

Jeffrey M. Bandman
Acting Director
Division of Clearing and Risk
U.S. Commodity Futures Trading Commission
Derivatives World Congress Keynote
October 7, 2015

Introduction

Good morning, and thank you Stephan for that kind introduction.¹

It's a pleasure to be here in Chicago, which is home to some of the largest exchanges and clearinghouses in our industry, as well as an important regional office of the CFTC. I'm glad to see so many of you gathered here to discuss derivatives, and it is an honor to deliver opening remarks to kick off this conference. I am also pleased that this conference was scheduled to coincide with major league baseball playoffs. It is very exciting to see the Cubs in the post-season for the first time in several seasons. Of course, this should come as no surprise, for those of you who are familiar with the prediction made in the film *Back to the Future II* that the Cubs would win the World Series in 2015. Gametime tonight is even 19.08, the last year the Cubs won the series. As a long-suffering

¹ The remarks in this speech reflect solely the personal views of the author, and do not necessarily represent the views of the Commodity Futures Trading Commission, the individual members of the Commission, or its Staff. The Commodity Futures Trading Commission and the author reserve the right to use the materials, statements, and the author's biographical information in any manner, including at other conferences and legal education programs.

Mets fan, I have plenty of appreciation for the experiences of the even longer-suffering Cubs fans.

Now back to futures.

Overview

In my remarks today, I thought it would be useful to provide a regulatory update on the priorities of the Division of Clearing and Risk. I also am going to spend some time highlighting the activities of DCR's risk surveillance branch in the Commission's oversight of clearinghouses. And then I would be happy to take your questions.

Clearing

Central clearing is one of the great innovations of the financial system.

- It enables market participants to reduce exposures through netting, mitigate counterparty credit risk, and mutualize tail risk.
- One of the most important reforms we've undertaken was to require that more derivatives transactions be cleared through clearinghouses.
- We have now implemented mandatory clearing for a significant portion of the swaps market.

Final – Oct 6, 2015

- Clearing is now mandated for most interest rate and credit default swaps. Today, approximately 75 percent of such swap transactions are being cleared, as compared to only about 15 percent in 2007.
- But central clearing is not a panacea. It allows us to monitor and mitigate risk, but it does not eliminate it. And more risk is concentrated in clearinghouses now than ever before. So as we increase our use of central clearing, it becomes even more important to focus on making sure clearinghouses are strong and resilient.

Clearinghouse Resiliency

- Over the last few years, we have done a major overhaul of our clearinghouse oversight. We have:
 - Substantially strengthened risk management and increased transparency,
 - Incorporated international standards into our

regulations,

- Strengthened customer protection measures, and
 - Enhanced our examination, compliance, and risk surveillance programs.
- But there is more to do.

Currently, recovery and resolution planning for clearinghouses are at the top of our agenda.

Final – Oct 6, 2015

- The Commission is also working on clearinghouse strength and stability with other regulators internationally.
 - In fact the CFTC is helping to lead much of this important work.
- While we must engage in recovery and resolution planning, our goal is never to get to a situation where either of those is necessary. This is why risk management is so important in the first place
 - And that is why I am speaking in more detail today about some of the things we do – because these are the everyday activities that fundamentally matter to clearinghouse safety.

Let me touch now on some of our other current regulatory priorities in clearing.

Regulatory Update

1. System Safeguards and Cyber

- a. we're stepping up efforts to protect against cyber threats – as well as technological and operational risk generally.

That's because clearinghouse risk does not come only from credit or market risk.

Final – Oct 6, 2015

- b. The need to strengthen the security and resilience of our financial markets against cyber-attacks and technological failures is clear.
- c. Examples of cyberattacks or significant technological disruptions from inside and outside the financial sector are all too frequent and familiar.
- d. And the interconnectedness of our financial institutions and markets means that the failure of one institution can have significant repercussions throughout the system.
- e. So we are addressing this risk in several ways:
- f. First, system safeguards are part of the core principles and regulations with which clearinghouses, exchanges and other institutions, must comply.
- g. Second, we are focusing on these issues in our examinations – to determine whether an institution is following good

practices and paying adequate attention to these risks at the board level and on down.

- h. Third, Commission staff are currently working on proposals to make sure the entities that run the core infrastructure under our jurisdiction –the major clearinghouses as well as exchanges and swap data repositories – are doing adequate evaluation and testing of their vulnerabilities to these risks

Final – Oct 6, 2015

and their own systems of control and protections against them.

- i. We don't have the resources to do this type of testing ourselves. But these companies do. In fact, many major financial institutions have cyber defense budgets that exceed the entire budget of the CFTC.
- j. So I expect that the Commission will be proposing a number of principles-based standards on testing, to make sure these companies are following best practices.
- k. I am hopeful that the Commission will take these proposals up for consideration this fall.

2. CCP equivalence

- a. We are having ongoing dialogue with European regulators over their recognition of U.S. clearinghouses, or the issue of

- “equivalence.” I believe there is an ample basis for Europe to declare us equivalent, and I think this should have happened some time ago. But we are continuing to discuss some differences in our regulatory systems and, in particular, differences related to margin methodologies. Margin methodologies are complex and have many parameters. In addition, they are only one part of overall risk management.
- b. And that is why I think we should not focus on one or two particular aspects of margining in this process – but rather

Final – Oct 6, 2015

- look at overall outcomes. That is especially appropriate because our rules are consistent with existing international standards—the PFMI—and when measured through back testing or in other ways, our margining is just as robust.
- c. Moreover, I think there is a better way to consider whether we need international standards on margining that are more granular than the PFMI. That is part of a current CPMI-IOSCO process that is already underway. Both Europe and the U.S. are participants.
 - d. The EU has already granted equivalence to Australia, Hong Kong, Japan and Singapore. Recently, the European Commission recommended that five additional jurisdictions be deemed equivalent—Canada, Mexico, South Africa, South Korea and Switzerland. Many of these jurisdictions actually

follow practices similar to ours.

We will continue our dialogue, and I hope that equivalence can be granted soon.

3. Exempt CCPs and Registered CCPs

- a. The Commission recently issued an order approving ASX, from Australia, as the first clearinghouse to qualify as an “Exempt DCO”. An exemption from DCO registration permits a CCP to clear swaps for clearing members and their affiliates, but not for customers. To ensure customer

Final – Oct 6, 2015

protection, customer swaps should only be cleared through a fully registered clearinghouse. An Exempt DCO must be held to international standards – the PFMI – and be in good standing with their home country regulator. They also must comply with certain reporting obligations.

- b. Others have filed petitions to become Exempt DCOs – JSCC, KRX and OTClear – and those have been posted for public comment on the CFTC web site.
- c. In addition, we recently approved the registration of Nodal Clear as a fully registered DCO clearing for Nodal Exchange, and they will be formally launching their operations later this month.

4. Cleared Swap reporting NPRM

- a. Recently, the Commission issued a proposed rule to improve the way cleared swaps are reported. This will ensure that there is a clear record in the SDR when the original swap is accepted for clearing and results in two equal and opposite swaps, along with termination of the original swap. The new proposed rule will eliminate unnecessary reporting and improve the Commission's ability to trace swaps from execution through clearing.