following the cftc's kiss

Who's Stupid?

Sure, we all know the meaning of the KISS principle. Literally, it's *keep it simple, stupid*. What you might not know is who came up with the idea and further, who exactly is being referred to as the stupid party in the CFTC's ongoing rule review initiative. The original phrase was likely coined by engineers in the US Navy/Lockheed skunkworks back in the 1960s. The project at the time was the Blackbird spy plane. Heady stuff for sure. In the current context at the CFTC, there is an appropriateness to the term, considering all the years of layering on complex policy and rule over complex policy and rule. Markets seemed more impeded than protected by commission actions. This was the core thinking behind the effort. As for the actual term, KISS, the question was eventually raised by staff, sometime after the initiative was publicly announced, "who's stupid" in *keep it simple stupid*?" Chief of staff Mike Gill offered this little anecdote during the panel discussion on the agency's KISS initiative at the National Press Club recently. "Well," he said, "it's certainly not the staff who's stupid. And it's not the chairman. It's not members (of Congress) on the Hill and certainly not folks in the market," Gill said. "This question was also raised by a lawmaker at an appropriations committee hearing that featured Chairman Giancarlo. "Well," the chairman said, "my chief of staff Gill is leading the initiative, so I guess … he's stupid … " This was said on live television he noted, "and it was pointed out to my mother." So, Gill has been left holding the ultimate KISS distinction. As such, it was only right and proper that we hosted Gill and several of his division directors in an open forum to discuss the finer points of the initiative.

Gill opened the session, followed by Matt Kulkin, the director of Division of Swap Dealer and Intermediary Oversight (DSIO), Amir Zaidi, the director of the Division of Market Oversight (DMO), and Brian Bussey, the director of the Division of Clearing and Risk. Each made brief statements on how the initiative as affecting their divisions, and then joined an open panel discussion.

The KISS Forum we hosted offered a basket of intel and insights on this near-comprehensive internal rule review process, how it's organized and how it's being categorized, who's who in the process, what we won't see this year as a result of the effort and what we might see. As we noted previously, there was no earth-shattering news, but a lot of very key indicators and subtle guidance on matters that have hounded this sector for nearly a decade.

Recall, too, that besides the internal staff assessments of rules and procedures, the agency also opened a comment period for KISS so everybody else in the sector could join in the fun. Gill noted in his opening statement that there is a total of 149 comments submitted from the public and 51 proposals from staff. Breaking it down further, 35 submissions concerned registration, 37 reporting, 20 clearing, 20 executions and 37 were catalogued as "other." From this group the comments and recommendations were further divided into three broad categories:

- Tier One is "simple housekeeping with no discretionary policy changes."
- Tier Two was classified as "reducing regulatory burdens with minor policy implications.
- Tier Three suggested more significant policy implications, and as such, "outside of the KISS initiative." *Position limits, for example.*

Gill also noted that the process is far from over and many of the decisions that have already been made to change or tweak rules may not be immediately implemented. However, we note that since the event, at least one big change has actually been locked and loaded. On Feb. 15, a couple days after our forum, the agency announced an amendment approved for publication in the *Federal Register* as an interim final rule concerning the CFTC's primary definitions regulation, Regulation 1.3. This interim final rule replaces the arcane lettering system used in its list of defined terms with an alphabetical list. May not seem like much, but during the panel dis-

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cussion, DSIO chief Matt Kulkin spoke at length about how crazy the current archival search and organization process really is. It's impossible to navigate, he implied. Somebody else offered that the process is so bad, and often impossible to find requisite forms and data, "that it's quite possibly what stops some folks from registering new products and services to begin with." So, that's good.

As we noted in our intro to the event, this was a forum that only policy geeks can love. One such candidate, Bob Zwirb of Cadwalader, a former CFTC attorney, noted that even within the strict parameters of this in-house exercise at the CFTC, limiting its scope to cleaning up the rulebook, cleaning up the clutter, and otherwise improving rules in a policy-neutral way, "there is a lot to be excited about here, especially given that past efforts to prune the barnacles of the CFTC's 2,088-page rulebook came to naught."

"Codifying a significant amount of past no-action and exemptive relief, eliminating silly hoops to obtain such relief, and promising to issue future requirements in an ABA compliant manner alone are worth the price of admission," Zwirb says.

Though no formal list of actions was provided, Gill did mention quite a few in his presentation and dozens more were laid out in the panel discussion and during the Q&A session that followed the panel. Below are the bits Gill mentioned specifically:

The Division of Clearing and Risk (DCR) will (likely) propose changes to codify the process of granting exemptions from derivative clearing organization (DCO) registration. Other proposed changes codify an interpretative letter that gives DCOs some flexibility in determining when the customer margin "bump-up" rule, which requires customer initial margin to be greater than clearing member initial margin, applies. Another change would eliminate the requirement that DCOs petition for a commission order when seeking to hold cleared swaps customer collateral in a futures customer account. DCOs would do that with a rule filing, consistent with the process for holding futures in the swaps customer account. Yet another change would eliminate the need for DCOs that requires full collateralization for positions to comply with certain risk management standards. Another proposed change would codify existing no-action relief through amendments to the commission's required clearing rules for certain small bank holding companies, savings and loan holding companies and community development financial institutions to qualify for an exemption to the clearing requirement, and to codify existing no-action relief relating to an exemption for swaps between affiliates. DCR is also looking at extensive proposed amendments to current Part 190 regulations based on a set of Model Part 190 Rules prepared by a subcommittee of the American Bar Association's Business Law Section. Specifically, the amendments would revise and reorganize provisions that pertain to FCM liquidation, add explicit provisions that pertain to a DCO liquidation, clarify general provisions and simplify standard forms.

The Division of Market Oversight (DMO) seeks to revise and repropose guidance on peaking supply contracts, including to clarify that other similar customary commercial agreements are not swaps. Another proposed change would codify the no-action letter regarding notice filing requirements under the final aggregation rule for position limits. Further, DMO says a revision to remove the applicable "hard coded" reporting lev-

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els under Part 15 (large trader reporting levels) from the regulatory text and instead publish such lists on the CFTC website. Another proposed change is to reduce the timeline to complete designated contract market rule enforcement reviews (RERs). Other proposed changes would codify several no-action letters for SEF rules in Part 37. Staff will be proposing changes to no-action relief for SEF confirmation requirements for uncleared swaps, SEF error trade policies and SEF audit trail requirements for post-execution allocation information. Staff will also be proposing several changes to swap data reporting rules as part of the commission's Roadmap to Achieve High Quality Swaps Data.

Within the Division of Swap Dealer and Intermediary Oversight, several proposed changes would codify no-action letters. These would include NAL 13-11, which would allow swap dealers to allocate disclosure obligations to other swap dealers acting as executing dealers in prime brokerage transactions. Another proposal would codify NAL 13-70 to provide exceptions to business conduct and documentation requirements for swap dealers entering into "intended to be cleared swaps" on SEFs. NAL 17-12 would be codified to permit SDs entering into swaps with separately managed accounts to treat each account of the same legal entity as a separate counterparty for purposes of applying a maximum minimum transfer amount (MTA) of $50,000 per account. Further, the agency would simplify risk management rules (1.12 for FCMs and 23.600s for swap dealers) to allow more effective programmatic risk management, rather than prescriptive policies and procedures that don't apply for many registrants. With respect to regulations for commodity pool operators and commodity trading advisers, certain Part 4 regulations would be changed to codify currently applicable staff letters regarding CPO and CTA registration relief, such as for family offices (12-37 and 14-143), JOBS Act solicitation activities (14-116) and business development companies (12-40).

So we asked, codifying no-action letters (NALs) is basically the low-hanging fruit in the process? Gill concurred. "All those NALs that have already been accepted as industry practice is one of the easier things to address."

Matt Kulkin, director of DSIO, said that his division has has the honor of issuing 60 percent of the NALs over the past 10 years. "But only a handful in my four months at the agency," he says. Funny guy. "There is a lot of work yet to do in this no-action letter space," he began. "When I was in private practice (Kulkin joined the agency last Fall from the DC office of Steptoe & Johnson), I always found it hard to find the relevant suite of NALs. The SEC has a great format, they publish chronologically and by subject area. At the CFTC you search by year and other parameters, it's complicated. We have embarked on an effort internally, a new work stream to revamp the NAL website area," he says.

Bussey, who recently joined the CFTC after 17 years at the SEC, agreed the fixes to NALs can't be understated. "We all have them (other agencies). It's a quick way to get response to real-world issues. But the three of us (along with Kulkin and Zaidi) have letters that have been out there for a while, so this is just good government to get these long-standing letters into a rule, so they have the benefit of notice and comment before they are included in the rulebook. This is the motivation for all of us, NAL codification," Bussey says.

Amir Zaidi, head of DMO, noted that several NALs deal with his division, but it generally relates to bigger rulemakings. "We don't specifically have any KISS items per se, as most of the comments we received from external commenters were related to bigger rulemakings. Mike (Gill) mentioned several items in the SEF space we're looking at, like the confirmation requirement for uncleared swaps. So some of our NALs relate to famous footnotes, like Footnote 195 for confirmation requirement. There was a requirement for SEFs to have agreements in place before confirming those trades … we're looking at this right now, to get rid of some of these requirements for these categorized agreements, pre-trade," he says. "Another thing we're looking at is error trades. DCMs have error trade policies that they are able to put into their rules and we're looking at similar things in the SEF space, as a less-prescriptive approach for error trades." Another area he's looking at is deals with the audit trail for post-execution allocation information. SEFs generally don't have this information, he says, "so this is something we issued a no-action letter on in October. It's another requirement we're also looking to eliminate," Zaidi says.

We asked about other matters beyond NALs moving through their divisions. DCR chief Brian Bussey said that "one of the most significant things we will be recommending for consideration is related to possible changes to the Part 190 space. We hope to get something to the commission on this later in the year." Per Dodd-Frank, the bankruptcy rules may technically cover FCMs and DCOs, but he said "we don't really have DCO-specific rules in the commodity world for bankruptcy provisions." He says the division is trying to tailor some of the bankruptcy rules to the nonsystemically significant DCOs. On the NAL score, he says there is still "some cleanup stuff on Part 39 under consideration."

Zaidi says the SDR data situation has been taking up a lot of time, "not just here but also with international data harmonization groups," he says. DMO took over this huge nagging SDR data debacle last year. He said that the division has made good progress so far since it published a strategy roadmap last Summer. "We received a lot of comments and we've worked through these and have established terms sheets and other documents. We continue to work with international groups and will be leveraging all of it for our own rulemaking. We look forward to releasing several proposals this year." But first, he adds, in the next couple months DMO will be putting out the final indemnification rule that was proposed last January. "We will hopefully have one of these rulemakings out of the way and move on to some other swap data rules that are awaiting us," Zaidi says.

Zaidi also noted that certain supply contracts are under the magnifying glass at the moment, which we thought was a reference to forward agreements, always a favorite topic in the energy sector. We asked him for more details. "If you recall from the proposed guidance, it was pretty narrowly tailored to specific types of peaking supply contracts. If somebody used some of these contracts in another state, for example, the terms might be different. The proposed guidance didn't really encompass a broad range of contracts, so we're taking a fresh look at this to see if we can more appropriately tailor it to cover

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multiple, different contracts. It's on our agenda that we hope to get to this year."

Kulkin reiterated that the redo of Rule 1.3, involving basically the re-alphabetizing of everything, all regs, "is a big redo."

Gill noted that alphabetizing, reorganizing all the rules in a clear, logical manner, was initially thought to be "the lowest hanging fruit out there, until we got deep into it and wondered if the benefit outweighed the costs." It's taken a lot of staff time, he says, a lot of manual time to get it done. Kulkin said he did an informal survey with the ABA about whether fixing this broken system was better than leaving it alone, since all thee lawyers were used to it. Gill quipped that "everybody in this room (is) probably less excited about it because understanding this arcane process was a sort of gatekeeping role of the derivatives bar. Our apologies for making it easier to get into this space." Funny guy.

We asked the panel how hard it was to keep this KISS process policy-neutral. Gill noted that a lot of what came in from the public comment portal involved elements related to other significant policy changes and legislative changes. "These suggestions won't be cast aside in this effort," he says, "even if they may have seemed like small things, but will be part of some larger changes, some bigger fixes or rulemakings later on."

Kulkin noted his team is also working on several nonpolicy-neutral NALs, for example, "we're trying to move them forward at the same time as the non-policy stuff, so, two tracks at the same time."

Bussey said that about 40 of the comments submitted had to do with DCR matters. "There were many themes, but one of the big ones was about more active participation in DCO governance, such as increased representation on boards and committees. New product launches are another matter. Governance is hard to wedge into the policy-neutral category (KISS). But it's something else we're quite focused on this year," he says.

We asked if the KISS initiative will lead us to any rulemakings this year and on what timelines?

Gill said that "everything we discussed today is expected to be accomplished between the Spring and Summer, before this Fall. It's our expectation that the notice and comment period will be 60 days for those that require it, but probably no longer, since many of the things we've identified are already common practices. Everything will be done in an ABA-compliant manner. And it will get done," Gill says.

So, why not publish a list publicly? "We won't put out a formal list of what we plan to accomplish beyond our prepared remarks today. These things will take on lives of themselves once they formally move through the commission and commissioners will have a lot of say over what is finally produced, so I think publishing a formal list would make the process less simple … "

On that note, we asked Gill if all the commissioners been kept in the loop on all of this KISS stuff. He said that "we've briefed the commissioners on general outlines, so they know what's coming.

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We maybe could have briefed them better if we delayed this forum by a month, but for transparency's stake, we wanted to share with the market what we're doing. But, they know more about what we're working on then the general public."

We dug through a number of the submitted comments, in particular those submitted by the FIA (see all outside on the CFTC site at https://comments.cftc.gov/KISS/KissInitiative.aspx), which insiders tell us have generally received a lot of attention by staff at the various divisions, particularly enforcement, though Gill noted that the enforcement division was largely left out of the process. Why is this? "There was some concern that any possible KISS connection to that division would suggest some sort of political bias, so we passed," he says. "Jamie (McDonald, director of enforcement) pointed out a couple areas that he thought were KISS-like, and we will address those, but we wanted to keep this project separate from the potential for bias." Surveillance was also off the table for the KISS project.

The submitted FIA suggestions were nonetheless substantive, and we reckon we will hear more about them going forward, KISS-related or otherwise. The FIA suggested that the commission should inject more transparency and predictability to the enforcement process. For example, FIA says the CFTC should r*equire notice to subjects of investigations when the commission has decided not to pursue an enforcement action*. "As the commission is aware, market participants incur substantial legal, operational, document retention and other costs while being the subject of an investigation." Sounds reasonable. The FIA also suggested that the commission g*rant the subjects of enforcement matters the right to appear before the commissioners or staff*. We've heard this one before, for many moons, and it's been dodged by both Republican and Democratic administrations. Maybe this time will be different. Another idea was to c*reate a new role: an enforcement ombudsman*. "The creation of an ombudsman would help ensure consistency across the CFTC's Division of Enforcement regarding how it conducts an investigation, decides whether to proceed with an enforcement action, and assesses penalties." Hmm. The role works wonders at newspapers, for sure, but in this context? Three former office of enforcement attorneys we spoke to on background (now white-shoe lawyers) think it's a dandy idea. Three current enforcement attorneys we spoke to on background thought it was an awful idea. Go figure. The FIA also suggested that the agency *publish an enforcement manual* "that outlines in detail the practices and procedures followed by the CFTC's Division of Enforcement in investigations would promote transparency and consistency in the enforcement process." Hard to argue the point, though in this ever-changing marketplace, it was hinted to us that to hard-code such a thing would be more of a hinderance in the long term, mostly for the division. The FIA comments are worth a read.

The Natural Gas Supply Association suggested that the commission should modify its requirements for swap dealer approval of new swap product offerings under Rule 23.600(c)(3)(iii), "so that end-users can obtain new, customized products to meet their ever-changing hedging needs in a timely manner," the point being that the current process is overly restrictive and time-consuming, like full board approval and so on. Good call. We're also told that there is some momentum behind this particular point internally, although since it is not exactly policy-neutral, it's outside of the KISS program. Nonetheless, we may see this comment come back this year under a related rulemaking, we're told.

One questioner from the floor wondered how the KISS initiative squares with President Trump's 2017 executive order that for every new rule proposed, two old rules need to be pulled. Gill noted that the 2-for-1 exec order doesn't technically apply to the CFTC.

Another questioner noted that as the KISS initiative was a significant undertaking, "how do you envision working at the same time on some of the bigger policy questions still hanging out there, and still get most of it done by September?" Gill's short answer was that "we're working everything in parallel." "We will be advancing policy while cleaning up the rulebook. These are the marching orders that have been given," Gill said.

Another questioner asked if there was a "Version 2.0 of KISS that allows you to work with other agencies, to apply the same methods to multiple or duplicative requirements among agencies?" Gill replied that there are things beyond what was discussed at the forum "that are in this bucket. Specific to other agencies, duplicative stuff for example, we have developed work streams with the SEC, and are in the initial stages of identifying obstacles and harmonization, but it's not really a KISS basis, it's just something we're doing," he said. "Do you want to suggest it to other agencies?" he asked the audience. He added that a number of comments were received relating to harmonization of rules with the SEC. "The chairmen of both agencies will be receiving a briefing by staff on where we stand on this (harmonization), sometime soon," Gill said.

We asked Gill what topped the proverbial KISS list before the effort formally kicked into gear? What was already known that needed fixing before all the comments rolled in. He pointed to Amir Zaidi. The DMO chief said that when the chairman was in the minority office a couple years back (and Zaidi was his senior counsel), "we began keeping a running list of things we saw as bad rules or policy that one day should be fixed, if the commissioner got the chance to or be in that position, at some point in the future," he said. "Stupid and nonstupid things," he said. "It wasn't necessarily a KISS list, but it was a rulemaking and nonrulemaking list. This is where the KISS idea was born." Obvious things were on the list, he noted, like various SEF rules, fixing the SDR data and fixing position limits once and for all. "It was a big list and it's morphed into an even bigger one."

Bussey fielded a question regarding the redo of NALs relating to clearing exceptions and whether it included the treasury affiliate NAL. "It's one that we're considering," Bussey said. "For the batch of NALs we're looking at, however, it won't be in that initial batch. The inter-affiliate will be a big one (50.52) in that group, however," he says.

A question was raised about definitions of certain financial entities, end-users and the like, and whether this was viewed as policy-neutral or part of the KISS portfolio. *Great question, another unsolved mystery of derivatives law.* Gill said that, "with definitions, there is going to be a bias, based on whether it's a Republican or Democratic

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administration. So, that wouldn't fall into what we're doing with KISS."

Kulkin also noted that a number of comments directed to his division fell outside the pale of what KISS was intended to accomplish. Definitions like financial entity or financial end-user is a good example. "This is a substantive, a policy issue. I raise this because even though that comment may have fallen outside the KISS agenda, it's helpful to us as staff. There is an awful lot of work being done as part of regular order. The comments that came in September (2017), refreshed a lot of these discussions and give us a newer more current perspective on issues that have been around a while … " So, movement on definitions, at long last? *No comment.*

Throughout this lengthy review process, we asked the panel if there was one particular "are you kidding me" moment that they might recall. Oddly, nobody took that bait. Gill noted that they saw lots of references to "telex" and the like, fax reporting requirements, etc., but since the agency really isn't that old, there weren't as many really strange things on the books. Kulkin said he was surprised at how many "errant section references and outdated compliance dates, and fax reporting obligations references to form reports that no longer exist. I was surprised at the sheer volume of the cleanup effort that we could do."

Zaidi agreed. He added that, "So many things out there needed a fresh look or to be fixed." Why is this? "We're seeing the aftermath of the rush to get Dodd-Frank rules done in such a short time. Now we're left to clean up a lot of the mess." True enough. Bussey, having spent much of his professional career across town at the SEC, sounded the most hopeful on the effort and the potential results, noting that he'd seen a lot of similar efforts like KISS peter out over time, mostly due to lack of interest from leadership. "Not the case here," he said. "This effort will bear fruit."

blockchain & energy, ch.4

Six months ago, we interviewed Deloitte's Mike Prokop on blockchain technology, something he described as "the most widely talked about term in this sector – or any sector for that matter – that nobody actually knows anything about … " Has anything changed? It certainly feels like it. Platts announced a new blockchain platform for processing global oil data, adding transparency and certitude to the old manual process. Shell and BP and other big physical players and trading firms attached to a new blockchain-based energy trading platform seem to release details on the project every couple weeks. Last September we were able to identify what we might describe as the development or significant deployments of some form of blockchain-based platform, on one finger in the energy sector. Now, we think that 2018 may one day be seen as the breakout year for this new technology, thanks mostly to an accelerated move toward greater standardization among the top blockchain variants. Six months ago, Prokop also noted that blockchain, like any breakthrough technology, will develop rapidly, once the money begins to flow. He said that the time horizon for significant technology breakthroughs and adaptation of the technology has moved from seven to 10 years, "way back in 2015," to two to three years, today. In 2018 we now anticipate the number of deployments in this sector will rise significantly, as the cost of development drops, the value of the technology becomes better recognized (or at least understood), regulators continue to dish on the benefits of the technology, and, of course, legacy platforms continue to be hacked and compromised.

Mike Prokop is the North American blockchain lead for Deloitte's global energy and resources practice. Despite the obvious trends in other sectors for this technology, we asked him if he sees the energy sector lagging in the uptake and deployment of blockchain. He said yes, but with a big caveat. "This sector has a tendency to lag behind other sectors, to dip a toe in the water. Which, I think isn't a bad thing," he says. "Blockchain has been around for years and it's only been fairly recently that there are so many possible offerings or functions associated with the technology, that can appeal to the energy sector, from supply chain and logistics to trading, to the bit you mentioned with Platts."

He said to also keep in mind the sector is coming out of a period of very low commodity prices. "A lot of companies tightened up, budgets and tech spend was cut

TAC on Blockchain

The CFTC's first TAC (Technology Advisory Committee) meeting in many moons pulled the lid off of a bunch of long-simmering issues and considered a whole bunch of additional challenges posed by new technologies as well. The blockchain technology discussion was particularly good. (See the day-long webcast replay at https://www.youtube.com/watch?v=qinevlp2g2Y&feature=youtu.be). Blockchain, or distributed ledger technology (DLT), and its many possible uses in the derivatives sector(s) was the central discussion. Not a lot of new stuff offered during the TAC discussion, but nonetheless it was a good, broad pitch on the tech itself, and more subtly, why it will likely be a big part of foundational changes to digital markets now underway. Blockchain won't be forcing an overnight change in financial markets anytime soon, but the conversation has indeed shifted to when, and not if. If there was any news here at all, it was that the panel generally agreed with this basic assessment of the technology and the scale of its disruptive potential. Even last year, there was less agreement on that score, around the market.