



## DERIVATIVES OVERSIGHT AND TAXPAYER PROTECTION ACT

### OVERVIEW

For questions please contact [Kwon Park](#) at (202) 547-3035.

On June 29, 2016, Senators Elizabeth Warren (D-MA) and Mark Warner (D-VA) introduced a new derivatives regulation bill entitled the “Derivatives Oversight and Taxpayer Protection Act.” A PDF version of the bill is attached.

The bill will be referred to the Senate Ag Committee, where it will likely sit dormant in the Republican controlled Committee, but may become an important part of CFTC reauthorization efforts going forward (more on this below).

### SUMMARY

#### Background

##### Derivatives Oversight and Taxpayer Protection Act

The proposed bill authorizes the Commodity Futures Trading Commission (CFTC or Commission) to do the following:

- Collect fees for the cost of the Commission’s regulatory services and from registered entities and persons;
- Updates the Commission’s enforcement authority to impose higher civil penalties;
- Amends the cross-border swaps provision in the Commodity Exchange Act (CEA) to make it more difficult to obtain substituted compliance;
- Eliminates the exemption of certain foreign exchange (FX) swaps and forwards from CFTC jurisdiction (as previously exempted by Treasury pursuant to authority granted in Dodd-Frank);
- Requires the CFTC to share swap data reported to swap data repositories (SDR) with other financial regulators upon request;
- Requires swap dealers (SDs) to report to an SDR, accurate, consistent, and standardized swap data that can be aggregated and analyzed – failure to comply will result in a revocation of their SD status;
- Modifies the CFTC rule on margin requirements for uncleared swaps, requiring entities to collect margin on all interaffiliate transactions;
- Bans closeout netting for capital purposes; and
- Requires the CFTC, OCC, FDIC, and the Fed to jointly publish a report on clearinghouses (answering specific questions included in the bill) that includes a policy recommendation.

##### CFTC Reauthorization

Congress typically renews the CFTC’s authorization for appropriations every five years. The last authorization expired in 2014, meaning the Commission is currently being funded through unauthorized appropriations (a practice that is frowned upon and makes their funding subject to a budget point of order during the appropriations process). The reauthorization process provides the Congress with oversight to periodically reexamine the Commissions statutory authority and rule set. Currently, both the Republican controlled Senate and House Agriculture Committees have introduced legislation to reauthorize the CFTC.

##### Why This Matters?

With the elections fast approaching, there is a possibility that the Republicans could lose control of the Senate, the House, or both Chambers. This means that if Congress does not pass the CFTC reauthorization bill this year and the Democrats do take control of one or both Chambers, the “Derivatives Oversight and Taxpayer Protection Act”

introduced by Senators Warren and Warner could influence the legislative efforts next year to reauthorize the CFTC, and quite possibly will affect reauthorization negotiations regardless.

Congressman Elijah Cummings (D-MD) introduced a similar bill in the House.

## **Title I – Strengthening Oversight and Enforcement**

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### **Fees to Recover Costs**

Effective date: October 1, 2016

The CFTC may assess fees to recover the costs of regulatory services and may assess fees from registered entities and persons:

- Designated contract market (DCM) market compliance examinations (exams)
- Foreign board of trade (FBOT) registration reviews
- Swap execution facility (SEF) designation reviews
- SDR registration reviews
- DCM designation reviews
- SEF compliance exams
- SDR compliance reviews
- DCM review and approvals
- SEF review and approvals
- DCM certification and rule reviews
- SEF certification and rule reviews
- SDR rule reviews
- Reviews of mergers, transfers, and other action requests from DCMs, SEFs, and SDRs
- Designated self-regulatory organization (SRO) financial surveillance reviews
- Registered futures association (RFA) compliance program reviews
- DCO reviews
- FCM exams
- Registered FX dealer exams
- SD registration reviews
- SD exams
- Other entity registration, reviews, or exams, or other regulatory services

Fee Rates:

- The Commission must publish in the Federal Register fee rates and a schedule of fees for the fiscal year
- The Commission will deposit and credit fees collected as offsetting collections to the account providing appropriations to the Commission for that fiscal year
- No fees collected will be deposited and credited as general revenue of the Department of Treasury (Treasury)
- Fees will be adjusted based on the factors listed in this bill

### **Civil Penalties and Fines and Related Enforcement Actions**

This section effectively amends the CEA to increase the civil penalties and fines related to enforcement actions

### **Closing the Cross-Border Loophole**

*CEA Section 2(i) (7 U.S.C. 2(i) is amended as follows:*

(i) Applicability. (1) In General - The provisions of this chapter relating to swaps that were enacted by the Wall Street Transparency and Accountability Act of 2010 (including any rule prescribed or regulation promulgated under that Act), shall not apply to activities outside the United States unless those activities—

(A) have a direct and significant connection with activities in, or effect on, commerce of the United States;

(B) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this chapter that was enacted by the Wall Street Transparency and Accountability Act of 2010; or

(C) except as provided in paragraph (2), involve a swaps transaction in which a financial entity that is domiciled or organized in the United States, or a subsidiary entity that is majority owned or controlled by a financial entity that is domiciled or organized in the United States, bears swaps-related risks.

(2) Substituted Compliance – Notwithstanding paragraph (1)(C), the Commission may allow a swaps transaction that involves a subsidiary entity that is majority owned or controlled by a financial entity that is domiciled or organized in the United States to be conducted in whole or in part under the rules and oversight of a foreign jurisdiction if the Commission determines, by rule, that-

(A) the applicable elements of the foreign rules are substantially equivalent to, or offer greater protection than, the applicable rules in the United States; and

(B) enforcement of and oversight with respect to the rules described in subparagraph (A) is not less stringent than enforcement of and oversight with respect to the applicable rules in the United States.

### **Providing Oversight of Foreign Exchange Swaps**

FX swaps and forwards will be considered swaps under the CFTC's jurisdiction

### **Improving Data Sharing Between Regulators**

The CFTC will be required to share SDR data with any other financial regulatory agency upon request

### **Improving Data Quality and Accessibility**

In two years after the date of enactment, the CFTC and the SEC will determine whether the data provided by registered SDs to an SDR are accurate, consistent, and standardized for the data to be aggregated and analyzed

The CFTC shall revoke the license of any SD in violation

## **Title II – Shifting Derivatives Risks from Taxpayer to Financial Institutions**

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### **Ending Favorable Treatment**

11 U.S. Code Section 560 is repealed

*“Contractual right to liquidate, terminate, or accelerate a swap agreement”*

The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title or to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title. As used in this section, the term “contractual right” includes a right set forth in a rule or bylaw of a derivatives clearing organization (as defined in the Commodity Exchange Act), a multilateral clearing organization (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991), a national securities exchange, a national securities association, a securities clearing agency, a contract market designated under the Commodity Exchange Act, a derivatives transaction execution facility registered under the Commodity Exchange Act, or a board of trade (as defined in the Commodity Exchange Act) or in a resolution of the governing board thereof and a right, whether or not evidenced in writing, arising under common law, under law merchant, or by reason of normal business practice.

### **Interaffiliate Margin Exception**

The CFTC must modify the rule on margin requirements for uncleared swaps to require entities to collect margin on all interaffiliate swaps

### **Banning Closeout Netting for Capital Purposes; Ensuring Minimum Capital**

For covered financial institutions (i.e. SDs/MSPs), when determining the amount of capital required under the risk-based capital requirements and leverage limits, consolidated assets will include the fair value and potential future exposure of derivatives without recognizing the benefits of any netting arrangement, unless the netting arrangement meets certain factors

Total derivatives risk exposures will not be assessed at a level less than 2% of total gross notional derivatives contracts to which the covered financial institution is a party and the leverage limits will not vary for derivatives exposures as compared to other assets

### **Report on Clearinghouses**

The CFTC, OCC, FDIC, and the Fed will jointly publish a report that answers the following questions:

- Are prefunded default funds at major clearinghouses, along with prefunded liquidity resources, adequate to absorb losses and continue operations in the event of the failure of multiple large clearing members during a systemic stress event affecting the financial system as a whole?
- Are capital and liquidity resources associated with cleared derivatives at clearinghouse members adequate to meet clearinghouse capital and margin calls that might occur during a systemic stress event associated with the failure of multiple large clearing members during a systemic stress event?
- Based on planned resource levels at clearinghouses and major clearing members, in what ways might a lack of prefunded resources at a clearinghouse, or the level of member capital and liquidity resources associated with cleared derivatives, contribute to increased financial system stress during a systemic event?
- How would the answers to the three questions above be affected if portfolio correlation levels in clearinghouse margin and default fund models were significantly lower than those assumed in current risk models?
- Are such lower correlation levels possible in a stress event?
- Are capital levels held by clearinghouses currently adequate to align risk management incentives between clearinghouses themselves, their members, and end user clients of their members?
- Do the fiduciary duties of clearinghouse management to their stockholders in any way conflict with the public interest?

The report will include policy recommendations associated with answers to the above questions.