Eliminate the Leverage Ratio's Punitive Impact on Clearing

- The Financial Stability Oversight Council should include the leverage ratio on its agenda and discuss the tradeoffs between the clearing mandate and the leverage ratio, specifically addressing the conflicting policy priorities among market and prudential regulators.
- U.S. prudential regulators that are members of the Basel Committee on Banking Supervision should ensure that any revised Basel Committee standard on the leverage ratio includes an offset for client initial margin arising from centrally cleared derivative transactions.
- U.S. prudential regulators should amend their respective leverage-based capital rules to include an offset for client margin received as part of a centrally cleared derivative transaction.

Modernize the Regulatory Toolbox

- FIA supports principles-based regulation for the flexibility it provides and encourages the Commodity Futures Trading Commission (CFTC) to fully utilize this authority as provided by Congress.
- Congress should restore CEA section 4(c) to its original authority prior to the Dodd-Frank Act.
- The CFTC should issue public guidance on its use of economic analysis in the rulemaking process to clarify what factors it considers.
- The CFTC should adopt a policy requiring that the Office of the Chief Economist sign off on the cost-benefit for any rule.
- The CFTC should review existing staff guidance and revisit those staff interpretations that have materially amended the regulation in a manner that is causing market confusion and compliance challenges.

Improve End-User Access to Risk Transfer Markets

- The CFTC should re-propose position limit rule to expand the availability of bona fide hedging exemptions.
- The CFTC should remove the artificially restrictive "economically appropriateness" test and abandon efforts to impose limits beyond the spot month.
- The CFTC should restore a risk management exemption for all market participants.
- The CFTC should provide participants in the commodity markets with greater certainty about the *de minimis* threshold for swap dealer registration by confirming the threshold will remain at $8 billion.

Simplify Reporting Rules

- The CFTC and SEC should work with international regulatory authorities to harmonize reporting requirements.
- The CFTC should do a holistic review of its recordkeeping and reporting rules to: (i) improve the quality of information collected, (ii) tailor requirements to the risk posed by the activity, and (iii) avoid duplicative data collection.
- The CFTC should ensure that special calls are only used for unique circumstances of limited time length and that they not be used as a substitute for regular and on-going reporting.

Avoid Fragmentation of Markets

- The CFTC should develop a recognition regime for non-U.S. DCOs that is available for clearing derivatives for U.S. end-users and a recognition regime for SEFs that is available when trading swaps on non-U.S. platforms in order to preserve cross-border flows of capital and avoid duplicative regulation.

Make Regulation Efficient, Effective and Appropriately Tailored

- The CFTC should avoid duplicative oversight of automated trading by ensuring that SROs function as the "front-line regulators."
- Regulation AT should be withdrawn. If federal regulation of electronic trading is deemed necessary, it should be principles-based.
- The CFTC should ensure that the source code underpinning automated trading systems enjoys the same legal protections as other forms of intellectual property and in the absence of voluntary production, be made available only through the existing subpoena process.
- The CFTC should review its implementation of the swaps trading regulatory framework to ensure end users have choice in the execution of their swaps trades.

Avoid Regulation by Enforcement

- The CFTC should avoid creating rules and interpretations through selective enforcement.
- Enforcement guidance and processes should be renewed to ensure transparent and fair rules.
- The CFTC should work with self-regulatory bodies to allocate enforcement responsibilities and leverage limited resources.

INTRODUCTION

FIA believes now is the appropriate time to review the regulatory framework developed following the financial crisis and to determine whether this framework is, in fact, meeting its stated objectives. Since the financial crisis, the Dodd-Frank Act has generated more than 22,000 pages of regulations and has fundamentally changed the regulatory structure of financial markets.[1] FIA commends the Administration for launching a review of the financial regulatory framework in the United States.[2]

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets. FIA's membership includes clearing members, exchanges, clearinghouses, trading firms and agricultural, commodity and financial customers from more than 48 countries. FIA strongly believes that derivatives markets are critically important to economic growth and allow businesses of various sizes to manage risk and discover prices.

More than 70% of surveyed companies said they use derivatives to hedge price fluctuations.

— U.S. Chamber of Commerce

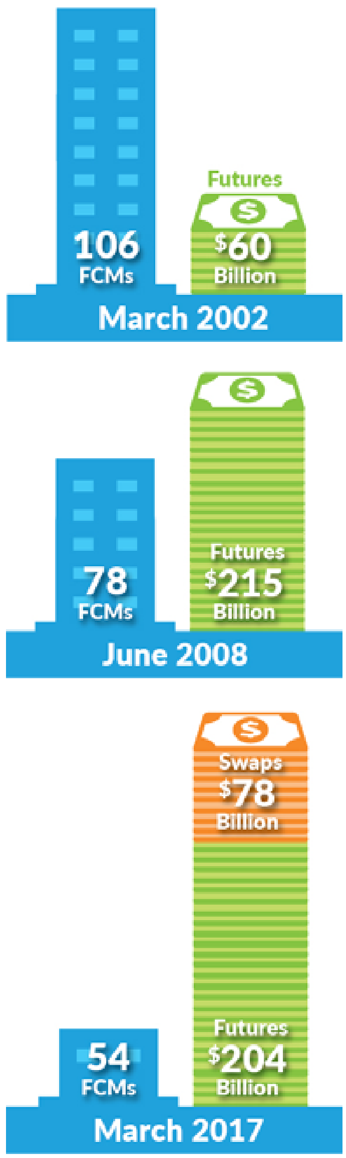
Since the passage of the Dodd-Frank Act, considerable progress has been made on implementing regulatory and structural changes to the OTC derivatives markets. An overwhelming majority of interest rate and credit default swap transactions are now centrally cleared on regulated clearinghouses, compared to just a fraction before the financial crisis. A large number of these products are also traded on regulated trading venues, bringing more transparency and oversight to these markets than ever before.

On the whole, FIA supports the goals of these changes to make the derivatives markets safer. However, the implementation of this regulatory framework has created unintended consequences and burdens for many market participants, including commercial end-users who had nothing to do with the financial crisis. It is becoming clear that the cumulative impacts and costs of these rules are making it more challenging for market participants to access these markets.

One of the core functions of derivatives markets is to provide safe and efficient tools for companies to manage price risk. Thousands of companies, large and small, use futures, options and swaps to hedge the price volatility of currencies, commodities and interest rates so they can focus on growing their business. According to a 2016 survey by the U.S. Chamber of Commerce, more than 70% of the companies surveyed said they used derivatives to hedge price fluctuations.[3] These instruments serve as shock absorbers that help productive enterprises

Increasing Burden on Clearing Firms

Since 2002, customer funds held by FCMs to meet margin requirements have increased dramatically, but the number of FCMs holding those funds has decreased by almost 50%.



Note: Represents FCMs holding customer funds that are required by the CFTC.

Source: CFTC, data available at https://fia.org/fcm-tracker

thrive in an uncertain world. This protection translates to more stable prices for producers and consumers and more predictable growth for the U.S. economy.

For more than three decades leading up to the financial crisis, the use of exchange-traded derivatives expanded rapidly as more end-users gained access to these markets. The development of electronic trading dramatically reduced costs and increased the range of products available for end-users to manage risk. And the regulatory environment permitted cross-border trading to thrive, allowing U.S. exchanges to offer their products worldwide and transforming several U.S. futures contracts into global benchmarks.

In recent years, however, this long-term trend of growth and innovation has stalled, especially among regulated futures contracts. One telling indicator of demand is the amount of margin that customers post with clearing members to support their positions. With the advent of new regulations requiring the collection of margin for *swaps* contracts, we have actually witnessed a decrease in the total amount of customer margin for traditional *futures* products since its peak before the financial crisis. According to CFTC data, from 2002 to 2008 the amount of customer margin collected for futures positions grew on average by 22% per year. Since the crisis, however, customer margin for futures has not returned to its pre-crisis peak. In other words, the flow of customer funds into exchange-traded futures has been at a standstill for nearly a decade.

It is important to note that the exchange-traded futures markets performed admirably during the crisis and were held out as a model to emulate. As the G20 recognized, clearing helps mitigate systemic risk and should be encouraged by policymakers. Instead, we are seeing stagnation, and we believe one of the main reasons is the burdens and inefficiencies created by the new regulatory framework.

Complicating this trend is the dwindling number of firms that clear trades for end-users. These firms, known in the industry as "futures commission merchants" (FCMs), play an essential role in providing customers with access to exchanges and clearinghouses. Equally important, they provide the lion's share of the capital that backstops the clearing system and protects the markets from losses related to customer defaults.

CFTC data shows that since 2002 the number of FCMs that clear futures products has fallen from 106 to 54—a drop of almost 50%. We have also seen a decline in the number of FCMs that clear OTC business due to the

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declining economics associated with it. Since 2014, five major banks have announced their departure from the swaps clearing business.[4] Today the top five clearing firms hold more than three-quarters of the client margin for cleared swaps in the U.S., concentrating this demand among only a handful of clearing members. In other words, at the very moment that policymakers are attempting to get more derivatives into clearing to make the financial system safer, there are fewer firms willing and able to provide this on-ramp to clearing.

RECOMMENDATIONS FOR A SMARTER REGULATORY FRAMEWORK

We agree that the current regulatory framework can be made smarter and simpler without weakening the safety and stability of these important markets. FIA strongly supports the Administration's call for reviewing the regulatory structure of the U.S. under its guiding principles.[5] We strongly support the launch by Acting CFTC Chairman Giancarlo of Project KISS,[6] which is a complementary agency-wide review of its rules, regulations and practices to make them simpler, less burdensome and less costly.[7]

As we stated in our open letter to President Trump[8] shortly after the inauguration, we believe three principles should guide our review of the regulatory structure:

- **SMART REGULATION** — in which rules are tailored to the risk of the activity posed so as to keep markets safe without stifling growth. Smart regulation does not mean more or less regulation but the right level of regulation that allows us to keep our markets safe without stifling growth.
- **GLOBALLY ACCESSIBLE MARKETS** — that allow U.S. customers the ability to manage their risks safely and cost effectively.
- **FOCUS ON INNOVATION AND COMPETITION** — we support regulations that strike an appropriate balance between protecting market integrity and promoting responsible innovation and fair competition that allows the marketplace to grow and thrive. Innovation and competition are the lifeblood of a healthy market and must always be nurtured and encouraged.

With these guiding principles in mind, FIA recommends the following changes to improve the regulatory framework for derivatives.

Eliminate the Leverage Ratio's Punitive Impact on Clearing

One of the fundamental financial reforms agreed upon by the leaders of the G20 nations in 2009 was a requirement to clear "standardized over-the-counter derivative contracts" through clearinghouses in order to mitigate market and counterparty risk.[9] We strongly support these reforms, as they allow investment managers, commodity producers and other customers to hedge their risks while maintaining the resilience of the financial system.

Leaders of the G20 nations also agreed to increase the overall level of bank capital in the financial system to serve as a shock absorber for the next crisis. In setting these international standards, the Basel Committee for Banking Supervision adopted a leverage ratio that requires banks to hold capital against actual exposures to loss. Unfortunately, the current standard fails to recognize the collection of customer margin in the clearing process as an offset to these exposures and as a result, directly contradicts policymakers' efforts to encourage more clearing for its risk-reducing impact within the financial system.

Regulators have recognized the risk that the leverage ratio could result in a further concentration of client clearing business in a smaller number of clearing members.

One of the essential attributes of central clearing is the ability for customers to move or "port" their trades and collateral from a failing clearing member to a healthy one. Because customer margin is required to be segregated from the banks' own money in the form of cash or highly liquid securities, it is always available to protect the continuity and functioning of the cleared derivatives markets in the event of a clearing member default.

However, due to the constraints caused by the leverage ratio, it is less likely that a healthy clearing member will have the capital capacity to take on a large book of clients from a failing clearing member, thereby increasing the possibility that a clearinghouse would be forced to conduct a fire-sale of these client positions in a distressed market. Without the ability to transfer client positions in an orderly manner, the clearinghouses would be forced to liquidate customer positions, leaving many clients unhedged and intensifying market stress at exactly the wrong moment. Regulators such as Acting CFTC Chairman Giancarlo and European Central Bank Executive Board Member Benoit Coeuré have recognized the risk that the leverage ratio could result in a further concentration of client clearing business in a smaller number of clearing members. This could limit the ability to port client positions and collateral in case of member default, heightening potential systemic spillover risks.[10]

The current leverage ratio proposal also impedes access to clearing by end-users and limits their choice of clearing firms. As already noted, there is a higher concentration among remaining clearing firms. The declining economics of clearing mean this concentration will only get worse. In turn, this FCM concentration harms companies that need access to these markets, such as farmers seeking to manage commodity price fluctuations, commercial firms wishing to lock in prices as they distribute their goods, transportation companies hedging their fuel costs and pension funds using derivatives to both enhance and protect workers’ retirement benefits.

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The impact of the leverage ratio is especially problematic for U.S. banks as the European Commission has proposed to offset client initial margin for cleared derivatives in its Capital Markets Requirement Directive (CRD IV). If Europe approves this directive in its current form and the U.S. retains its current approach, U.S. banks will be at a significant disadvantage to EU banks.

Recommendations:

- The Financial Stability Oversight Council should include the leverage ratio on its agenda and discuss the tradeoffs between the clearing mandate and the leverage ratio, specifically addressing the conflicting policy priorities among market and prudential regulators.
- U.S. prudential regulators that are members of the Basel Committee on Banking Supervision should ensure that any revised Basel Committee standard on the leverage ratio includes an offset for client initial margin arising from centrally cleared derivative transactions.
- U.S. prudential regulators should amend their respective leverage-based capital rules to include an offset for client margin received as part of a centrally cleared derivative transaction.

Modernize the Regulatory Toolbox

Regulators must have modern tools and processes to oversee a highly technical and evolving marketplace. Advancements in technology have exponentially changed the speed and manner in which trading and clearing occurs in our markets. Rules developed for past generations may not be fit for purpose in today’s marketplace. Regulators must be equipped with flexible tools that allow them to tailor their oversight to the evolving marketplace and anticipate the next crisis rather than solving for the last one.

As innovation transforms our financial markets, regulators should be equipped with modern tools for tailoring the oversight of the activity to

Regulators must be equipped with flexible tools that allow them to tailor their oversight to the evolving marketplace and anticipate the next crisis rather than solving for the last one.

the risk posed to the financial system. Congress provided the CFTC with such authority by enacting a principles-based regulatory framework in the Commodity Exchange Act (CEA). Principles-based regulations provide flexibility to regulators and market participants by enabling outcomes-based compliance for certain rules rather than a "check the box" approach. While many regulations require prescriptive rules, principles-based regulation can effectively focus oversight authorities on the desired public outcomes and provide additional flexibility to market participants in meeting those outcomes. FIA supports the goals of principles-based regulation and would encourage the CFTC to fully utilize this authority as provided by Congress.

Another flexible regulatory tool in the CFTC's toolbox is its exemptive authority in section 4(c) of the CEA with the express purpose of "promoting responsible economic and financial innovation and fair competition." For many years, the CFTC used this tool to tailor its regulations as the markets evolved from pit trading to electronic. However, Dodd-Frank significantly curtailed this authority for certain activities, which has limited the CFTC's ability to evolve with the marketplace and properly tailor its oversight to those activities posing the highest risk. FIA supports restoring this authority to its original form.

Regulators could use such authority to help promote innovative technologies and products that are hampered by the high regulatory barriers to entry. Several policymakers outside the U.S. have created regulatory "sandboxes" to provide a more tailored regulatory framework for innovative technologies and products.[11] Restoring the CFTC's full exemptive authority would help the industry and regulators to modernize the market infrastructure under a better tailored regulatory framework.

Additionally, regulators and the public would benefit from improved economic analysis that enhances the transparency and accountability of the rulemaking process and provides the public a transparent appraisal of the likely overall economic impact of a proposed rule. Most regulatory agencies have requirements to conduct cost-benefit analyses for rulemakings, including section 15(a) of the CEA that requires the CFTC to "consider" costs and benefits in the rulemaking process as follows:

> "The costs and benefits of the proposed Commission action shall be evaluated in light of (A) considerations of protection of market participants and the public; (B) considerations of the efficiency, competitiveness and financial integrity of futures markets; (C) considerations of price discovery; (D) considerations of sound risk management practices; and (E) other public interest considerations."

Regulators and the public would benefit from improved economic analysis that enhances the transparency and accountability of the rulemaking process.

Unfortunately, the CFTC has not provided public guidance of its cost-benefit process to clarify what factors it considers in the rulemaking process. This makes it difficult for market participants and the public to provide the appropriate information and data that best inform the rulemaking process. Other regulatory agencies, including the Securities and Exchange Commission (SEC), have published such guidance to provide the public with greater clarity on how they weigh various factors in the rulemaking process.[12] We believe requiring the CFTC to provide such guidance would lead to higher-quality economic analysis being placed on the rulemaking record, resulting in enhanced transparency and accountability in the rulemaking process to the benefit of the markets and public.

Furthermore, in advancing a culture of transparency and compliance, FIA supports the use of guidance to clarify regulatory expectations consistent with notice-and-comment rulemaking. However, guidance should not be utilized by agency staff to make substantive changes to rules without going through the full notice and comment process required by the Administrative Procedures Act (APA). The CFTC has utilized guidance in recent years to expand requirements beyond the Commission-approved rules without the protections provided by the APA. FIA encourages the CFTC to carefully review existing staff guidance and procedures around their issuance to ensure the use of guidance does not conflict with the underlying rule.

Recommendations:

- FIA supports principles-based regulation for the flexibility it provides and encourages the CFTC to fully utilize this authority as provided by Congress.
- Congress should restore CEA section 4(c) to its original authority prior to the Dodd-Frank Act.
- The CFTC should issue public guidance on its use of economic analysis in the rulemaking process to clarify what factors it considers.
- The CFTC should adopt a policy requiring that the Office of the Chief Economist sign off on the cost-benefit for any rule.
- The CFTC should review existing staff guidance and revisit those staff interpretations that have materially amended the regulation in a manner that is causing market confusion and compliance challenges.

Improve End-User Access to Risk Transfer Markets

Since the financial crisis, certain elements of the regulatory framework have had the unintended effect of discouraging end-users from using derivatives to manage their risks and restricting their access to derivatives markets. This undermines one of the core economic benefits provided by derivatives markets. We are pleased to see that the CFTC has begun to reassess its rules with an eye to minimizing this unintended effect, but we believe that more can be done.

Certain elements of the regulatory framework have had the unintended effect of discouraging end-users from using derivatives to manage their risks and restricting their access to derivatives markets.

For example, we believe the position limit rule needs to be withdrawn and re-proposed. In order to implement position limits as a tool to control the burden of excessive speculation, the CFTC must first determine that each position limit is necessary and appropriate to address that burden as required by statute. Thus far, in several iterations of the rule, the CFTC has failed to establish this threshold requirement. Furthermore, the rules as proposed are so restrictive as to prevent the use of the derivatives markets by those who need to hedge risk the most.

Another example is the CFTC's swap dealer registration requirements. These requirements are intended to make sure that swap dealers not regulated by any other branch of the federal government register with the CFTC and comply with an array of post-crisis rules and regulations. While we agree with the need to make sure that swap dealer regulation is applied comprehensively, we share the concern expressed by many end-users that these requirements are causing participants in the commodity derivatives markets to reduce their trading in order to avoid the dealer designation and the attendant regulatory burden. This is decreasing the number of counterparties and reducing liquidity in the commodity derivatives markets. Furthermore, the uncertainty about whether the CFTC will maintain the current *de minimis* threshold of $8 billion in notional value, or lower that threshold to $3 billion, is affecting the willingness of non-financial companies to enter into risk-hedging activities with their customers.

Recommendations:

- The CFTC should re-propose position limit rule to expand the availability of bona fide hedging exemptions.
- The CFTC should remove the artificially restrictive "economically appropriateness" test and abandon efforts to impose limits beyond the spot month.

- The CFTC should restore a risk management exemption for all market participants.
- The CFTC should provide participants in the commodity markets with greater certainty about the *de minimis* threshold for swap dealer registration by confirming the threshold will remain at $8 billion.

Simplify Reporting Rules

Another G20 recommendation post-crisis was to collect data on OTC swaps in order to provide regulators with an overall view of the market. This stated goal is noble but only works if the quality of the data is good.

Piecemeal reporting rules need a wholesale review to ensure the information collected is useful.

Post financial crisis, regulators patched together on-going reporting obligations with new reporting requirements for swaps, exchange-traded derivatives and cleared derivatives. Regulators also have used tools such as "special call" requests to convert ad hoc information requests into on-going reporting obligations. Piecemeal reporting rules, including requirements for Chief Compliance Officer (CCO) Annual Reports and for maintaining taped phone lines, need a wholesale review to ensure the information collected is useful and to identify unnecessary burdens from duplicative collection of data and collection of data that is not used. It is time to consider whether the reporting requirements meet the intended regulatory purposes.

Additionally, data collection requirements have not considered existing compliance challenges faced by those required to report. Some of the data required to be reported pursuant to the CFTC's Ownership and Control Reporting (OCR) rules is inconsistent with foreign privacy laws, thus forcing reporting entities either to violate foreign privacy laws by reporting the data or violate the U.S. regulations by failing to report in order to be in compliance with foreign law. In addition, reporting fields required by OCR rules such as "Natural Person Controller" have been defined so broadly (by staff guidance) as to make timely and accurate reporting of the data impossible.

Recommendations:

- The CFTC and SEC should work with international regulatory authorities to harmonize reporting requirements.
- The CFTC should do a holistic review of its recordkeeping and reporting rules to:
  (i) improve the quality of information collected,
  (ii) tailor requirements to the risk posed by the activity, and
  (iii) avoid duplicative data collection.

- The CFTC should ensure that special calls are only used for unique circumstances of limited time length and that they not be used as a substitute for regular and on-going reporting.

Avoid Fragmentation of Markets

Access to global derivatives markets on a cross-border basis is key to reducing risks and supporting economic growth. Globally accessible markets mean more options for end-users to find the product that allows them to most efficiently manage and hedge their risk. The derivatives markets do not have a set domicile as these markets are global, with intermediaries able to service global clients wherever their hedging needs may exist. Thus rules must facilitate access to those markets while keeping the safety of markets and participants in mind.

Globally accessible markets mean more options for end-users to find the product that allows them to most efficiently manage and hedge their risk.

In order to facilitate access to markets on a cross-border basis, regulators should defer to each other when the rules in the home country of the firm or infrastructure are comparable. This recognition of home country oversight fosters mutual trust among jurisdictions. Such a regime tends to drive jurisdictions closer to harmonized rules and eliminates conflicting and duplicative rules. The U.S. has an opportunity to once again lead by example and encourage other global regulators to do the same.

Historically, the CFTC has been a leader in the recognition of comparable foreign rules. Since 1997, the CFTC has allowed non-U.S. intermediaries to access U.S. customers for trading futures and options on non-U.S. platforms if the home country has comparable protections to those offered by the CFTC. Similarly, the CFTC has an equally long history of recognizing non-U.S. regime's rules for foreign boards of trade offering direct access to U.S. participants trading futures and options where comparable rules existed.

For clearing and trading swaps, the Dodd-Frank Act allowed the CFTC to rely on non-U.S. rules rather than requiring registration of non-U.S. clearinghouses and non-U.S. swap trading platforms if those non-U.S. clearinghouses and swap trading platforms were comparably and comprehensively regulated. However, the CFTC provided recognition to only a narrow subset of non-U.S. DCOs and has not instituted a recognition regime for non-U.S. swaps platforms. The law has given the CFTC tools to provide such access once the regulators are satisfied that the local regulator comparably and comprehensively regulates in a similar manner to the U.S. Unfortunately, the CFTC has not wielded this tool.

Recommendation:

- The CFTC should develop a recognition regime for non-U.S. DCOs that is available for clearing derivatives for U.S. end-users and a recognition regime for swap execution facilities (SEFs) that is available when trading swaps on non-U.S. platforms in order to preserve cross-border flows of capital and avoid duplicative regulation.

Make Regulation Efficient, Effective and Appropriately Tailored

Regulators must optimize their effectiveness by avoiding duplicative or overly-broad rules and by utilizing self regulatory organizations (SROs).

We strongly support the Administration's Core Principle that regulation should be efficient, effective, and appropriately tailored.[13] In order to keep markets safe and thriving, regulators must optimize their effectiveness by avoiding duplicative or overly-broad rules and by utilizing self-regulatory organizations (SROs) as their policing partners. For many years, self-regulation has been a cost-effective way to raise and maintain the compliance standards of the industry. The derivatives markets have benefitted from the strong oversight conducted by the National Futures Association (NFA), the statutory self-regulatory organization funded by industry fees, as well as the self-regulatory arms of the exchanges and clearinghouses. We encourage the CFTC, particularly during this time of budgetary constraint, to effectively leverage these self-regulatory mechanisms in its mission to oversee and protect the marketplace. The CFTC, as Acting Chairman Giancarlo recommended in March,[14] should delegate responsibility to the NFA, the exchanges and other self-regulatory organizations where the SROs are able to act effectively. This is equally important in the enforcement space where SROs are often the most expedient first line of defense against wrongful market activity. In leveraging this relationship, regulators should oversee the activities of SROs with the aim of avoiding duplicative investigations, audits and enforcement actions that layer cost and confusion on the industry.

We also encourage the CFTC to revisit certain duplicative or overly broad rules and proposals that are not tailored to the risk of the activity. One such rule is proposed Regulation AT, which should be withdrawn because it is too prescriptive and is neither necessary nor appropriate to address the risks of electronic trading. Any regulation regarding electronic trading, including automated trading, should be principles-based, requiring electronic trading to be subject to policies and procedures reasonably designed to prevent market disruption. In addition, the CFTC should defer to exchanges to adopt more detailed rules as appropriate for each market. Such an approach would provide the flexibility necessary to accommodate new technology and innovation.

As currently proposed, Regulation AT seeks unfettered government access to source code. This sets a dangerous precedent for access to highly sensitive intellectual property, which should be protected through due legal process.

Regulation AT should be withdrawn because it is too prescriptive and is neither necessary nor appropriate to address the risks of electronic trading.

As markets have become more automated in nature, market participants have also changed. Firms are embracing developments in technology, not just for trading but also for their own pre-trade risk controls, and creating new types of liquidity providers. Smart regulation should reflect the changing market participant roles emerging from the innovations of automated trading. Instead of attempting to oversee markets and their participants centrally through tools such as registration and direct regulation (such as proposed Regulation AT), smart regulation should allow for delegation of responsibility to self-regulatory bodies such as the exchanges to oversee their marketplaces.

We support the CFTC reviewing its implementation of its swaps trading regulatory framework under Title VII to ensure end-users have sufficient choice in how to execute their trades. Acting CFTC Chairman Giancarlo's 2015 White Paper[15] provides a number of proposed changes to the SEF framework that are worth serious consideration.

Recommendations:

- The CFTC should avoid duplicative oversight of automated trading by ensuring that SROs function as the "front-line regulators."
- Regulation AT should be withdrawn. If federal regulation of electronic trading is deemed necessary, it should be principles-based.
- The CFTC should ensure that the source code underpinning automated trading systems enjoys the same legal protections as other forms of intellectual property and in the absence of voluntary production, be made available only through the existing subpoena process.
- The CFTC should review its implementation of the swaps trading regulatory framework to ensure end users have choice in the execution of their swaps trades.

Avoid Regulation by Enforcement

A robust enforcement program is an effective and essential tool for smart regulation and safe markets. However, enforcement should not be a substitute for rulemaking nor a mechanism for reinterpreting the law. An enforcement program is most effective as a deterrent to disruptive behavior when it is fair, clear and predictable.

Regulators should not use selective enforcement to create new interpretations of rules. Rather, this is better achieved through rules or guidelines that put the industry on notice that it will be held accountable to a different standard.

Enforcement should not be a substitute for rulemaking nor a mechanism for reinterpreting the law.

The CFTC should renew and update its written guidance on penalties and cooperation. We recommend that the CFTC make clear to the marketplace that it values self-reporting of violations. Equally important, the CFTC should provide clarity on how civil monetary penalties will be assessed on institutions that cooperate with the enforcement authorities. Refreshed guidance would strengthen the CFTC's enforcement program, encourage more cooperative behavior and restore transparent and equitable application of enforcement practices.

We also believe that certain provisions in the Financial Choice Act could serve as a model for the CFTC. This legislative proposal introduced by the House Financial Services Committee calls for changes to the enforcement processes at the SEC. These include:

- Requiring notice to subjects of investigations that the Commission has decided not to proceed;
- Granting the subjects of enforcement matters the right to appear before the Commissioners or their staff;
- Creating an Enforcement Ombudsman;
- Requiring publication of its Enforcement Manual; and
- Providing a party against whom an administrative action has been brought the right to remove the matter to Federal Court.

We believe that each of these provides for more balanced and equitable enforcement and should be adopted by the CFTC as a matter of process. The CFTC has the authority to and should undertake to review these issues. It does not need to wait for legislative action.

Finally, we encourage the CFTC to work with self-regulatory bodies such as the exchanges and the NFA in order to allocate oversight where rules can best be enforced. This will improve enforcement outcomes and make more effective use of limited regulatory budgets.

Recommendations:

- The CFTC should avoid creating rules and interpretations through selective enforcement.
- Enforcement guidance and processes should be renewed to ensure transparent and fair rules.
- The CFTC should work with self-regulatory bodies to allocate enforcement responsibilities and leverage limited resources.

CONCLUSION

FIA believes that the current regulatory framework can be made smarter and simpler without weakening the safety and stability of these important markets. The above recommendations would significantly further this agenda and return these markets to a pathway of improved health, competition and innovation. We look forward to further engaging on these important issues with the Administration, Congress and industry stakeholders.

Endnotes

1 See Davis Polk infographic, July 2015; http://www.volckerrule.com/infographic/july2015infographic.html

2 See Presidential Executive Order, February 3, 2017; https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states

3 See Financing Growth: The Impact of Financial Regulation, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, June 16 2016; https://www.uschamber.com/sites/default/files/documents/files/financing_growth_report_16_june_16.pdf

4 Deutsche Bank: https://www.ft.com/content/2392bc42-ee47-11e6-930f-061b01e23655; Nomura: https://www.ft.com/content/e1883676-f896-11e4-be00-00144feab7de; RBS: http://uk.reuters.com/article/uk-rbs-primeservices-divestiture-idUKKBN0DY0PU20140519; State Street: https://www.bloomberg.com/news/articles/2014-12-04/state-street-exiting-swaps-clearing-business-citing-new-rules; BNY Mellon: http://www.pionline.com/article/20131210/ONLINE/131219993/bny-mellon-closes-us-derivatives-clearing-business

5 See executive order, section 1: "It shall be the policy of my Administration to regulate the United States financial system in a manner consistent with the following principles of regulation...: (a) empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth; (b) prevent taxpayer-funded bailouts; (c) foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry; (d) enable American companies to be competitive with foreign firms in domestic and foreign markets; (e) advance American interests in international financial regulatory negotiations and meetings; (f) make regulation efficient, effective, and appropriately tailored; and (g) restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework."

6 See Remarks of Acting Chairman J Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL, March 15, 2017; http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20

7 See CFTC Requests Public Input on Simplifying Rules, May 3 2017; http://www.cftc.gov/PressRoom/PressReleases/pr7555-17

8 See FIA letter to President Trump, January 25, 2017; https://fia.org/articles/lukken-requests-comprehensive-review-all-financial-reform-regulation

9 See Leaders Statement of G-20 Meeting, Pittsburgh, 25 September 2009; https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf

10 See remarks of Acting Chairman Giancarlo before International Swaps and Derivatives Association 32nd Annual Meeting, Lisbon, Portugal, May 10 2017, available at http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-22; and paper by Benoît Cœuré, Member of the European Central Bank Executive Board and Chair of the Committee on Payments and Market Infrastructures, Banque de France Financial Stability Review No. 21 - April 2017, available at https://www.ecb.europa.eu/press/key/date/2017/html/ecb.sp170420_tBdF-FSR21.en.pdf

11 See Giancarlo's CFTC May Give Fintech Innovators Their Own Sandbox, BNA, February 22, 2017; https://www.bna.com/giancarlos-cftc-may-n57982084153; See Overview of Regulatory Sandbox Regimes in Australia, Hong Kong, Malaysia, Singapore, and the UK, 18 Dec 2016; https://www.law.ox.ac.uk/business-law-blog/blog/2016/12/overview-regulatory-sandbox-regimes-australia-hong-kong-malaysia.

12 https://www.sec.gov/dera/economicanalysis.

13 See Core Principle (f) of Presidential Executive Order, February 3, 2017; https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states

14 Remarks of Acting Chairman Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL, March 15, 2017; http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20

15 See Paper by Commissioner Giancarlo, Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank (Jan. 29, 2015); http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf

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