**MANAGED FUNDS ASSOCIATION**

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# WRITTEN STATEMENT

**OF**

**STEPHEN BERGER**
**MANAGING DIRECTOR,**
**GLOBAL HEAD OF GOVERNMENT & REGULATORY POLICY,**
**CITADEL LLC**

**ON BEHALF OF**
**MANAGED FUNDS ASSOCIATION**

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**For the Hearing on**
**Brexit and Other International Developments**
**Affecting U.S. Derivatives Markets**

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**BEFORE THE**

**U.S. HOUSE COMMITTEE ON AGRICULTURE**
**SUBCOMMITTEE ON COMMODITY EXCHANGES, ENERGY, AND CREDIT**

***JUNE 26, 2019***

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**WRITTEN STATEMENT OF MANAGED FUNDS ASSOCIATION**

**Brexit and Other International Developments Affecting U.S. Derivatives Markets**
**June 26, 2019**

Chairman Scott, Ranking Member Scott, my name is Stephen Berger and I am the Managing Director, Global Head of Government & Regulatory Policy, of Citadel LLC. Citadel is a global financial firm built around world-class talent, sound risk management, and innovative market-leading technology. Citadel is a leading investor in the world's financial markets. For over a quarter of a century, we have sought to deliver industry-leading investment returns to clients including corporate pensions, endowments, foundations, public institutions, and sovereign wealth funds. Our global team works to help our clients' capital fulfill its greatest potential across a diverse range of markets and investment strategies, including fixed income & macro, equities, quantitative, commodities and credit.

I am here today to speak on behalf of Managed Funds Association ("**MFA**") and its members regarding Brexit and other international developments affecting U.S. derivatives markets. MFA represents the world's largest alternative investment funds and is the primary advocate for sound business practices for hedge funds, funds of funds, managed futures funds, and service providers. MFA's members manage a substantial portion of the approximately $3 trillion invested in hedge funds around the world. Our members serve pensions, university endowments, and charities, among others.

MFA's members are a valuable component of the capital markets. They provide liquidity and price discovery to capital markets, capital to companies seeking to grow or improve their businesses, and important investment options to investors seeking to increase portfolio returns with less risk, such as pension funds trying to meet their future obligations to plan beneficiaries. Our members' skills help their customers plan for retirement, honor pension obligations, and fund scholarships, among other important goals.

MFA members are also highly sophisticated investors who participate in the commodities and derivatives markets. MFA has consistently supported the reforms to the over-the-counter ("**OTC**") derivatives markets contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**") that mitigate systemic risk, increase transparency, and promote an open, competitive, and level playing field. We welcomed the U.S. market's transition to central clearing for liquid, standardized swaps that occurred over the course of 2013. We believe that liquid, safe, and efficient derivatives markets facilitate investment to the benefit of everyone in the market place, including corporate treasurers, farmers, and ranchers who need to protect themselves against swings in crop prices, and pensioners who seek reliable returns on their retirement investments.

The hedge fund industry is a global industry active in many of the largest economic centers in the world. Most of our members are headquartered in the United



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States, but many also either are headquartered in foreign jurisdictions, or have established legal entities in foreign jurisdictions. Europe, and particularly the United Kingdom ("**UK**"), is an active jurisdiction for our members.

Hedge funds are well-regulated investment tools. Many aspects of our members' activities are subject to an array of regulations and oversight both domestically and abroad. Regulators in the United States, Europe, and beyond have a wealth of information about our members' investment activities. As a result, MFA has devoted substantial resources to advocating overseas – and especially in the European Union ("**EU**") given its importance – for open, efficient, and fair capital markets.

MFA strongly supports a coordinated approach to regulation that fosters capital formation, increases transparency, mitigates systemic risk, and facilitates fair and open access to financial markets. We were pleased that, following the financial crisis, there was robust coordination between the United States and the EU, and both jurisdictions implemented regulatory regimes with largely comparable requirements that mitigated potential conflicts. The cross-border regulatory tools of cooperation include deference, substituted compliance, mutual reliance, and outcomes-based "equivalence" determinations. International convergence on regulatory outcomes makes compliance easier for U.S.-based financial firms that operate on a global basis, which in turn, facilitated the cross-border flow of capital.

The UK's anticipated withdrawal ("**Brexit**") from the EU will introduce additional complexities for global regulatory coordination. MFA has been actively engaging with policymakers in Brussels, London, Frankfurt, Dublin, Paris, and elsewhere to highlight potential challenges. We have also committed substantial time and resources to preparing MFA members for potential regulatory uncertainties.

MFA continues to stand ready as a constructive partner to officials in the U.S. and Europe to highlight areas of particular challenge for asset managers, and to propose policy and regulatory solutions to those challenges. We were pleased to be invited by the UK House of Commons Treasury Select Committee to provide evidence to its inquiry on "[t]he future of the UK's financial services", and we have also been engaging with policy officials in Brussels to provide constructive suggestions on the EU's Capital Markets Union project. MFA also interacts with international bodies such as the International Organization of Securities Commissions ("**IOSCO**"), the Financial Stability Board, and the Bank for International Settlements and its associated committees, including the Basel Committee on Banking Supervision.

Our members allocate substantial resources to ensure they comply with the laws and regulations of all jurisdictions in which they operate and invest. However, when policymakers and regulators do not coordinate to achieve convergent regulatory outcomes, investment managers end up subject to laws and regulations in other jurisdictions that are inconsistent with, or unnecessarily duplicate, U.S. law and regulations. Divergent or duplicative rules and, in some cases, extraterritorial application of those rules, can increase costs to investors by creating barriers to investment managers doing business in multiple jurisdictions.



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MFA has continuously been a constructive partner to this Committee. In that spirit, and in support of the broader policy and regulatory authorities in the United States and beyond, we offer observations on the following seven key regulatory areas that are currently presenting challenges for our members:

(1) The EU enhanced supervision regime ("**EMIR 2.2**") for third country central counterparties ("**CCPs**"),[1]

(2) The Basel III leverage ratio ("**Leverage Ratio**");

(3) Swaps market and liquidity fragmentation issues addressed by the CFTC Global Markets Advisory Committee ("**GMAC**");[2]

(4) The implementation of initial margin requirements for uncleared derivatives;

(5) The EU General Data Protection Regulation ("**GDPR**"),[3]

(6) The need for greater data protection at regulators through the Protection of Source Code Act; and

(7) Regulatory coordination in the U.S. between the Securities and Exchange Commission ("**SEC**") and the CFTC.

On behalf of MFA, I appreciate the Committee's consideration of Brexit and other international developments affecting U.S. derivatives markets. MFA wishes to promote enhanced global coordination and ensure the continued stability of our financial system. We believe our views are consistent with the Committee's public policy goals, and as investors, we would like to work with Congress, the Committee, EU policymakers and regulators, the CFTC, and all other interested parties in addressing these issues towards the goal of preserving the strength of our nation's economy. Specific concerns about the effect of international policymaking follows, as well as discussion on certain U.S. policy matters.

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[1] Regulation of the European Parliament and of the Council of . . . amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, available at: http://www.europarl.europa.eu/doceo/document/A-8-2018-0190-AM-002-002_EN.pdf ("**EMIR CCP Regulation**"). Please note that this link is to the final text as agreed by European Parliament and the Council, but it remains subject to the corrigendum procedure, and has not yet been published in the Official Journal of the European Union.

[2] *See* letter from Laura Harper Powell, Associate General Counsel, MFA, to the CFTC its response to its April 15, 2019 GMAC meeting, dated May 10, 2019, available at: https://www.managedfunds.org/wp-content/uploads/2019/05/MFA-Letter-on-CFTC-GMAC-Meeting-on-April-15-2019-Final.pdf.

[3] Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32016R0679&from=EN.



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## EU EMIR CCP REGULATION

MFA has long championed the post-crisis reform efforts of Congress, and we broadly support the G-20's efforts to apply the reforms in a consistent way across jurisdictions. A major reform that MFA strongly supports is the effort to reduce risk in the derivatives markets by transitioning standardized and liquid OTC derivative contracts into central clearing. MFA believes that central clearing has greatly benefited the derivatives markets by reducing systemic, counterparty, and operational risk, and has resulted in a well-functioning and safer system where counterparties face a well-regulated CCP.

Recently, the EU amended its European Markets Infrastructure Regulation ("**EMIR**"), which is the EU regulation that implemented the G-20 objective of mandating central clearing of derivatives. The recently adopted changes to EMIR (commonly referred to as EMIR 2.2) allow EU authorities to conduct enhanced supervision of CCPs established outside the EU that clear derivatives denominated in one of the currencies of the EU. In extreme cases where the EU perceives excessive systemic risk, the amended EMIR regulation allows EU authorities to require CCPs to relocate clearing activities to an EU member state.

MFA understands that the EU's goal in modifying its rules for non-EU CCPs is to improve financial stability – a goal MFA shares. This goal becomes even more important as financial markets prepare for the UK's withdrawal from the EU. However, the EU approach could have wide-ranging implications for the U.S. derivatives markets depending on how EU authorities exercise these new authorities.

The current transatlantic regulatory framework is built on substituted compliance, equivalence, and the deference of U.S. and EU regulators to each other's comparable regulatory regimes. It is the product of significant effort and coordination over the last nine years, with input from stakeholders including MFA. MFA welcomes this cross-border regulatory coherence between U.S. and EU rules, and encourages policy and regulatory officials to collaborate even more closely to avoid the risks of fragmenting derivatives markets. If cross-border trading and clearing of derivatives were to become more costly and burdensome, it would undermine the benefits that global central clearing has achieved.

Much will depend on how EU authorities choose to implement their new powers under EMIR 2.2 and how well U.S. and European authorities employ the tools of cross-border regulatory cooperation. For example, if EU authorities exercise their power to require a relocation of clearing activities into the EU, the markets for derivatives clearing would become fragmented along jurisdictional lines. If that fragmentation occurs, it would harm the financial system by, among other things, impeding competition, limiting market participants' ability to operate in certain jurisdictions, and ultimately creating barriers across the global marketplace.



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Like CCPs and clearing members, the changes contained in the EMIR CCP Regulation are relevant to our members, who are a vital part of the cleared derivatives markets, and access central clearing and CCPs indirectly through those clearing members. As a result, regulatory changes that impact central clearing or CCPs also indirectly impact customers and could expose customers to increased risks.

Therefore, MFA encourages U.S. and European authorities to continue to coordinate, using tools of deference, substituted compliance, and outcomes-based equivalence to ensure that customers and end-investors who use central clearing do not experience disruptions to their investing and hedging activities due to a breakdown of existing or future equivalence arrangements. In particular, MFA urges Congress to ensure that U.S. departments and regulatory agencies continue engaging with the EU on EMIR so that there is an agreed and coordinated approach to CCP supervision such that transatlantic central clearing is not hindered and the risk-reducing benefits of central clearing remain intact.

We note that with respect to U.S. and UK markets, earlier this year, the CFTC, the Bank of England, and the UK Financial Conduct Authority issued a joint statement providing assurances that they are taking measures to ensure that the UK's withdrawal from the EU will not impede or create regulatory uncertainty regarding derivatives clearing and trading market activity between the UK and the United States. We also welcome the joint statement issued by the CFTC and European Commission in March clarifying that the updates to EMIR and the swaps regulatory framework will result in more deference as between the CFTC and the EU supervisors than is currently the case.

MFA strongly supports such efforts and the issuance of clear, unified guidance as it relates to the EMIR CCP Regulation.

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## LEVERAGE RATIO IMPACT ON CUSTOMER CLEARING

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The ongoing success and benefits of central clearing have been at risk of being undermined by the Leverage Ratio rules of the Basel Committee on Banking Supervision ("**BCBS**" or "**Basel Committee**"). Without revision, these rules threaten the affordability and accessibility of customer clearing.

Specifically, the current Leverage Ratio disincentivizes derivatives clearing because it does not provide an offset for customer initial margin ("**IM**"). That unfavorable treatment limits the ability of customers to use centrally cleared derivatives and could limit the ability of end-users to hedge their risks. MFA was gratified, therefore, by the announcement last week that the Basel Committee has called for an offset for IM in the Leverage Ratio for customer-cleared derivatives. If the Basel Committee's forthcoming published standards are consistent with the announcement, we would join CFTC Chairman J. Christopher Giancarlo in his call to U.S. prudential regulators to implement expeditiously the revised leverage ratio in their respective rules.



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Customers have been key to the success of central clearing in the United States and across the globe. While some clearing of swaps between dealers existed prior to enactment of the Dodd-Frank Act, artificial barriers to entry prevented customers from similarly participating in the cleared swaps market. Implementation of the central clearing requirement eliminated many of those artificial barriers and resulted in substantial customer clearing.

At present, swaps customers exclusively access CCPs indirectly through clearing members (typically banks), rather than becoming direct members of CCPs, for a variety of reasons, both financial and operational. Swaps customers must post IM, which is the customer's money, and CFTC rules require clearing members to hold customer funds from the clearing member's own assets (*i.e.*, "segregate" the IM).

Unfortunately, the current BCBS Leverage Ratio rules fail to provide an offset that recognizes the exposure-reducing effect of customers' segregated IM. According to the BCBS, the reason for the lack of an offset for customer IM that is held by the clearing member and not segregated not only offsets exposures, but also can be used by the clearing member for further leverage. In the U.S., segregation rules severely restrict the ability of IM to be held in anything other than extremely low-risk and extremely liquid assets, assuring that it is always available to absorb losses ahead of the bank. Moreover, the substantial majority of segregated IM is posted to the CCP, and therefore, is entirely outside the control of the clearing member.

The failure of the Leverage Ratio to recognize the purpose of segregated IM discourages the use of cleared derivatives by customers. The lack of offset will result in clearing members incurring large Leverage Ratio exposures, which will likely raise prices for customer clearing significantly. As the CFTC stated in its recent letter to the U.S. prudential regulators, "[f]ailing to reduce a clearing member's exposure by the segregated client margin it holds results in an inflated measure of the clearing member's exposure for a cleared trade."

In addition, the Leverage Ratio's current overstatement of a clearing member's actual economic exposure in a cleared derivative transaction has disincentivized banking organizations from providing clearing services to many customers. The Leverage Ratio is estimated to increase significantly the cost of using cleared derivatives. As a result, MFA members expect reduced access to clearing services and higher prices for such access without an appropriate revision to the Leverage Ratio. This substantial cost increase may cause customers to reduce their hedging activities to levels that are inadequate to manage their risk, which could result in price increases and volatility for food, gasoline, and other consumer goods.

In MFA's view, prudential requirements that inflate the economic risk of derivatives, particularly the Leverage Ratio, impose artificial barriers for clients to access cleared derivatives and work at cross-purposes with mandates to clear. We commend Chairman Scott for recognizing the adverse impact of the current formulation of the U.S. supplementary leverage ratio on customer clearing, and for serving as a lead co-sponsor in the last Congress of H.R. 4659 to require the appropriate Federal banking agencies to

recognize the exposure-reducing nature of client margin for cleared derivatives.

Therefore, to ensure the continued affordability and robustness of customer clearing in this country, we urge U.S. prudential regulatory authorities to implement a similar offset for U.S. clearing members to the announced BCBS revision to the Leverage Ratio. To avoid competitive disadvantage to U.S. banks, U.S. prudential regulators should act promptly.

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## CFTC GMAC DISCUSSION OF SWAPS MARKET AND LIQUIDITY FRAGMENTATION

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During a recent CFTC GMAC meeting, MFA noted that much of the discussion focused on the need for global regulators to address purported market or liquidity fragmentation in swaps trading activity. MFA would like to provide buy-side perspectives to the Committee on the current state of global swaps market liquidity and liquidity fragmentation.

MFA believes that, on the whole, the introduction of central clearing, organized trading, and greater pre- and post-trade transparency in the standardized interest rate swap and index credit default swap ("**CDS**") markets has improved – rather than fragmented – liquidity. In these markets, central clearing has made it easier for investors to transact with a wider array of trading counterparties while organized trading has improved pricing and competition, among other benefits. However, in other segments of the swaps market where central clearing and organized trading are not as prevalent, such as the single-name CDS markets, MFA members report that market liquidity has suffered due to lack of participants and lack of breadth of names traded.

MFA is concerned that, if implemented, the CFTC's proposed comprehensive reforms for swaps trading on swap execution facilities ("**SEFs**") would result in the fragmentation of the swaps market. To avoid this fragmentation, the SEF reforms should be targeted in scope. A targeted approach is necessary to preserve the CFTC-EU mutual recognition agreement on derivatives trading venues and to minimize regulatory fragmentation where possible by reducing regulatory divergence and related burdens on existing and potential participants in OTC derivatives markets. Disruptions to such mutual recognition/equivalence agreement may jeopardize impartial access to derivatives trading venues, straight-through processing efficiencies, price discovery, and post-trade transparency. MFA submitted a recent comment letter on the CFTC's SEF proposals with alternative recommendations that would preserve and enhance the CFTC-EU mutual recognition agreement and its important benefits for investors in facilitating cross-border swaps trading.[4]

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[4] *See* MFA letter in response to the CFTC's Proposed Rule, "Swap Execution Facilities and Trade Execution Requirement" (RIN 3038-AE25), submitted to Christopher Kirkpatrick, Secretary of the



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While the current SEF regime has improved conditions for investors, it has failed to provide buy-side market participants with true impartial access to the unique trading protocols and liquidity available on inter-dealer ("**IDB**") broker SEFs that historically served the "dealer-to-dealer" segment of the market. For example, buy-side firms do not have true impartial access to voice-based execution protocols on IDB SEFs that may be best suited for their specific trading activity. The continuing access barrier of post-trade name give-up on IDB SEFs that offer anonymous execution for cleared swaps reduces pre-trade transparency for investors regarding available bids and offers on such SEFs and limits their choice of trading protocols to those offered by a few viable SEFs serving the "dealer-to-client" segment of the market.

We respectfully urge the Committee to support targeted reforms to the CFTC's swaps trading regime to avoid the risk of introducing swaps market and liquidity fragmentation.

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## UMR INITIAL MARGIN IMPLEMENTATION

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The implementation of the final phases of the IM requirements under the uncleared margin rules ("**UMR**") adopted by the CFTC and other U.S. regulators has presented a myriad of challenges for buy-side firms. We are concerned that outstanding issues might result in prohibitive price increases and decreases in liquidity. MFA has recommendations for various short-term and long-term measures that are necessary to provide certainty and clarity for market participants.

While our members support incentives for central clearing of standardized OTC derivatives, we recognize that market participants have an ongoing need to be able to enter into bespoke and customized derivatives contracts that cannot be easily cleared by a CCP (so-called "uncleared derivatives"). MFA supports requiring buy-side firms to collateralize these uncleared derivatives through the posting of margin. Many MFA members already post IM for their uncleared derivatives, but currently, most do not collect IM from their swap dealer counterparties. Under UMR, buy-side firms will be required to receive regulatory IM from their swap dealers and segregate it with a third-party custodian bank.

For the last several years, MFA has engaged with U.S. and international regulatory bodies on implementation of UMR. Our primary concern with UMR implementation is maintaining reasonable costs and sufficient market liquidity for this important part of the swaps market. If the cost of trading uncleared derivatives is disproportionately increased by UMR implementation, it could reduce liquidity and adversely impact market participants' ability to invest and properly hedge their portfolios

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Commission, on March 15, 2019, available at: https://www.managedfunds.org/wp-content/uploads/2019/03/MFA-Comment-Letter-on-CFTC-SEF-Proposed-Rule-Final.pdf.



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using these instruments. Moreover, for products where no central clearing offering is available and/or where central clearing is not appropriate, calibrating UMR to incentivize such clearing is unrealistic, and accordingly, may need to be revisited. UMR should be designed to properly mitigate the risks associated with uncleared derivatives, not to penalize market participants for using uncleared derivatives to meet their trading needs for prudent risk management, including entering into customized transactions where warranted.

On March 5, 2019, BCBS and IOSCO[5] issued a public statement that the BCBS-IOSCO international margin framework does not specify documentation, custodial or operational requirements if the bilateral IM amount does not exceed the framework's 50 million US$/Euro IM threshold. Although the BCBS-IOSCO Guidance is a good first step in providing needed clarity to market participants, MFA urges the CFTC, the U.S. prudential regulators, and other regulators to adopt expressly the BCBS-IOSCO Guidance this summer.

Although the UMR does not require an in-scope entity to post regulatory IM until its bilateral IM amount in a counterparty relationship exceeds $50 million, the requested guidance would, nonetheless, help clarify the obligations of market participants and manage and prioritize their resources. MFA believes the issuance of the requested guidance this summer is critical to ease resource burdens and avoid trading disruptions for swaps market participants in the final phases, especially for the relatively large influx of newly in-scope entities, including many MFA members, on the September 1, 2020 implementation date for Phase 5.

MFA also requests that the CFTC coordinate with the U.S. prudential regulators and other regulators to provide a forbearance period of six months after a Phase 5 entity's counterparty relationship that was initially below the $50 million regulatory IM exchange threshold later exceeds such exchange threshold. Such forbearance is necessary to allow the Phase 5 entity to put the necessary bilateral collateral documentation and trilateral custodial arrangements in place to both post and receive regulatory IM and avoid trading disruptions. A reasonable forbearance period would help to alleviate the complexities, compliance expenses, and resource constraints facing Phase 5 entities, including with respect to separately managed accounts and associated risks.

In addition to these near-term measures, MFA urges the CFTC to coordinate with the U.S. prudential regulators and other regulators through the BCBS-IOSCO Working Group on Margining Requirements ("**WGMR**") to implement broader regulatory solutions that would involve targeted recalibration of UMR IM requirements. MFA recommends that the CFTC and other WGMR members consider:

- Excluding physically settled foreign exchange swaps and forwards in calculations of aggregate average notional amount thresholds for determining

[5] Available at: https://www.bis.org/press/p190305a.htm (the "**BCBS-IOSCO Guidance**").



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whether counterparties are in-scope of the UMR IM requirements. This recalibration is logical and would smooth implementation by avoiding the inclusion of products that should not otherwise be affected by the rules into the process.

- Adopting another phase-in threshold between 750 billion US$/Euro and 8 billion US$/Euro; specifically, MFA recommended a Phase 5.a. threshold of 100 billion US$/Euro in 2020, with 8 billion US$/Euro pushed back to 2021 as Phase 5.b. A more gradual and orderly staging would ensure that there is market infrastructure in place to support the final stages of IM phase-in and avoid market disruption. Such a further phase-in would also be preferable to a blanket delay of Phase 5, which would simply defer the cliff-edge effect of the threshold dropping from 750 billion US$/Euro to 8 billion US$/Euro without further facilitating the industry's transition.

- Enhancing the use and risk-sensitivity of approved IM models, including the ISDA SIMM™, by:

    - Exempting Phase 4-5 non-dealer counterparties from prudential-style governance of IM models designed for bank capital standards;

    - Enhancing portfolio margining in IM models;

    - Accelerating regulatory approvals of business-specific IM models to avoid model herding to a single standard IM model; and

    - Authorizing opt-in margining of non-regulated products to enhance portfolio offsets in IM models.

- Requiring robust data security protections by third-party software vendors that provide functionality for regulatory IM calculations, reconciliation, and margin workflows.

We respectfully urge the Committee to encourage the CFTC to coordinate with other regulators and the WGMR to implement our requested regulatory measures as soon as possible to avoid significant swaps market disruption.

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## EU GENERAL DATA PROTECTION REGULATION

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MFA supports robust data privacy and protection of confidential or sensitive data. GDPR took effect in May 2018 and seeks to protect the personal data of EU citizens. Because the rules under GDPR extend beyond the EU's geographical borders, GDPR has had a significant impact on the operations of many U.S. businesses.



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MFA members are subject to a panoply of U.S. federal and state privacy requirements because most are registered with the CFTC and/or SEC as commodity trading advisors ("**CTAs**"), commodity pool operators ("**CPOs**"), or investment advisers. Nevertheless, many U.S.-based investment managers that do not have EU offices are, or may be, subject to GDPR as well because it has broad extraterritorial application that extends to non-EU businesses that offer goods or services to individuals in the EU.

While GDPR does not appear to directly conflict with U.S. privacy regulations, it has imposed requirements on U.S.-based investment managers and other U.S. businesses that are significantly more stringent than what U.S. privacy rules impose. As a result, U.S. firms have had to modify their operations to comply with GDPR, notwithstanding their compliance with existing U.S. privacy laws. In effect, GDPR has become the primary privacy rule with which firms must comply with because it sets more stringent and prescriptive compliance standards than the U.S. privacy regimes prescribed by federal agencies through the Gramm-Leach-Bliley Act and other federal legislation, as well as by state law.

GDPR is an example of an EU law that has a significant impact on U.S. businesses and markets. While MFA does not take a position on whether GDPR is the appropriate rulemaking for U.S. entities, we note that Congress may wish to consider that it is now effectively a set of rules with which many U.S. firms must comply even though U.S. actors had little or no influence over the EU's rulemaking in this important area. Once again, MFA strongly encourages U.S. and EU authorities to engage in active regulatory collaboration to ensure coordination of approaches on privacy matters across jurisdictions, and we encourage Congress to exercise its oversight and lawmaking powers as appropriate.

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## ENHANCING DATA PROTECTION

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For several years now, MFA has engaged with regulators, including the CFTC, on the issue of data security and treatment of confidential information. MFA and its members have significant concerns about information security at regulatory agencies. Information security vulnerabilities at a regulator jeopardize not only market participants and their investors, but also the U.S. economy through the loss of domestic trade secrets and confidence in the integrity of the regulatory framework. This month, the CFTC Office of Inspector General issued a report highlighting the vulnerability of the CFTC's Integrated Surveillance System to hacking, which reinforces this concern.

Over the last several years, due to both statutory mandates and regulatory discretion, agencies have expanded the scope and breadth of the types of information that they request of registrants. These agencies, however, have generally continued to rely on the same frameworks for information collection and protection. Thus, we were especially pleased with the announcement earlier this year of CFTC Commissioner Dawn Stump's data protection initiative. That initiative aims to ensure that the CFTC only collects data



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required for its regulatory responsibilities, removes duplicative reporting streams, explores alternative mechanisms for accessing sensitive information, enhances internal controls for interacting with data, examines response procedures to cyber incidents, and updates data retention best practices.

MFA believes that the Committee should also consider legislative solutions with respect to enhancing data privacy, protection, and collection. We commend Chairman Scott for his leadership during the 115th Congress in supporting the "Protection of Source Code Act", and for co-sponsoring HR 3948, companion legislation that would amend securities statutes to apply the same scheme proposed for the CFTC to the SEC. The Protection of Source Code Act would amend the Commodity Exchange Act to require the CFTC to issue a subpoena before compelling a person to "produce or furnish source code, including algorithmic trading source code or similar intellectual property that forms the basis for design of the source code."

MFA believes that legislation such as the Protection of Source Code Act and companion Senate legislation introduced in the 115th Congress (S. 3732 and S. 3733) would be an important and constructive step for implementing and ensuring that regulators have a robust process in place when it comes to determining the necessity of highly sensitive, confidential information. Significantly, the legislative measure does not impede regulators from seeking the information they need, it only ensures that regulators have a process in place before seeking certain types of information, balancing the needs of regulators and registrants.

As such, MFA supports the policy of the "Protection of Source Code Act" and recommends that the Committee consider proceeding with such legislation during this Congress.

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## A HARMONIZED U.S. APPROACH TO REGULATION

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MFA supports the harmonization efforts that CFTC Commissioner Brian Quintenz and SEC Commissioner Hester Peirce have undertaken to enhance regulatory efficiency and effectiveness between the SEC and CFTC. To support this initiative and the goals of the CFTC, SEC, and Treasury that relate to promoting coordination, harmonization, and efficiency across regulators, MFA developed a proposal for a harmonized approach to CFTC and SEC regulation of firms that are registered with both the CFTC as CPOs or CTAs and with the SEC as investment advisers ("**dual registrants**").[6] We have urged the CFTC and SEC to enhance coordination and

[6] *See* letter from the Honorable Richard H. Baker, President and CEO, MFA, and Jennifer W. Han, Associate General Counsel, MFA, to the Honorable Jay Clayton, Chairman, SEC, and the Honorable Christopher Giancarlo, Chairman, CFTC, dated November 15, 2018, on "A Proposal for a Harmonized Primary Regulator Approach to SEC and CFTC Regulation of Dual Registrants", available at:



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efficiency in the regulation of dual registrants, and we believe that this Committee has an important oversight role to play in ensuring that regulators take a more harmonized or coordinated approach to regulation of dual registrants.

Dual registrants are subject to a wide range of related, but not identical, requirements arising from CFTC, SEC, and National Futures Association ("**NFA**") rules. These requirements include systemic risk reporting, examinations, advertising, marketing, sales practice and promotional materials, recordkeeping, privacy policies, information security and cybersecurity, self-assessment, business continuity and disaster recovery planning, ethics, and registration forms.

Under our proposed CFTC-SEC approach to harmonized regulation, currently dual registrants would continue to be registered with, and subject to oversight by, both agencies. All trading activities in the futures and swaps market would continue to be governed by CFTC rules and all securities market activities would continue to be subject to SEC rules. However, through an exemptive-relief safe harbor, each agency would provide substituted compliance for CPO/CTA and adviser regulations, whereby a registrant would be able to satisfy its compliance obligations with one agency by complying with the other agency's rules that serve the same purpose. A dual registrant would determine which agency's rules it would need to comply with based upon an assets under management test. For example, if a majority of a registrant's exposure was from derivatives overseen by the CFTC, it would comply with the CFTC and NFA regulations, and would be granted substituted compliance by the SEC for certain investment adviser regulations.

MFA believes that a harmonized approach to CFTC-SEC regulation of dual registrants could significantly enhance regulatory efficiency and effectiveness, and reduce regulatory burdens by streamlining systemic risk reporting and implementing joint or coordinated exams of dual registrants. These aspects to dual regulation create the greatest additional ongoing cost and burden. A harmonized approach would also provide clear and quantifiable benefits to the CFTC and SEC, registrants and the investing public, as well as conserve valuable government resources, reduce waste, promote good governance, and greatly enhance regulatory efficiency and effectiveness.

MFA continues to engage with CFTC and SEC staffs to discuss an optimal framework for a harmonized approach to CFTC and SEC regulation of dual registrants. MFA has recommended that the CFTC and SEC prioritize adopting a harmonized framework approach to regulation of dual registrants that would decrease duplicative regulation, allow for substituted compliance, joint, or coordinated exams, and permit the submission of a single systemic risk report to the CFTC, SEC, and NFA.

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https://www.managedfunds.org/wp-content/uploads/2018/11/MFA-Proposal-for-Dual-Registrants.final_.11.15.18.pdf.



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We respectfully request that the Committee exercise its oversight role in ensuring that regulators take a more harmonized or coordinated approach to regulation of dual registrants.

## CONCLUSION

On behalf of MFA, I appreciate the Committee's consideration of Brexit and other international developments affecting U.S. derivatives markets. As discussed, we strongly support global regulatory coordination and regulatory efforts to define consistent, effective, and fair cross-border rules that foster capital formation, increase transparency, mitigate systemic risk, and facilitate open access to the financial markets. To prevent the financial markets from becoming fragmented along jurisdictional lines and otherwise undermining the progress made in safeguarding the financial system against another financial crisis, we urge Congress, through its oversight powers, to examine and encourage Treasury and regulators to formulate positions in each of these important areas, and then work with their international counterparts to resolve impediments to the objectives of open, efficient, and fair capital markets.

In addition, to strengthen the U.S. financial system, we would appreciate Congress' continued oversight on harmonization issues by requesting that the CFTC and SEC implement a more harmonized and coordinated approach to regulation of dual registrants. We also request that Congress consider adoption of measures to enhance protection of U.S. intellectual property.

MFA is committed to working with Members and staff of Congress, the Committee, and regulators to address these issues towards the goal of preserving the strength of our nation's economy. MFA is also committed to its role as a constructive partner to policy and regulatory officials in overseas jurisdictions, including in Europe. Thank you for the opportunity to appear before you today. I would be happy to answer any questions that you may have.

CITADEL

# Stephen Berger

## Managing Director, Global Head of Government & Regulatory Policy

Stephen Berger is a Managing Director and Global Head of Government & Regulatory Policy at Citadel. He leads the firm's engagement on legislative and regulatory initiatives impacting the financial industry globally, including the Dodd-Frank Act in the United States and EMIR and MiFID II in Europe.

Mr. Berger has testified before the House Agriculture Committee on the impact of the G-20 clearing and trade execution requirements, presented before CFTC advisory committee meetings on issues including package transactions and position limits, participated in workshops at the New York Fed and Chicago Fed on CCP recovery and resolution, and spoken on panels at MFA, FIA, and ISDA conferences on topics ranging from cross-border harmonization to margin requirements for uncleared swaps.

Mr. Berger is a member of the CFTC's Market Risk Advisory Committee, NFA's CPO / CTA Advisory Committee, and the Federal Reserve Bank of Chicago's Working Group on Financial Markets. He has served as Chair of the Managed Funds Association's Derivatives and Swaps Committee and is an active participant in a number of MFA, AIMA, SIFMA AMG, and ISDA committees.

Prior to joining Citadel, Mr. Berger was an Executive Director at UBS Investment Bank, where he led UBS's US financial regulatory reform team.

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# Truth in Testimony Disclosure Form

In accordance with Rule XI, clause 2(g)(5)*, of the *Rules of the House of Representatives*, witnesses are asked to disclose the following information. Please complete this form electronically by filling in the provided blanks.

**Committee:** Agriculture

**Subcommittee:** Commodity Exchanges, Energy, and Credit

**Hearing Date:** June 26, 2019

**Hearing Title :**

Brexit and Other International Developments Affecting U.S. Derivatives Markets

**Witness Name:** Mr. Stephen Berger

**Position/Title:** Managing Director, Global Head of Government & Regulatory Policy, Citadel LLC

**Witness Type:** ○ Governmental ● Non-governmental

**Are you representing yourself or an organization?** ○ Self ● Organization

**If you are representing an organization, please list what entity or entities you are representing:**

Managed Funds Association

**If you are a non-governmental witness, please list any federal grants or contracts (including subgrants or subcontracts) related to the hearing's subject matter that you or the organization(s) you represent at this hearing received in the current calendar year and previous two calendar years. Include the source and amount of each grant or contract.** *If necessary, attach additional sheet(s) to provide more information.* **House Rules do NOT require disclosure of federal payments to individuals, such as farm program payments or assistance to agricultural producers.**

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