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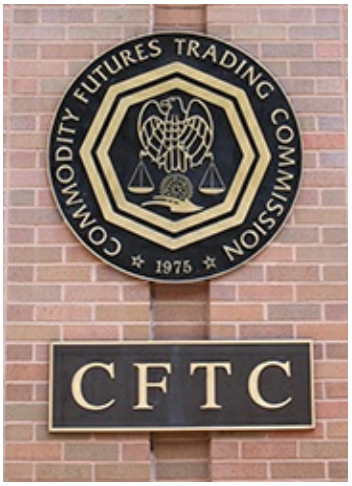
Financial Reform Newsletter: March 31, 2017
Wall Street's Insidious Strategy to Cripple CFTC Derivatives Enforcement Through Underfunding; SIFMA, Chamber of Commerce and the ICI Endorse the Volcker Rule Ban on Proprietary Trading at a Congressional Hearing

Wall Street's Insidious Strategy to Cripple CFTC Derivatives Enforcement Through Underfunding



The Commodities Futures Trading Commission (CFTC) is the primary cop on the Wall Street derivatives beat. The importance of this job cannot be overstated.

Unregulated and non-transparent derivatives were at the core of causing and spreading the financial crash of 2008. They were a primary reason the financial system almost collapsed, which is what caused the need for massive taxpayer bailouts. In fact, they were so central that an entire chapter of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was devoted to reining in derivatives, which Warren Buffett famously and correctly called "financial weapons of mass destruction."

However, while incredibly dangerous to the country, unregulated derivatives trading generated huge revenues and bonuses for Wall Street's biggest banks. In fact, just five of those gigantic banks control almost 95% of all derivatives trading in the US so whenever anyone is talking about derivatives they are really taking about the five biggest Wall Street banks. Unsurprisingly, Wall Street hates the regulations of derivatives and has done everything possible to cripple the CFTC and prevent it from doing its job. It's most insidious strategy has been to get its political allies to grossly underfund the agency so it can't enforce its rules and so that misconduct goes undetected and unprosecuted.

Before the 2008 crash, the CFTC was responsible for regulating the $40 trillion futures markets. However, because the $400 trillion or so in US unregulated swaps derivatives markets were at the core of causing and spreading the 2008 financial crash, the 2010 Dodd-Frank financial reform law mandated that the CFTC also regulate these markets. Thus, the CFTC's responsibilities expanded from regulating derivatives markets of about $40 trillion to regulating markets of about $450 trillion.

The only responsible response to that would be to dramatically expand the CFTC's funding and capability. Shockingly, that didn't happen. The CFTC has only seen incremental increases, many of which have come with restrictions, as Wall Street's derivatives dealers have used their political allies to grossly underfund the CFTC. For example, the CFTC's entire budget last year was $250 million to regulate, oversee and enforce the law in markets greater than $450 trillion. That has, by design and as intended, crippled the agency, prevented proper rulemaking and resulted in minimal enforcement.

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This was spelled out in detail in a recent *Reuters* article focused on these issues. Former CFTC Enforcement Director, Aitan Goelman, who left the CFTC last month, put it in simple and frightening terms,

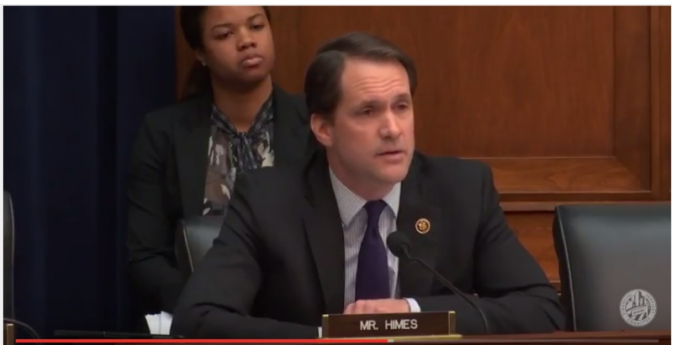
> "One of my regrets is there's such a massive amount of misconduct in the market we're just not pursuing. We have all these new enforcement tools and this vastly expanded jurisdiction and data but you have to be acutely conscious about the limited resources."

As one of the country's most astute observers of the markets, Joe Saluzzi from Themis Trading, put it: "Mr. Goelman is telling us that because of budget constraints the CFTC is not doing their job." Indeed, the CFTC cannot do its job.

The reason for this is clear: Wall Street's five biggest banks - the derivatives dealers club -- have crippled derivatives enforcement in this country by getting their political allies to deliberately underfund the CFTC. Of the CFTC's $250 million budget, just over 30 percent ($75 million) is devoted to enforcement. Compare this to the Securities and Exchange Commission's $1.6 billion budget (with a third going to enforcement) and the numbers speak for themselves: it is impossible to effectively enforce the law in a $450 trillion market with the $75 million CFTC has to devote to enforcement.

As Better Markets president and CEO summed it up in the *Reuters* piece, this is "one of the biggest scandals in this town."

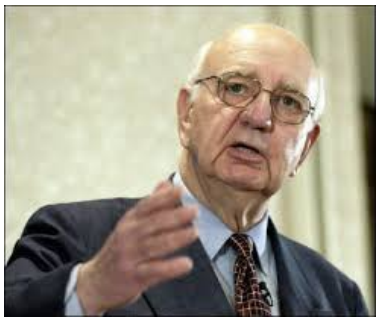
SIFMA, Chamber of Commerce and the ICI Endorse the Volcker Rule Ban on Proprietary Trading at a Congressional Hearing



It's rare that a question during a Congressional hearing leaves an entire panel of witnesses silent, but that is exactly what happened during Representative Jim Himes' (D-CT) questioning of the panel during the House Financial Services Subcommittee on Capital, Markets, and Investment hearing on the impact of the Volcker Rule.

As we detailed in this Op-Ed, Rep. Himes focused in on the key issues raised by the Volcker Rule, asking this key question (Be sure to check out the video of Himes' questioning, which begins at about the 1:18:00 mark):

> I understand that ... there's a pretty dramatic difference between my Toyota dealer [example] and the bank, which is that the Toyota dealer is disciplined by the fact that if he keeps 700 cars on the lot and it goes wrong, he's out of business. And the FDIC is not there to bail him out. The TARP is not there to bail him out. The 1994 Peso rescue is not there to bail him out. **So, I guess my big question, and this is for the panel as a whole, I've heard a lot of talk about short-term proprietary trading. Does anybody here think the FDIC-insured institutions should be taking long-term proprietary bets?**



There was total silence from the entire panel of witnesses, to which Himes responded, "OK, the silence there I am going to take to be a no." Not one witness thought that "FDIC-insured institutions should be taking long-term proprietary bets." Thus, **SIFMA, the Chamber of Commerce and the Investment Company Institute (ICI) agreed that FDIC-insured institutions should NOT be taking long-term proprietary bets, which is precisely what the Volcker Rule prohibits.**

With this acknowledgement, Rep. Himes cut to the real issue that serious, reasonable people should be focused on:

> "[It] is not on the regulators to explain why insured institutions should not be able to take proprietary bets.... The burden is on the industry to come up with constructive ways, if there are more constructive ways, in determining the legitimate inventory as opposed to making the argument that we should take away the idea that proprietary trading is somehow permissible

inside a depository institution."

That's the point: the industry should stop trying to kill the Volcker Rule, which would unleash FDIC insured banks to engage in unlimited, high risk, dangerous prop trading with depositors' money. If there are better ways to distinguish between permissible genuine market making and prohibited prop trading, then that's the discussion we should be having.