Fact Sheet: The CFTC Must Act Now to Protect Taxpayers from Another Derivatives-Driven Financial Crash and More Taxpayer Bailouts

Wall Street's biggest derivatives dealers are successfully working nonstop to kill, weaken or evade essential reforms in the derivatives markets. The CFTC's inaction is enabling this to happen. That must stop and the CFTC must act now to stop it. Our Policy Brief details what is happening and what must be done. This is a summary.

The CFTC recently gave final approval to the applications of 18 Swap Execution Facilities ("SEFs"), the exchange-like derivatives trading platforms mandated by Dodd-Frank to bring stability, transparency and fair competition to the swaps markets. However, since these SEFs came online nearly 2 years ago they have faced enormous resistance from the handful of swap dealers that have dominated and controlled the derivatives market since its inception, who view an open swap market as a direct threat to their profitable market-making businesses. Numerous swap market participants and SEFs have voiced their concerns about the inordinate influence of the largest dealers in the swaps markets, and in particular the harmful and anti-competitive practices that SEFs have been pressured to enact to retain the crucial business of the largest liquidity providers.

While CFTC officials, including the Chairman, initially recognized and expressed concern over the significant problems in these markets due to the dealers' power and tactics, the most recent position of the Commission follows a destructive and baseless narrative: that market structure will "evolve naturally" and markets will "decide what they want" without the need for regulatory intervention.

However, this is impossible in a market that begins with such a deep and fundamental concentration of entrenched market-power that the biggest dealers use to ensure that markets are not reformed. The Commission has been presented with numerous examples of how market transparency and competition are being actively undermined by the collusive actions of this handful of largest dealers.

These facts have also been starkly detailed in two recent lawsuits brought against these dealers by end-users. One of these suits was recently settled for nearly $2 billion and illustrates the enormous costs to the market of this deeply engrained, anticompetitive and systemically dangerous behavior. With embedded market control strangling new SEFs and competition, the market simply cannot fix itself. Only swift and broad-reaching action by the CFTC will break open these markets from the dominance and control benefiting the few to a market that benefits the many and systemic stability at the same time.

The Policy Brief provides the context for understanding the many actions the big dealer-banks have taken and continue to take to undermine SEFs and the swaps market as well as transparency and stability in the markets as a whole. We conclude with the following straightforward, common-sense ways the CFTC can take action to fix the problems that are becoming more deeply engrained in the swap markets every day:

1) Exercise oversight of activity conducted by swaps traders located in the U.S.

It is clear that derivatives activities engaged in by traders located in the U.S. have a direct and significant connection to the U.S. and warrant oversight from U.S. regulators. The CFTC specifically highlighted that it has a "strong supervisory interest in regulating the dealing activities that occur within the United States,

irrespective of the counterparty." Therefore the CFTC should immediately enforce this baseline principle – regulating all derivatives activitites within the United States – and impose its existing rules, ceasing the continuous relief to the dealer banks to actually comply with them.

2) Enforce CFTC rules on impartial access and eliminate post-trade name disclosure on SEFs

The CFTC has clear impartial access rules applicable to trading on SEFs. These must be actually enforced to ensure dealers are not able to preserve prohibited dealer-only platforms through other techniques, such as the practices highlighted in this brief. Specifically, the legacy practice of post-trade name disclosure cannot be justified for cleared derivatives. This harmful and unnecessary practice only helps keep certain SEFs as dealer-only platforms in violation of the CFTC's impartial access requirements. Consistent with prior statements made by the CFTC Chairman, Commissioners and staff, post-trade name disclosure must be immediately prohibited for cleared derivatives on SEFs.

3) Promote harmonization with global regulators to eliminate regulatory arbitrage

It is critical that U.S. regulators continue to promote harmonization with global regulators and ensure substituted compliance is not granted unless U.S. core principles including in particular impartial access, are implemented in an equivalent manner in fact, so that U.S. market participants cannot be shut-out of swaps trading venues. In the face of dealer opposition and evasion, the CFTC must not back away from its current approach for granting trading venue equivalence, which requires as a pre-condition that impartial access be implemented in an equivalent manner.

4) Ensure transparency regarding the derivatives activities of de-guaranteed affiliates

To adequately assess the risks these newly de-guaranteed affiliates of U.S. entities may pose to the U.S. financial system, at a minimum there needs to be full transparency around their derivatives activities and a 'de facto guarantee' test must be applied to ensure that U.S. law is not being evaded. U.S. regulators have the obligation to understand how U.S. financial reforms are undermined by the act of de-guaranteeing, and use their anti-evasion authority whenever appropriate.

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