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Swaps-Trading Rules Top Agenda For CFTC In 2019

By **Tom Zanki**

Law360 (January 1, 2019, 12:03 PM EST) -- The U.S. Commodity Futures Trading Commission could overhaul swaps-trading rules in 2019, which tops a broad list of priorities that also includes potential action on cross-border matters, position limits and digital currencies as the agency prepares for new leadership.

Chairman J. Christopher Giancarlo, who has served on the commission five years, including the last two as its leader, is stepping down at the end of his term in April. Giancarlo has focused on streamlining rules, including pushing to rewrite regulations governing swaps-trading platforms, which is expected to be a major item of business in 2019.

President Donald Trump has named Heath Tarbert, assistant secretary for international markets at the U.S. Treasury Department and a former Allen & Overy LLP partner, to succeed Giancarlo on April 14. It remains unclear how the CFTC's agenda will change under Tarbert, if he is confirmed, though the CFTC will continue to be governed by a Republican majority appointed by Trump.

"I would expect that there will be continuity in terms of the CFTC chairman's priorities because his agenda is addressing the issues the derivatives markets are currently grappling with — those issues will remain," said Covington & Burling LLP partner Stephen Humenik, who leads the firm's futures and derivatives practice.

Here is an overview of unfinished business and potential new developments that await the CFTC.

Swaps-Trading Rules

The CFTC in November proposed rewriting swaps-trading rules in order to require more entities to register as swap execution facilities, or SEFs, which are centralized trading platforms that were created by the Dodd-Frank Act in order to increase market transparency. The CFTC proposal mandates that more swaps market intermediaries such as interdealer brokers register as SEFs, potentially increasing the number of trades that occur on regulated platforms.

At the same time, the CFTC is proposing to loosen restrictions on how swaps trades are executed. Currently, market participants making trades on an SEF must either do so through a central order book or by requesting quotes from at least three counterparties.

The CFTC proposal would do away with those requirements and allow SEFs to offer more "flexible methods of execution," provided they disclose details for any method they offer. Giancarlo says the changes would increase liquidity in the swaps market, which he argues has been harmed under current CFTC rules that were enacted after Dodd-Frank.

The proposal is not without controversy. Commissioner Dan Berkovitz dissented in the agency's 4-1 vote to introduce the plan for public comment, arguing it threatens to reduce competition by favoring large bank dealers and would reduce price transparency, thus turning back progress since Dodd-Frank.

Giancarlo, who has advocated for changes to swaps-trading rules as far back as 2015 when he authored a white paper on the topic, is expected to work hard for a consensus.

"I strongly suspect that [Giancarlo] wants to get that across the finish line sooner rather than later and certainly before he leaves the CFTC," Davis Polk & Wardwell LLP partner Gabriel Rosenberg said. "I would expect a finalized version of that rule in 2019."

Cross-Border Matters

The CFTC, more broadly, could continue pushing to simplify cross-border rules on swaps trading. Giancarlo has said increased clarity is needed given the market's international scope.

The agency is also closely monitoring the impact of Brexit on international derivatives markets. Giancarlo has warned that the U.K.'s departure from the European Union may disrupt trading, expressing concern that central clearinghouses based in London could disassociate with EU entities to avoid legal uncertainty.

In an effort to mitigate such risks, the European Commission on Dec. 19 adopted new laws that will let Europe's banks continue using London's clearinghouses for an additional 12 months if Britain crashes out of the bloc.

"That's an important priority of the CFTC to make sure that transition goes as smoothly as possible from a regulatory perspective," Humenik said.

Position Limits

The CFTC could also finalize rules around position limits regarding certain physical commodity futures and swaps markets. Such rules are intended to prevent traders from cornering the market, but previous iterations have faced stiff headwinds and a successful legal challenge.

Morgan Lewis & Bockius LLP partner Michael Philipp said he will watch for regulatory developments on position limits, a topic that the CFTC has been discussing since 2008.

"That's supposed to be something that is going to be dealt with in 2019," Philipp said.

Digital Currencies

The CFTC is delving deeper into its oversight of digital currencies beyond bitcoin, which it has defined as a commodity, and is taking a closer look at Ether, the second largest cryptocurrency.

The futures regulator on Dec. 11 invited public comment to improve its understanding of the technology and markets around Ether. The CFTC said input will better inform the agency in the event that market participants submit proposals to list new cryptocurrency-based futures or derivatives products. The CFTC has already recognized the trading of bitcoin-based derivatives.

The CFTC said public input will help the regulator insure "integrity of the derivatives markets as well as monitoring and reducing systemic risk by enhancing legal certainty in the markets."

"This all fits into: How do we take a set of rules and laws and regulations that were created without this [technology] in mind and make it work for these new digital asset economies and trading systems?" Rosenberg said.

--Additional reporting by Ed Beeson and William Shaw. Editing by Kelly Duncan and John Campbell.