

**HOUSE COMMITTEE ON AGRICULTURE**  
**SUBCOMMITTEE ON COMMODITY EXCHANGES, ENERGY, AND CREDIT**

**UNITED STATES HOUSE OF REPRESENTATIVES**

**REAUTHORIZING THE CFTC: MARKET PARTICIPANT VIEWS**

**STATEMENT OF GERALD F. CORCORAN**  
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Chairman Scott, Ranking Member Scott and members of the Subcommittee, thank you for the opportunity to discuss matters affecting the cleared derivatives industry. I am testifying today in both my roles as Chairman and CEO of R.J. O'Brien and Chairman of the Futures Industry Association (FIA). As you consider reauthorizing the Commodity Futures Trading Commission (CFTC), FIA and its members stand ready to assist in any way we can. FIA is the leading trade organization for the futures, options and over-the-counter cleared derivatives markets. Our membership includes derivatives clearing firms, customers and exchanges from more than 20 countries. FIA's core constituency consists of futures commission merchants (FCMs), such as R.J. O'Brien that I manage in Chicago. As a trade association, our primary focus is the global use of exchanges, trading systems and clearinghouses for derivatives transactions.

I would first like to commend the Agriculture Committee for continuing the bi-partisan approach to reauthorizing the CFTC. It is this spirit that resulted in the House passing a good bill during the last Congress. As derivatives markets are adapting and responding to major regulatory transformations, they need stability and certainty to thrive, and the House Agriculture Committee recognized this as they developed H.R. 4413 during the 113<sup>th</sup> Congress. This legislation contained provisions designed to make the CFTC operationally more effective, and FIA supports those enhancements to cost-benefit analysis and internal risk controls.

## Customer Protection

One of the most important aspects of any legislation reauthorizing the CFTC is enhanced customer protection. As you know, the failures of MF Global Inc. and Peregrine Financial Group resulted in severe and unacceptable consequences for futures customers and the markets generally. The entire industry has been working collaboratively to identify and improve procedures required to better protect the integrity of these markets. A number of changes are already being implemented, many of which were recommended by FIA in the aftermath of these insolvencies<sup>1</sup>:

- The industry's principal self-regulatory organizations (SROs) have adopted rules that subject all FCMs to enhanced recordkeeping and reporting obligations. For example, chief financial officers or other appropriate senior officers are now required to authorize in writing and promptly notify the FCM's designated SRO whenever an FCM seeks to withdraw more than 25 percent of its excess funds from the customer segregated account in any day – these are funds deposited by the FCM into customer accounts to guard against customer defaults.
- The National Futures Association (NFA) is also collecting additional financial information from FCMs and posting the information onto its online Background Affiliation Status Information Center (Basic) system, a key step in giving customers the tools they need to monitor the assets they deposit with their FCMs. The new service provides the public with access to specific information about an FCM, such as the firm's adjusted net capital, the amount of funds held in segregated, secured, and cleared swaps accounts, and the types of investments that the FCM is making with those customer funds.

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<sup>1</sup> See Futures Industry Association, Futures Markets Financial Integrity Task Force - Initial Recommendations for Customer Funds Protection:  
<https://americas.fia.org/articles/fia-task-force-issues-initial-recommendations-enhancing-customer-funds-protections>

- A newly developed segregation confirmation system allows SROs to run comparisons of the balances in customer segregated, secured, and cleared swaps accounts at the depositories with the daily reports they receive from FCMs, and identify any discrepancies.
- A set of frequently asked questions on customer funds protection<sup>2</sup> has also been developed by FIA, which is being used by FCMs to provide their customers with increased disclosure on the scope of how the laws and regulations protect customers.
- In November 2013, the CFTC finalized new regulations for “Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations”. FIA supports the vast majority of the comprehensive regulatory reforms contained therein and wishes to specifically applaud the Commission and the Agriculture Committee for devoting much time and attention to the appropriate timing of residual interest requirements.

The reauthorization legislation developed by the House Agriculture Committee during the last Congress contained several customer protection enhancements that FIA continues to support including two key clarifications – one relative to the timing of an FCM’s residual interest obligations and another restoring legal certainty as to the utilization of property outside of the segregated customer accounts to ensure that customers are the highest priority in the event of an FCM bankruptcy.

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<sup>2</sup> See Protection of Customer Funds, Frequently Asked Questions:  
<https://americas.fia.org/articles/fia-issues-fourth-version-guide-customer-fund-protections>

## Clearing Infrastructure Challenges

Clearing ensures that parties to a transaction are protected from a failure by the opposite counterparty to perform their obligations, and FIA's FCM members play a critical role in ensuring that transactions are secured with appropriate margin to facilitate this clearing process. Under the "Dodd-Frank Act" in the U.S. and the "European Market Infrastructure Regulation" (EMIR) in Europe, policymakers determined to extend clearing beyond futures and options to certain over-the-counter swaps, and as such the role of the FCM has also expanded. Because FCMs play a critical role in achieving and sustaining the clearing system, we would like to offer our thoughts on the ongoing development of various new regulatory initiatives.

- Cross Border Coordination

We operate in global markets and to assume otherwise is very dangerous given that market participants are best served with deep liquidity. If global regulations are not well coordinated the markets will fragment within regulatory jurisdictions and become far less liquid, to the detriment of the ultimate end-users. To date, much of the public regulatory scrutiny has focused on the cross-border regulation of trade execution parties, both the client and the swap dealers, but there are also cross-border challenges within the regulation of the infrastructure that is expected to support the clearing of derivatives. For example, the "Dodd-Frank Act" specifically provides the CFTC with the ability to exempt comparably regulated foreign clearinghouses from registration with the U.S. regulator yet the CFTC has never established a means by which clearinghouses, also known as central counterparties (CCPs), might seek such exemptions. Thus any foreign CCP clearing swaps for U.S. entities must register with the CFTC, as well as their home country regulator. U.S. based CCPs who are registered with the CFTC and do business with European participants are required under EU law to be "recognized" by having equivalent regulations to those in Europe. Assuming that each regulatory jurisdiction is unlikely to prescribe identical requirements, the practicality of such dual registration or recognition hinges upon the various jurisdictions' ability to acknowledge regulatory differences and rely upon each other as front line regulators. I would like to highlight one specific example of a current regulatory

coordination challenge we are facing: Europe and the U.S. have developed differing requirements relative to margin methodologies that CCPs must apply. As clearing members of CCPs in each country, we are perplexed by recent suggestions that the competing methodologies should be run simultaneously. As such, clearing members and their clients would be subjected to the model resulting in the highest margin requirement on any given day. This overly-complex and operationally risky policy seems to overlook the implication to those who post margin – the client and the clearing member. There has been very little transparency or involvement of the clearing members to date in the discussion between the CFTC and EU authorities.

- Clearing Member Reporting Requirements

I also want to briefly mention new reporting requirements that fall to clearing members. FCMs serve as the responsible party for the submission of various data sets to the CFTC – both for our own entities, as well as our customers. Recently, the CFTC has modified the manner in which information on large positions is reported to the regulator by broadening both the scope of reportable positions and the amount of data required for the reports. The new Ownership and Control Reporting (OCR) rules require FCMs to collect certain customer data that has never been required before and not all customers are willing to provide this new information. This presents challenges to FCMs who are required by regulation to gather data from customers who are under no regulatory obligation to provide such information. The current OCR Rule puts FCMs in an untenable position of either ceasing to do business with customers or incurring regulatory risk. In addition, privacy laws in foreign countries raise legal ramifications for reporting entities and their customers located outside the U.S. While we are happy to work with the Commission to improve this process, some regulatory refinements are likely necessary in order for the customer data to be available to the FCM and useful to the regulator.

Additionally, the “Dodd-Frank Act” requires new chief compliance officer annual reports that are quite extensive. These reports are linked to the filing of annual financial reports

even though the two reports are very different and require different inputs from different parts of the business. Given the complexity of compiling the chief compliance officer filings, it may be prudent to delink the two filings.

- **Basel III Capital Implications for Cleared Derivatives**

Another critical area of focus for the FIA is Basel III capital requirements for our prudentially regulated bank members. While my clearing firm is not affiliated with a bank, those FCMs who are face a real challenge relative to excessive capital costs for their client clearing businesses. This result seems at odds with the principles of the G20 and the “Dodd-Frank Act,” which were intended to encourage more clearing for its risk mitigating effects. Rather, these increased capital costs have made it increasingly expensive for many clearing member banks to offer clearing services to their clients. At issue is the recently finalized leverage ratio, which treats client margin posted to a bank-affiliated clearing member as a resource that can be used to leverage the bank. This assumption runs counter to the Commodity Exchange Act and CFTC regulations that require client margin to be segregated for the protection of the customer and thereby unable to be leveraged by the bank. The lack of recognition of the CFTC requirements in the context of the banking regulators’ new capital rules results in increased costs to the clearing system (including clients of bank-affiliated clearing members) exceeding tens of BILLIONS of dollars today and hundreds of BILLIONS of dollars once more products are subjected to clearing under new swap clearing mandates.

### **Conclusion**

These numbers are staggering and frankly will result in fewer FCMs to support the overall clearing system and fewer choices for customers who need to hedge their risk. Over the ten-year period between 2004 and 2014, the FCM community shrunk from 190 FCMs to 76 FCMs. The current number of FCMs registered with the CFTC has been reduced to less than half of those registered 10 years ago and is down from nearly 100 at the end of 2013. These new capital requirements on bank-affiliated FCMs will only serve to further consolidate the pool of clearing service providers. The FCM function has proven to be an essential foundation for

managing risk in the futures markets, and is integral for advancing the goals of the new trading and clearing requirements for swaps as well. As the Committee considers how best to ensure these markets are properly regulated, we encourage a holistic view of the clearing infrastructure and its sustainability.

I am fortunate to represent a wide array of stakeholders in the derivatives industry – all of whom want to see this industry continue to support the risk management needs of its customers in a productive way. This is a goal I know the members of this Committee share and I look forward to working with you as you consider the CFTC's role in achieving this mutual objective.