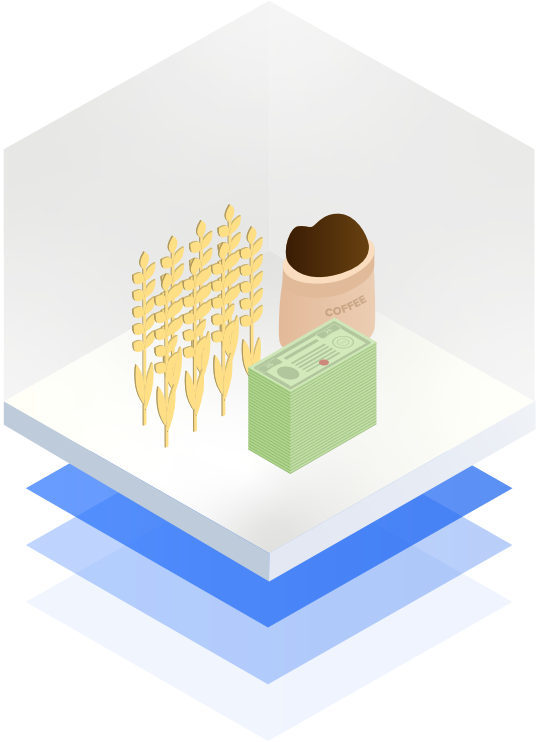



# DERIVATIVES

The Dodd-Frank Act's Title VII created a framework for regulating the swap markets, with both the Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) maintaining jurisdiction for regulatory oversight of derivatives. The CFTC is the primary regulator of swaps, while the SEC maintains authority over securities-based swaps.

CCMC supports clearing mechanisms for derivatives and advocates for regulation that allows end-users and investors to continue to use derivatives to deliver on investment objectives or reduce their risk. Many companies use derivatives to manage currency, interest rate, agricultural, or other risks depending on their lines of business. There are several areas where regulators and Congress can take action in order to make meaningful change to the derivatives regulation.

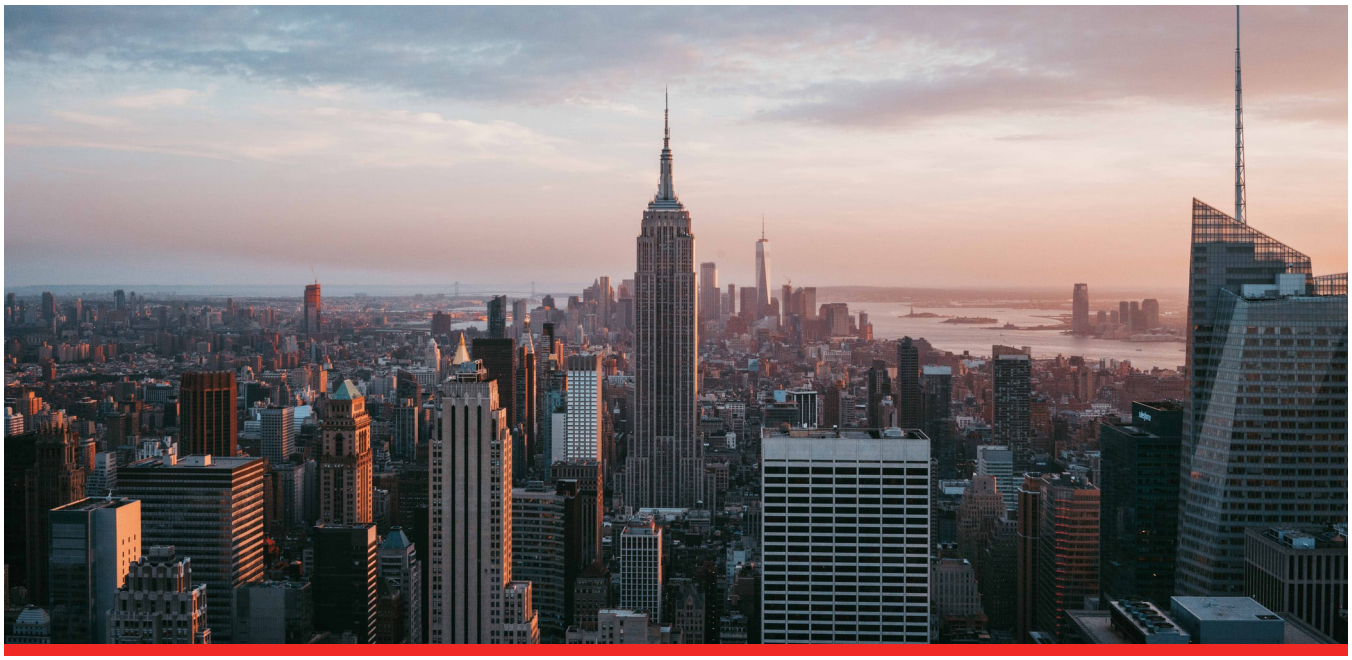
## SEC, CTFC: COORDINATE SWAPS REGULATION

Title VII of the Dodd-Frank Act required the SEC and CFTC to create a new regulatory regime for the swaps market. In this market, swaps are financial contracts in which counterparties agree to exchange payments with each other as a result of events like a change in interest rate, stock price, or commodity price. The CFTC is the primary regulator of swaps while the SEC has responsibility for security-based swaps. Progress has been made in implementing Title VII, but inadequate coordination between the two agencies has caused inconsistencies in regulation and uncertainty regarding the treatment of swaps.

**ACTION:** The SEC and CFTC should produce a report identifying shared statutory responsibility under Title VII, provide a status update on the respective agencies' implementation of rules, identify any inconsistencies, and make a public workplan for implementation. This report should be published every two years until no major inconsistencies remain.

## CONGRESS: PROVIDE RELIEF FOR END-USERS FROM CLEARING AND MARGIN REQUIREMENTS

The Chamber supports reforms that would provide meaningful relief from clearing and margin requirements for certain financial end-users that employ derivatives to hedge or mitigate their business risk in the same manner and for similar purposes as non-financial end-users. The Commodity Exchange Act (CEA), as amended by Title VII of the Dodd-Frank Act, precludes relief from clearing and margin requirements for all financial end-users due to an overly expansive "financial entity" definition under CEA Section 2(h)(7)(A)(i). In particular, the "financial entity" definition fails to distinguish between financial entities that utilize derivatives to take on risk for profit, like banks and hedge funds, and end-users of derivatives whose businesses necessitate prudent risk management to operate efficiently and reduce customer costs. Financial end-users who employ derivatives to manage risk serve fundamental roles in the real-world economy, and include payment processors, pension funds, insurance companies, and many others.



**The Certainty for End-Users Act (H.R. 4726–116th)** would bring relief to all eligible end-users by amending the "financial entity" definition in the CEA to provide greater precision in distinguishing businesses that are "engaged in activities that are in the business of banking or activities that are financial in nature." The legislation would also help to harmonize the exemptions from clearing and margin requirements and level the playing field for U.S. financial end-users compared to companies in other jurisdictions not subject to the clearing and margin requirements.

**ACTION:** Congress should enact the Certainty for End-Users Act (H.R. 4726–116th).

## SEC: UPDATE RULES FOR FUNDS' USE OF DERIVATIVES

On October 28, 2020, the SEC issued a final rule modifying the regulatory regime governing the use of derivatives by registered investment companies and business development companies (BDCs). Given the increased importance of the use of derivatives in managing funds, the Chamber recognizes the benefit from modernizing the regulatory framework on funds' use of derivatives. The new Rule 18f-4 would permit mutual funds, exchange-traded funds (ETFs), registered closed-end funds, and BDCs to enter into derivatives transactions notwithstanding the restrictions under Section 18 of the Investment Company Act of 1940. The final rule incorporated important changes sought by the Chamber.

The SEC also proposed new sales practice rules—Rule 15l-2 under the Securities Exchange Act of 1934 and Rule 211(h)-1 under the Investment Advisers Act of 1940 to require broker-dealers and investment advisers undertake due diligence prior to buying or selling shares of certain leveraged or inverse funds, so that they have a reasonable basis to believe that the customer or client is capable of evaluating associated risk with such an investment. The Chamber encouraged the SEC to incorporate several necessary modifications and clarifications to its 18f-4 proposal, but delay consideration of the 15l-2 sales practice rule until such time that the SEC's Regulation Best Interest can be fully assessed.

**ACTION:** Policymakers should support the SEC's efforts to provide a clear framework for registered funds' use of derivatives.

## CONGRESS: STUDY THE CREDIT VALUATION ADJUSTMENT

The Basel III capital standards introduced a new framework for calculating a credit valuation adjustment (CVA) for the purposes of determining an adjustment in the price of a derivatives instrument to account for counterparty credit risk. The updated CVA is intended to apply to all derivatives transactions that are subject to the risk that a counterparty could default (i.e., uncleared transactions, whether margin is posted or not). The updated CVA introduces a capital charge aimed at capturing variability in credit spreads.

The updated CVA could impose new financial costs on end-users that use derivatives for hedging activities. The European Union recognized this issue when it made the decision to provide an exemption for end-users, such as corporations seeking to limit their market risk.

**ACTION:** The Government Accountability Office should study and report to Congress on the impacts that differences between the U.S. and other jurisdictions in implementing the derivatives credit valuation adjustment capital requirements have on end-users of derivatives and the competitiveness of U.S. companies and U.S. derivatives markets.