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# CFTC Backgrounder on the Department of Treasury's Report on Capital Markets

On Friday, October 6, 2017, the U.S. Department of the Treasury released a report detailing how to streamline and reform the U.S. regulatory system for the capital markets. Treasury's evaluation of current capital market regulations found that there are significant reforms that can be undertaken to promote growth and vibrant financial markets while maintaining strong investor protections. The report issued was in response to Executive Order 13772 issued by President Trump on February 3, 2017, which calls on Treasury to identify laws and regulations that are inconsistent with a set of Core Principles of financial regulation.

Below are the key recommendations and quotes from the report as it pertains to the jurisdiction of the Commodity Futures Trading Commission (CFTC).

**Key Treasury Recommendations on Derivatives**

On Capital Treatment in Support of Central Clearing (p. 138):

- Reiteration of recommendation in Banking Report that initial margin for centrally cleared derivatives should be deducted from the supplementary leverage ratio denominator – this will dramatically reduce the cost for banks to provide clearing services
- Recommend risk-adjusted approach for valuing options under the capital rules to better reflect their true economic exposure
- Banking regulators should conduct regular assessments on how the capital and liquidity rules impact the incentives to centrally clear derivatives

On Swap Execution Facilities (SEFs) (p. 145):

- CFTC should consider rule changes to permit SEFs to use any means of interstate commerce to execute swaps subject to trade execution mandates

On the SEC-CFTC Merger Debate (p. 176):

- The securities and derivatives markets serve fundamentally different purposes and the US separation of regulation between the two agencies speaks to the exceptional size, diversity and sophistication of those two markets
- Rather than merging, the two markets regulators are best off harmonizing their rules where there is overlap and avoiding any failures of regulatory coordination
- Potential cost savings is minimal (less than five percent of combined budgets)

On SEC-CFTC Harmonization (p. 292):

- Two agencies should undertake joint review of their Title VII rulings to see what rules can be harmonized

On Cross-Border Issues (p. 134):

- The CFTC and SEC should provide clarity around the cross-border scope of their regulations and make their rules compatible with non-U.S. jurisdictions where possible to avoid market fragmentation, redundancies, undue complexity, and conflicts of law

On Economic Analysis (p. 181):

- Treasury supports efforts by CFTC and SEC to improve their economic analysis processes

On Swap Data Reporting (p. 147):

- Treasury supports the CFTC's "Roadmap" efforts to standardize reporting fields across products and SDRs, harmonize with other U.S. regulators, and improve validation and quality control processes

On CCP "skin in the game" (p. 152):

- Clearing organizations and their members must work together to strike an appropriate balance between the clearing organization's resources ("skin-in-the-game") and mutualized resources of clearing members

**Key Quotes**

CFTC Mission:

- "The CFTC's mission is to foster open, transparent, competitive, and financially sound markets to avoid systemic risk and to protect market users and their funds, consumers, and the public from fraud, manipulation, and abusive practices related to derivatives and other products that are subject to the Commodity Exchange Act." (p. 18)

General Derivatives Background:

- "Derivatives markets facilitate risk management strategies for many financial and nonfinancial businesses." (p. 4)
- "In financial markets, 'derivatives' are a broad class of financial instruments or contracts whose prices or terms of payment are dependent upon, or derive from, the value or performance of another asset or commodity. Unlike stocks and bonds, which are generally used by issuers to raise capital for their businesses and traded by investors hoping to earn a return on their investment, derivatives originated primarily for the purpose of managing, or hedging, the risks associated with the underlying assets. Such risks stem from unknown future changes in commodity prices, interest rates, foreign currency exchange rates, or other factors." (p. 17)
- "While their usage has grown and become more complex, derivatives have been used in one form or another since ancient times, for example, by farmers and merchants managing risks regarding the future delivery and price of livestock and crops." (p. 109)
- "Though the first derivatives originated as a means for farmers and merchants to manage risks in agricultural markets, today derivatives are used in virtually every segment of the U.S. and global economies, covering nearly every conceivable type of commodity." (p. 112)
- "Indeed, derivatives have become essential financial tools that when used properly allow companies to grow and create jobs, produce goods and services for the economy, and provide stable prices for American consumers." (p. 112)

Ending the SEC-CFTC Merger Debate:

- "The securities and derivatives markets serve fundamentally different purposes: capital formation and investment versus hedging and risk transfer. While it may be appropriate to harmonize differences in approach to regulation of these markets in some areas, it is far from clear that reconciliation across all differences – for example, statutory and regulatory approaches to margin, protection and management of customer funds, customer suitability, insider trading, short sales, speculative trading, and product approval processes, among others – would be practical or advisable without risks to market health." (p. 178)
- "Although the United States is unique in its separation of securities and derivatives markets regulation, it also has the largest, deepest, most liquid financial markets in the world. No other major market center has securities or derivatives markets of comparable size, diversity, and sophistication." (p. 178)
- "Treasury believes that merging the SEC and the CFTC would not appreciably improve on the current system." (p. 178)
- "Instead, policymakers, regulators and other stakeholders should focus on effecting changes that truly promote efficiency." (p. 167)