

United States Senate

WASHINGTON, DC 20510

November 27, 2023

The Honorable Rostin Behnam
Chair
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Dear Chair Behnam:

We write to express serious reservations about the CFTC's Proposed Rule on Seeded Funds and Money Market Funds ("Proposed Rule").¹ As members of both the Senate Banking, Housing, and Urban Affairs and Senate Agriculture Committees, we are charged with oversight of both CFTC and other aspects of the financial markets. We are seriously concerned that the Proposed Rule would roll back critical safeguards established under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"), creating a divergence with bank prudential regulators and increasing market instability. We urge you not to finalize the Proposed Rule, but to uphold Dodd-Frank and maintain current swap rules.

The Proposed Rule would reduce or eliminate initial margin requirements for up to three years for a subset of swap market participants. "Initial margin" is the collateral that participants must set aside when entering swap agreements. Initial margin requirements, along with "variation margin" and other capital requirements, protect counterparties to a swap in the event of a default. Dodd-Frank set up comprehensive rules for swap agreements after they significantly contributed to the 2008 financial crisis and the federal government was forced to bail out Wall Street. Dodd-Frank required CFTC rulemaking for both "cleared" swaps and "uncleared" swaps. Under Dodd-Frank, swap participants must post both initial margin at the outset of the swap agreement and "variation margin" as market conditions change.

Dodd-Frank required the CFTC to set rules for swaps and swap dealers to ensure market stability and protect customers. The CFTC previously engaged in rulemaking under Dodd-Frank setting out collateral requirements for the swap dealers it regulates. The Proposed Rule was first put forward by an industry advisory committee in 2020 during the Trump administration.² It is unclear why the CFTC is only now,

¹ Federal Register, "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," U.S. Commodity Futures Trading Commission (August 8, 2023). Web: <https://www.federalregister.gov/documents/2023/08/08/2023-16572/margin-requirements-for-uncleared-swaps-for-swap-dealers-and-major-swap-participants>.

² Global Markets Advisory Committee for CFTC, "Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps", (May 19, 2020). Web: https://www.cftc.gov/media/3886/download?name=GMAC_051920MarginSubcommitteeReport

three years later, considering moving forward with the Proposed Rule.³ The Proposed Rule would be a step in the wrong direction and undermine the goals of Dodd-Frank.

The CFTC should not move backwards on important safeguards that ensure adequate initial margin under Dodd-Frank. Initial margins requirements are vital for protecting customers and reducing risk. Eliminating initial margin requirements for up to three years between a new seeded fund and its sponsor entity would increase risks without concomitant benefits. Initial margin is not a penalty, but functions as insurance for counterparties, offering a vital safeguard for market participants and creating a buffer in times of market turbulence. The 2008 financial crisis showed the dangers that swaps can pose to economic stability, and Dodd-Frank directed regulators, including the CFTC, to require initial margin for uncleared swaps specifically to reduce those risks. It is vital for the CFTC to continue upholding its Dodd-Frank mandate and to maintain high standards and safeguards for this important market.

In an October 9, 2023, speech to the American Bankers Association, Federal Reserve Vice Chair for Supervision Michael Barr warned about the serious dangers of inadequate buffers in the financial system⁴. Vice Chair Barr noted that if there were another financial crisis it could cost the U.S. between \$5 trillion and \$25 trillion. He also said that ahead of the 2008 financial crisis “the rules didn’t fully capture the credit and operational risks of asset classes” such as derivatives, which “led to enormous losses at banks.”⁵ He argued that the reforms put in place under Dodd-Frank improved market stability, strengthened the financial system, and enabled economic growth. The CFTC should heed the Vice Chair’s wisdom and maintain the buffers put in place under Dodd-Frank instead of rolling them back.

The Proposed Rule would create a divergence between rules that apply to non-bank swap dealers and prudentially regulated swap dealers. Under this rule, the CFTC would reduce or eliminate initial margin requirements for some uncleared swaps provided by non-bank swap dealers. However, seeded funds transacting with prudentially regulated swap dealers would still be required to follow initial margin requirements. This regulatory divergence would invite regulatory arbitrage, a regulatory race to the bottom, and likely incentivize the movement of some uncleared swap transactions from prudentially regulated swap dealers to non-bank swap dealers. As members of both the Agriculture and Banking, Housing, and Urban Affairs Committees, we are particularly concerned that the CFTC proposes to unilaterally deregulate some market participants without coordination with prudential regulators overseeing other participants in the swaps market.

The U.S. financial markets are the best in the world because of our regulatory guardrails. To ensure that our markets are robust, our rules and regulations must also be robust. Market participants engaging in uncleared swap transactions should do so on the same regulatory playing field, and the U.S. should maintain high standards for its uncleared swaps market. Absent compelling evidence from the CFTC showing the benefits of creating a divergence with prudential regulators, the CFTC should not open up this regulatory gap.

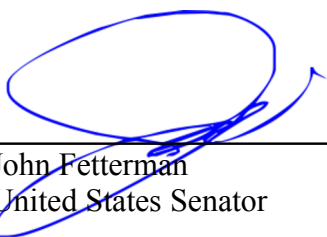
³ CFTC Commissioner Christy Goldsmith Romero, “Dissenting Statement on Notice of Proposed Rule Making for Seeded Funds and Money Market Funds,” (July 26, 2023). Web: <https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement072623e>

⁴ Federal Reserve Vice Chair for Supervision Michael Barr, “Capital Supports Lending”, Speech at the American Bankers Association Annual Convention, (October 9, 2023). Web: <https://www.federalreserve.gov/newsevents/speech/barr20231009a.htm>

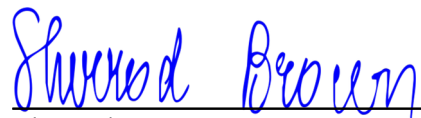
⁵ *Id.*

The CFTC's recent updated guidance on resolutions to enforcement actions was encouraging, showing the Commission recognizes the importance of holding market participants to high standards and taking aggressive enforcement actions when necessary to uphold market transparency and stability.⁶ The Proposed Rule, however, moves in the wrong direction, increasing the risks of market instability and creating different rules for different swaps market participants, depending on their primary regulator. The CFTC already faces significant resource constraints in its vital position regulating the derivatives market and should not increase risks to market stability. Now is not the time to peel back the important protections under Dodd-Frank. We urge the Commission to continue to focus on its vital work preserving market integrity and protecting the public, uphold the letter and spirit of the Dodd-Frank Act, and withdraw the Proposed Rule.

Sincerely,



John Fetterman
United States Senator



Sherrod Brown
United States Senator



Tina Smith
United States Senator

⁶ "CFTC Releases Enforcement Advisory on Penalties, Monitors and Admissions" (Oct. 17, 2023), Web: <https://www.cftc.gov/PressRoom/PressReleases/8808-23>.