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ISDA®

CENTER FOR CAPITAL MARKETS COMPETITIVENESS

A Regulatory Safe Harbor for Derivatives: Ensuring a Comprehensive and Consistent US Derivatives Regulatory Framework

A comprehensive and consistent regulatory framework for the US derivatives market is an important objective from public policy, risk mitigation and market liquidity perspectives. However, due to differences in the timing and substance of the rules implemented and/or proposed by the two primary US markets regulators – the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) – this objective is not being achieved.

Policy-makers and market participants have been discussing potential solutions for years, but haven't settled on a fix that would reduce regulatory and compliance burdens while preserving the authority of the respective agencies. For example, some have suggested that the CFTC and SEC undertake a rule-by-rule gap analysis and harmonization effort. However, such an effort would be costly and likely take years to complete. Others have proposed shifting statutory authority from one agency to the other, but this solution ignores the historic oversight and unique role of each agency (and their Congressional authorizing committees).

This paper suggests a potential solution: a regulatory safe harbor mechanism that would allow firms to rely on their compliance with one commission's rules to satisfy comparable requirements set by the other commission. This would ensure regulatory oversight over the entire market, while also enabling market participants to reduce the complexity and cost of complying with two similar but not identical regulatory regimes. The commissions could implement such a solution by adopting exemptive orders in line with their respective statutory authorities. This safe harbor mechanism could complement current efforts to achieve harmonization between the commissions' rule sets and should provide immediate relief to market participants, increasing the number of liquidity providers and, potentially, improving overall market liquidity.

EXECUTIVE SUMMARY

This paper proposes a safe harbor approach to mitigate the complexity and compliance costs of meeting similar but not identical CFTC and SEC rules

Eight years ago, Congress created a new regulatory regime for the US swaps market[1]. Under this framework, authority over US swaps was divided between the SEC and the CFTC, with the SEC given primary authority to regulate the security based swaps market and the CFTC given authority over swaps.

Congress intended for the regulatory regimes applying to swaps and security based swaps to achieve the same broad policy objectives – such as promoting market integrity and transparency, increasing centralized clearing and trading on regulated exchanges, and providing for the registration and comprehensive regulation of large swaps market participants. However, there is considerable discord between the CFTC's final rules implementing the new regime and the SEC's final and proposed ones[2].

These differences, many of which are technical in nature, create two key concerns. First, the SEC's regulatory regime has not yet taken effect, and is likely some years away from completion. Second, once the SEC's rules are implemented, market participants that have to register with both commissions as a result of their swaps and security based swaps activities will incur significant costs and suffer unnecessary compliance burdens. That's because they will have to implement two sets of substantively similar but not identical regulatory requirements for what are otherwise functionally and economically similar financial instruments.

ISDA and the US Chamber Center for Capital Markets Competitiveness (CCMC) have published this whitepaper as a suggested solution to address both of these immediate concerns through a regulatory safe harbor approach.

Such a safe harbor approach is consistent with:

- The letter and spirit of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act);
- The current Administration's stated goal of fostering "efficient, effective and appropriately tailored" financial services regulation[3]; and
- Prior actions taken by the commissions where regulatory jurisdictional issues were present.

Perhaps most importantly, the proposed safe harbor mechanism discussed in this whitepaper would strike an appropriate regulatory balance by ensuring a consistent and comprehensive rule set over all segments of the swaps market, while not unduly burdening registrants with inconsistent or duplicative regulatory requirements.

[1] In this whitepaper, the term 'swaps' generally refers to both 'swaps' that are regulated by the CFTC and 'security based swaps' that are regulated by the SEC, unless the context suggests otherwise

[2] To date, the SEC has issued 18 final rules and eight proposals related to its oversight over the security based swap market and security based swap market participants. The SEC has keyed the compliance date for the registration process for security based swap dealers and major security based swap participants (SBS entities) to the later of either: (1) six months after the publication date of the SEC's final rule establishing capital, margin and segregation requirements for SBS entities; or (2) the compliance date of the SEC's final rules establishing a process for statutorily disqualified persons to apply to be 'associated persons' of the SBS entity. The SEC has not indicated when and whether the agency plans to finalize either rule-making

[3] See Reducing Regulation and Controlling Regulatory Costs, Executive Order 13771, 82 Fed. Reg. 9339 (Feb. 3, 2017)

INTRODUCTION

Action is needed to mitigate the differences between CFTC and SEC rules

In 2010, Title VII of the Dodd-Frank Act established an entirely new structure for the regulation of swaps. Recognizing that swaps by their nature reference underlying instruments that fall within the jurisdiction of the SEC or the CFTC (or both commissions in the case of mixed swaps), Congress relied on a historical accord between the two agencies to divide the regulatory oversight of security based swaps and swaps[4].

Dodd-Frank amended both the Commodity Exchange Act (CEA) and the Securities Exchange Act of 1934 (the Exchange Act), granting new authority to the commissions and directing them to promulgate a number of rules to implement the statutory regimes for swaps and security based swaps. Dodd-Frank directed the commissions to jointly adopt certain foundational rule-makings, such as final rules defining certain commonly used terms. The overwhelming majority of rule-making areas, however, were left to each agency to promulgate alone.

Although the Dodd-Frank Act did not require the commissions to jointly issue the majority of rule-making areas, Section 712(a) of the law did require them to jointly develop and adopt key definitions and to coordinate and consult with one another in adopting their respective rules in order to ensure regulatory consistency and comparability to the extent possible[5]. Notwithstanding this requirement, there are some significant gaps in the commissions' finalized rules, a situation that has been acknowledged by the chairmen of both commissions. ISDA and the CCMC are encouraged that the chairmen recognize the compliance challenges of similar but not identical rule sets and are open to enhancing their respective regulatory oversight in a more efficient and cost-effective manner[6].

The Time to Act Is Now

ISDA and the CCMC fully support both commissions' implementation of swaps reforms, but believe it is critical the agencies act now to develop an acceptable mechanism to reconcile the disparities between the rules for swaps and security based swaps. Convergence of these rule sets would increase the effectiveness of the Dodd-Frank reforms and significantly reduce duplication, unnecessary complexity and incremental costs.

[4] The historical accord between the commissions dates back to 1981. In that year, the Shad-Johnson Jurisdictional Accord was reached between the then-chairmen of the SEC and the CFTC and named after them (the Shad-Johnson Accord). See Joint Explanatory Statement of the SEC and the CFTC reprinted in (1980-1982 – Transfer Binder), Comm. Fut. Rep. (CCH) ¶ 21,332 (Feb. 2, 1982). The Shad-Johnson Accord allocated jurisdiction between the commissions for, among other things, security based options and security based futures and options on futures. The accord also clarified SEC and CFTC jurisdiction over options and futures on, among other things, certificates of deposit and foreign currencies. The accord was enacted into law in January 1983 through the Securities Act Amendments of 1982 (Pub. L. No. 97-303, 96 Stat. 1409 (1982)), which amended the federal securities laws, and the Futures Trading Act of 1982 (Pub. L. No. 97-444, 96 Stat. 2294 (1983)), which amended the CEA

[5] See 15 U.S.C. § 8302

[6] For example, SEC chairman Jay Clayton recently stated that "the SEC's final and proposed rules governing security based swaps have differed, in some cases significantly, from the rules governing swaps that the CFTC adopted pursuant to its own Title VII mandates." SEC chairman Jay Clayton, Opening Remarks at the Securities Regulation Institute (Jan. 22, 2018), available at: https://www.sec.gov/news/speech/speech-clayton-012218. Similarly, CFTC chairman J. Christopher Giancarlo noted that the commissions must work "to better harmonize and simplify our rules, particularly where [they] have shared jurisdiction over certain types of markets." CFTC chairman J. Christopher Giancarlo Testimony, House Committee on Agriculture, Public Hearing Regarding Examining the 2017 Agenda for the CFTC (Oct. 11, 2017), available at: https://agriculture.house.gov/uploadedfiles/115-12_-_27184.pdf

Such an initiative is particularly timely since the SEC has not yet completed its rules. Market participants have already spent millions of dollars and countless hours building comprehensive and complex compliance frameworks in order to comply with Dodd-Frank requirements for their swaps activities. Once the SEC fully implements its security based swap rule-makings, firms will need to implement and comply with two sets of similar yet not identical regulations. In practice, it means the two rule sets will require a comprehensive gap analysis and significant resources in order to ensure concurrent compliance. Although many firms trade nearly identical instruments with similar economic and risk profiles, they will have to inefficiently manage their compliance obligations from two different groups within their organizations as a result.

ISDA and the CCMC propose that the commissions use their respective exemptive authorities to establish a safe harbor mechanism that would allow entities to rely on their compliance with one regulatory regime in satisfying their compliance obligations under the other regime.

The key consideration for the commissions issuing safe harbor exemptive orders is that this relief is necessary from a public interest perspective given market fragmentation, the disparities in existing rules and the uncertainty of when the SEC will fully implement its security based swap regulations. In other words, it is in the interests of both regulators to ensure there is adequate supervision over both markets and participants in those markets. This proposed mechanism would address current public policy concerns and would be an immediate first step towards ensuring the full regulatory coverage of swaps in the least complicated and costly way. The safe harbor mechanism may also complement current agency staff-level efforts to achieve harmonization between the two rule sets.

Perhaps most importantly, the use of exemptive authority, rather than a statutory delegation, preserves the CFTC's and SEC's oversight authority over their respective markets. Similarly, the relevant Congressional committees will continue to retain their important and historical oversight roles over these markets.

THE US SWAPS MARKET

Inconsistent rules and regulatory uncertainty can impact trading volumes and market liquidity

After Dodd-Frank, equity and credit swaps based on a single loan, a security or narrow-based security indices are regulated by the SEC, while swaps with 10 or more component securities (or two or more loans) are regulated by the CFTC[7]. Dodd-Frank therefore subjects swaps to differing regulatory regimes solely based on the number of underliers, regardless of trade characteristics or economic risk.

Despite this difference in regulatory classification, these two instruments behave functionally in the same manner, have identical risk profiles, are often used by market participants for the same economic purpose, are largely priced in the same manner, and are often offered by the same trader at the same dealer institutions. The following example highlights how the structuring of functionally and economically similar swap instruments may lead to different regulatory results.

Trader A, employed at a major bank derivatives division, enters into a Nasdaq 100 index swap. Since the reference asset is a broad-based index, the swap will be governed by CFTC transaction, reporting and clearing rules.

Trader B, employed at the same major bank, enters into 100 single-name swaps, each an issuer component of the Nasdaq 100 index. Since the reference asset is a single-name security, the security based swap will be governed by SEC transaction, reporting and clearing rules.

The jurisdictional line adopted by Dodd-Frank to distinguish between these similar instruments has aggravated volume and liquidity concerns in the security based swaps market, and may create adverse practical impacts for swap market participants once the security based swaps regime is finalized.

Volume and Liquidity Concerns

With each year that passes following the adoption and implementation of swaps reform under Dodd-Frank, trading volumes and liquidity in the security based swaps market have continued to decline[8]. The finalization of a security based swaps regulatory regime that is consistent with the existing CFTC framework can only help to foster participation in the market and, hopefully, reverse this trend.

Inconsistent rules, however, lead to regulatory uncertainty, which can have an adverse impact on trading volumes and liquidity. For example, market participants have already experienced the impact of diminished liquidity in the context of the swaps trading rules, where the global market was forced to comply with separate US and European Union requirements. As CFTC chairman J. Christopher Giancarlo noted in his 2015 whitepaper, "[f]ragmentation has led to smaller, disconnected liquidity pools and less efficient and more volatile pricing" further "exacerbating the inherent challenge of swaps trading – adequate liquidity"[9].

[7] As stated above, the jurisdictional boundaries imposed by Dodd-Frank were not new concepts, but rather an affirmation of the governance and oversight principles first established under the Shad-Johnson Accord. Indeed, the CFTC and SEC have had overlapping jurisdiction over certain instruments and market participants before the enactment of Dodd-Frank

[8] See Bank of International Settlements, OTC derivatives market activity in the first half of 2008 (Nov. 2008), available at: http://www.bis.org/publ/otc_hy0811.pdf and Bank of International Settlements, OTC derivatives statistics at end-December 2014 (Apr. 2015), available at: http://www.bis.org/publ/otc_hy1504.pdf

[9] See CFTC commissioner J. Christopher Giancarlo, Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank, p.50 (Jan. 29, 2015) available at http://www.cftc/gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf

Divergences between the two rule sets often appear minor or inconsequential. Due to the complicated nature of the derivatives market, however, minor differences can have significant effects, particularly when attempting to build a compliance framework that can be used with each rule set.

In the case of the swap data reporting rules, the time frames established for reporting differ between rule sets. The CFTC rules require swaps to be reported to a swap data repository (SDR) as soon as technologically practicable, and require SDRs to impose public dissemination time delays for certain trades, such as blocks and large notional off-facility trades. In contrast, the SEC rules require reporting counterparties to send their trades to security based swap data repositories (SBSDRs) within 24 hours after execution, and do not impose any public dissemination delays on SBSDRs. This seemingly slight mismatch between the two rules requires reporting counterparties to implement two separate compliance systems or, at a minimum, to build an internal delay mechanism specifically for their security based swaps trades.

The disparity between the rules may also complicate the way in which market participants trade mixed swaps. Currently, many market participants apply the CFTC's regulations to mixed swaps because there are no SEC regulations to apply to these instruments. However, once the SEC fully implements its security based swap rules, the gaps in requirements will create confusion, inefficiencies and potentially conflicting compliance results.

To address the current state of the market and practical concerns of the swaps rules, ISDA and the CCMC propose a more effective, holistic solution than rule-by-rule harmonization. This solution is consistent with both the letter and spirit of the Dodd-Frank Act, and allows appropriate regulatory oversight of the entire US swaps market – both swaps and security based swaps.

The following section provides a high-level description of the proposed contours of the commissions' safe harbor mechanism.

THE SAFE HARBOR MECHANISM

A safe harbor mechanism would allow firms to meet the requirements of one commission by complying with comparable rules of the other commission

A safe harbor mechanism would permit participants whose swaps activities might bring them within the scope of both commissions' regulatory jurisdiction to use registration and compliance with one agency's regulations as a substitute for registration and compliance with the relevant regulations of the other agency. Market participants that are in compliance with the CFTC's rules for swaps would therefore be granted a safe harbor for the same rule set issued by the SEC for security based swaps, and vice-versa. Ultimately, this mechanism would allow swap dealers that facilitate trading in these two markets to do so within a streamlined but comprehensive regulatory oversight regime.

The proposed exemptive regime allows the commissions to define the scope of the safe harbor mechanism. For example, a security based swap dealer (SBSD) that otherwise would have been required to register with the SEC would be deemed in compliance with the SEC security based swap-related rules if the SBSD registers with the CFTC and complies with the CFTC swap-related requirements. Conversely, a swap dealer (SD) that otherwise would have been required to register with the CFTC would be deemed in compliance with the CFTC swap-related rules if the SD registers with the SEC and complies with the SEC's security based swap-related requirements once they are in effect[10].

The safe harbor mechanism could also be employed at a more granular level. The commissions could allow a dealer to register with one agency and comply with that agency's specific rules in lieu of compliance with equivalent rule set of the other agency. For example, the exemptive order could allow an SBSD (that otherwise would have been required to register with the SEC) to register with the CFTC and comply with CFTC business conduct rules in lieu of compliance with the SEC's business conduct requirements. In this example, the SBSD (that is now registered with the CFTC) would still have to comply with other SEC security based swap-related rules (eg, margin, capital, clearing and trading rules).

At a minimum, the commissions should consider allowing firms to rely on the safe harbor mechanism when complying with dealer registration requirements, regulatory and real-time reporting rules, business conduct standards and chief compliance officer requirements (to the extent permitted). Regardless of the approach, the commissions may choose to retain their respective enforcement, anti-manipulation and anti-fraud authorities[11].

[10] We note that the commissions may retain their respective mandatory clearing and trade execution requirements – ie, a dealer choosing to comply with CFTC rules for its swaps and security based swaps may need to clear and/or SEF execute security based swaps that are subject to the SEC mandatory clearing and trade execution requirements

[11] As discussed in more detail in Part III infra, the Federal Energy Regulatory Commission (FERC) and the CFTC have reached memoranda of understanding for the joint oversight of US energy markets. Under those arrangements, both agencies maintain their individual enforcement authority over the physical energy markets and certain market participants. This enabled both agencies to pursue their own enforcement actions under their relevant regulations against the same conduct, while engaging in cooperative efforts where appropriate. See eg, CFTC press release, CFTC Files and Settles Charges against Total Gas & Power North America, Inc. and Therese Tran for Attempted Manipulation of Natural Gas Monthly Index Settlement Prices (Dec. 7, 2015), available at www.cftc.gov/PressRoom/PressReleases/pr7289-15; Total Gas & Power North America, Inc., 155 FERC Paragraph 61,105 (April 28, 2016) (indicating that the CFTC settled with Total Gas & Power North America in 2015 to resolve charges of attempted manipulation while, in 2016, FERC issued a show cause order to Total Gas & Power North America based on the same conduct)

PATHWAY TO A SAFE HARBOR

Both the CFTC and SEC have broad authority to adopt exemptions

The following section outlines a statutory pathway for utilizing a safe harbor mechanism.

The CFTC's Exemptive Authority: Section 4(c) of the CEA

CEA Section 4(c) provides the CFTC with broad authority to adopt an order exempting market participants, contracts and transactions from requirements under the CEA and CFTC regulations[12]. Dodd-Frank amended Section 4(c)(1) to reflect the CFTC's new jurisdiction over swaps. This section allows the CFTC to exempt a swap dealer from the registration requirements and other swap-related rules listed in Section 4(c)(1) unless these rules provide for a specific exemption[13].

The CFTC relies on this reading of Section 4(c)(1) in issuing two orders exempting certain non-financial derivatives transactions in the electricity markets from the CFTC jurisdiction[14]. The CFTC effectively acknowledged that swap transactions may be exempt from the CFTC jurisdiction under Section 4(c) pursuant to the requirements provided in 4(c)(1) and (2). ISDA and the CCMC believe this interpretation is also consistent with the intent of Congress to allow for more efficient and effective regulatory oversight.

In order to use its Section 4(c) exemptive authority, the CFTC must demonstrate that the exemptive relief satisfies three requirements: (i) the exemption is in the public interest[15]; (ii) the exemption will cover 'appropriate persons'[16]; and (iii) the exemption will not have an adverse effect on the CFTC's ability to discharge its responsibilities under the CEA.

(i) The exemption is in the public interest

Congress noted that the purpose of this provision was to give the CFTC a means of providing certainty and stability to existing and emerging markets, so that financial innovation and market development can proceed in an effective and competitive manner[17].

ISDA and the CCMC believe a safe harbor mechanism is the best way to promote responsible fair competition and market development between swaps and security based swaps markets. Further, reducing complexity, costs and unnecessary duplication for CFTC registrants would be in the public's interest, to the extent that those registrants are subject to comparable SEC regulations. In addition to the obvious compliance efficiencies, reconciling the two similar but not identical rules would promote responsible economic and financial innovation by, for example, allowing mixed swaps to continue to trade without the imposition of artificial and incremental compliance burdens and costs that have no concomitant benefits to the commissions.

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[12] See 7 U.S.C. § 6(c)

[13] We note that the statutory language could be susceptible to more than one interpretation. We propose the most plausible interpretation given the Congressional intent is to allow the commissions the most efficient oversight over derivatives markets and the CFTC's precedent in interpreting this provision

[14] While the CFTC relied on its exemptive authority under Section 4(c)(6) of the CEA, that section requires the exemption to be consistent with requirements of both Sections 4(c)(1) and 4(c)(2). See CFTC Final Order in Response to a Petition From Certain Independent System Operators (ISO) and Regional Transmission Organizations (RTO) to Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by FERC or the Public Utility Commission of Texas from Certain Provisions of the CEA Pursuant to the Authority Provided in the Act, 78 Fed. Reg. 19879 (Apr. 2, 2013). The CFTC issued a final order exempting specified transactions by certain RTOs and ISOs from various mandatory margin, registration and reporting requirements under the CEA – except CEA's anti-fraud and anti-manipulation provisions – and preserved the CFTC's authority to enforce these provisions through civil enforcement actions

[15] See CEA Section 4(c)(1)

[16] See CEA Section 4(c)(2)

[17] H.R. Rep. No. 102-978, 1992 U.S.C.C.A.N. 3179, 3213 (1992)

(ii) The exemption covers appropriate persons

With respect to the 'appropriate persons' requirement, ISDA and the CCMC believe that security based swap dealers meet the definition of appropriate persons as required under CEA Section 4(c)(2), as most entities that will likely be required to register as security based swap dealers fall within one or more of the categories listed in the definition. For example, the definition of appropriate persons expressly includes certain SEC registrants, such as registered investment companies and registered broker-dealers[18]. The definition also includes banks, insurance companies and other companies that meet certain financial qualifications.

(iii) The exemption does not adversely affect CFTC's ability to discharge its responsibilities

Finally, the CFTC would retain its ability to enforce compliance with the CEA and the CFTC's regulations under its anti-manipulation and anti-fraud authority, therefore meeting the third prong of the test. The proposed safe harbor would not restrict or otherwise have an adverse effect on that authority.

The SEC's Exemptive Authority: Section 36(c) of the Exchange Act

The Exchange Act permits the SEC to exempt security based swaps as to the same matters that the CFTC has under Dodd-Frank with respect to swaps, including under the CFTC's Section 4(c) plenary exemptive authority[19]. If the CFTC has exemptive authority under the CEA to adopt a safe harbor mechanism for its swaps registrants, the Exchange Act therefore provides that the SEC has the same authority with respect to the SEC's security based swaps registrants.

Like the CFTC, the SEC has used its exemptive authority to provide relief to swap market participants and activities that fall within the SEC's jurisdiction[20]. The SEC has not suggested that its exemptive authority is significantly limited or different from the CFTC's swaps exemptive authority in any way. The SEC would therefore be in a similar position to the CFTC in being able to demonstrate that proposing a safe harbor mechanism is necessary and in the public's interest.

[18] See CEA Section 4(c)(3)(A)-(K)

[19] See 15 U.S.C. § 78mm(c)

[20] See SEC Exemptive Order, Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, 76 Fed. Reg. 39927 (July 7, 2011). See also SEC Exemptive Order, Exemptions for Security-Based Swaps, Securities Act, 82 Fed. Reg. 10703 (Feb. 15, 2017); SEC Exemptive Order, Order Extending Until Feb. 5, 2019 Certain Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of "Security" to Encompass Security-Based Swaps and Request for Comment, 83 Fed. Reg. 5665 (Feb. 8, 2018). These orders are generally intended to enable the SEC to preserve the status quo for security-based swaps until the full mosaic of the SEC's new regulatory regime is in place

CONGRESSIONAL INTENT AND ADMINISTRATION RECOMMENDATIONS

A safe harbor approach is consistent with the intent of Congress and recommendations made by the current US Administration

ISDA and the CCMC believe the adoption of a safe harbor mechanism would be consistent with provisions in Dodd-Frank, Congressional intent in enacting Dodd-Frank swaps regulatory reform, and the current Administration's recommendations in a US Treasury report on capital markets. That report addresses Dodd-Frank harmonization concerns, among other things.

Section 712(a) of the Dodd-Frank Act

Congress expressly directed the commissions to coordinate and cooperate with one another to harmonize their swaps regulations in the text of Dodd-Frank. Specifically, Section 712(a) of the Dodd-Frank Act expressly requires the CFTC and the SEC to consult and coordinate their rule-makings and orders regarding swaps and security based swaps for the purposes of assuring regulatory consistency and comparability to the extent possible[21]. This section of Dodd-Frank further provides that "[i]n adopting rules and orders…the CFTC and the SEC shall treat functionally or economically similar products or entities…in a similar manner"[22]. The proposed safe harbor mechanism would allow entities to trade functionally and economically similar swaps instruments in a consistent and ascertainable manner[23].

Congressional Intent

In a floor colloquy following the passage of Dodd-Frank, then-Senate Agriculture Committee Chairwoman Blanche Lincoln encouraged both agencies to use their respective exemptive authority. When speaking about new and novel derivatives products, Chairwoman Lincoln noted:

> We strongly urge the agencies to work together under these new provisions to alleviate the ills that they themselves have identified. The agencies should make liberal use of their exemptive authorities to avoid spending taxpayer resources on legal fights over whether these novel derivative products are securities or futures and to permit these important new products to trade in either or both a CFTC- or SEC-regulated environment[24].

Chairwoman Lincoln's statement suggests that the commissions should use their exemptive authorities to the maximum extent possible in order to avoid unnecessary and ineffectual disparities. ISDA and the CCMC believe that adopting a safe harbor mechanism pursuant to the commissions' broad exemptive authority would be consistent with Chairwoman Lincoln's statement.

[21] In fact, the CFTC and SEC have already deferred to each other's regulatory authority in some cases. For example, in their proposed SD capital rules, the CFTC contemplates permitting SDs to elect a capital requirement that is based on the existing SEC broker-dealer capital rules or the SEC's proposed capital requirements for SBSDs. See 81 Fed. Reg. 91252, 91254 (Dec. 16, 2016)

[22] See 15 U.S.C. § 8302

[23] Consistent with its directive to coordinate and cooperate in conducting regulatory oversight, Congress also directed the prudential regulators, the SEC and the CFTC to coordinate the implementation of their capital and margin requirements and make such requirements comparable "to the maximum extent practicable". See Dodd-Frank Wall Street Reform and Consumer Protection Act, H. R. 4173—331 (2010). Coordination and cooperation among regulators therefore appears to be a consistent theme throughout the Dodd-Frank Act

[24] Cong. Rec. Vol. 156, Number 105, p. S5923 (July 15, 2010)

Administration Support for Convergence

The current Administration has similarly expressed support for the commissions to take immediate action to harmonize or reconcile their respective swaps regulations[25]. In October 2017, the US Department of the Treasury expressly recommended greater harmonization between the SEC and the CFTC, more appropriate capital and margin treatment for swaps, allowing space for innovation and flexibility in execution processes, and improvements in market infrastructure. In the Treasury's view, the roles of the SEC and the CFTC, the management of regulatory overlaps and areas for harmonization should be evaluated. Finally, the Treasury expressed support for the commissions to have appropriate authority to provide exemptions to facilitate market innovation. ISDA and the CCMC believe the proposed safe harbor would help manage regulatory overlaps and allow for swaps market innovation and greater harmonization in the long term.

Precedent for Issuing a Safe Harbor

Historically, the commissions have worked together in several areas to relieve burdens on dual registrants. Certain provisions in the CEA and the Investment Advisers Act of 1940 provide exemptions for investment advisers already registered with the other agency. For intermediaries that are registered with both commissions, the CFTC will also accept the SEC's disclosure, reporting and record-keeping regime as substituted compliance for substantially all of Part 4 of the CFTC's regulations, so long as the intermediary complies with comparable requirements under the SEC's statutory and regulatory compliance regime. This recognition and acceptance of comparable regulatory compliance is at the heart of the proposed safe harbor mechanism.

In addition to the CFTC's coordination with the SEC, the CFTC has entered into formal arrangements to ensure coordination on overlapping jurisdictional issues. Pursuant to Section 720(a) of Dodd-Frank, the Federal Energy Regulatory Commission (FERC) and the CFTC entered into two memoranda of understanding (MOUs) in January 2014 to establish procedures for: (1) applying the agencies' respective authorities in a manner that ensures effective and efficient regulation in the public interest; (2) resolving conflicts concerning overlapping jurisdiction between them; and (3) avoiding conflicting or duplicative regulation to the extent possible[26]. The MOUs have allowed the CFTC and the FERC to defer to one another without ceding oversight authority to the other agency. The SEC and the CFTC should look to these MOUs as a template for developing a safe harbor mechanism.

The CFTC has also reached agreement with non-US regulators to recognize each other's authorized market infrastructures. For example, the CFTC and the European Commission announced their Common Plan on Trading Venues at the end of 2017, which lays out their agreement to recognize each other's authorized trading venues[27]. The CFTC's efforts to coordinate and cooperate on swaps regulation with regulators outside the US can be a model for coordination and cooperation with its sister agency on joint supervision of the US swaps market. We also encourage the SEC to work with the CFTC and join their ongoing efforts to coordinate and cooperate with foreign regulators, providing deference to their authority, where appropriate[28].

[25] See US Dep't of the Treasury, A Financial System That Creates Economic Opportunities: Capital Markets (2017), available at https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf

[26] See Memorandum of Understanding between the Federal Energy Regulatory Commission and the CFTC Covering Jurisdiction, (Jan. 2, 2014), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/cftcfercjmou2014.pdf; Memorandum of Understanding between FERC and the CFTC Covering Information Sharing, (Jan. 2, 2014) available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/cftcfercismou2014.pdf

[27] See CFTC, A Common Approach on Certain Derivatives Trading Venues (Oct. 13, 2017), available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dmo_cacdtv101317.pdf. The Common Plan on Trading Venues was modeled after their common approach adopted in 2016 to address cross-border recognition issues dealing with derivatives clearing houses

[28] See ISDA whitepaper: Cross-Border Hamonization of Derivatives Regulatory Regimes, available at https://www.isda.org/a/DGiDE/isda-cross-border-harmonization-final2.pdf

CONCLUSION

A safe harbor mechanism would bring significant benefits to the CFTC and SEC in terms of regulatory oversight, and would reduce complexity and costs for market participants

There are significant challenges to achieving regulatory harmonization and efficiency, which are driven by a variety of factors including joint rule-making responsibilities, overlapping mandates and jurisdictional friction. ISDA and the CCMC welcome that fact that the CFTC and SEC are working to harmonize their swaps and security based regulations to the extent possible.

It is positive that the commissions agree with the industry's concerns that implementing separate and duplicative compliance regimes for functionally and economically similar financial instruments is costly and does not provide meaningful benefits to either agency in meeting their underlying public policy objectives. Trying to engage in rule-by-rule harmonization would very likely lead to protracted consultations, diminished market liquidity and market fragmentation.

The commissions should therefore consider adopting the proposed safe harbor mechanism since it is a more immediate solution, which would result in significant benefits to both the commissions in terms of their regulatory oversight of the entire swaps markets, and to market participants that are required to register with both agencies because of their swaps and security based swaps activities.

ABOUT THE US CHAMBER'S CENTER FOR CAPITAL MARKETS COMPETITIVENESS

The Center for Capital Markets Competitiveness's (CCMC) mission is to advance America's global leadership in capital formation by supporting diverse capital markets that are the most fair, transparent, efficient, and innovative in the world. CCMC advocates on behalf of American businesses to ensure that legislation and regulation strengthen our capital markets allowing businesses – from the local flower shop to a multinational manufacturer – to mitigate risks, manage liquidity, access credit, and raise capital.

The US Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

ABOUT ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 900 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.