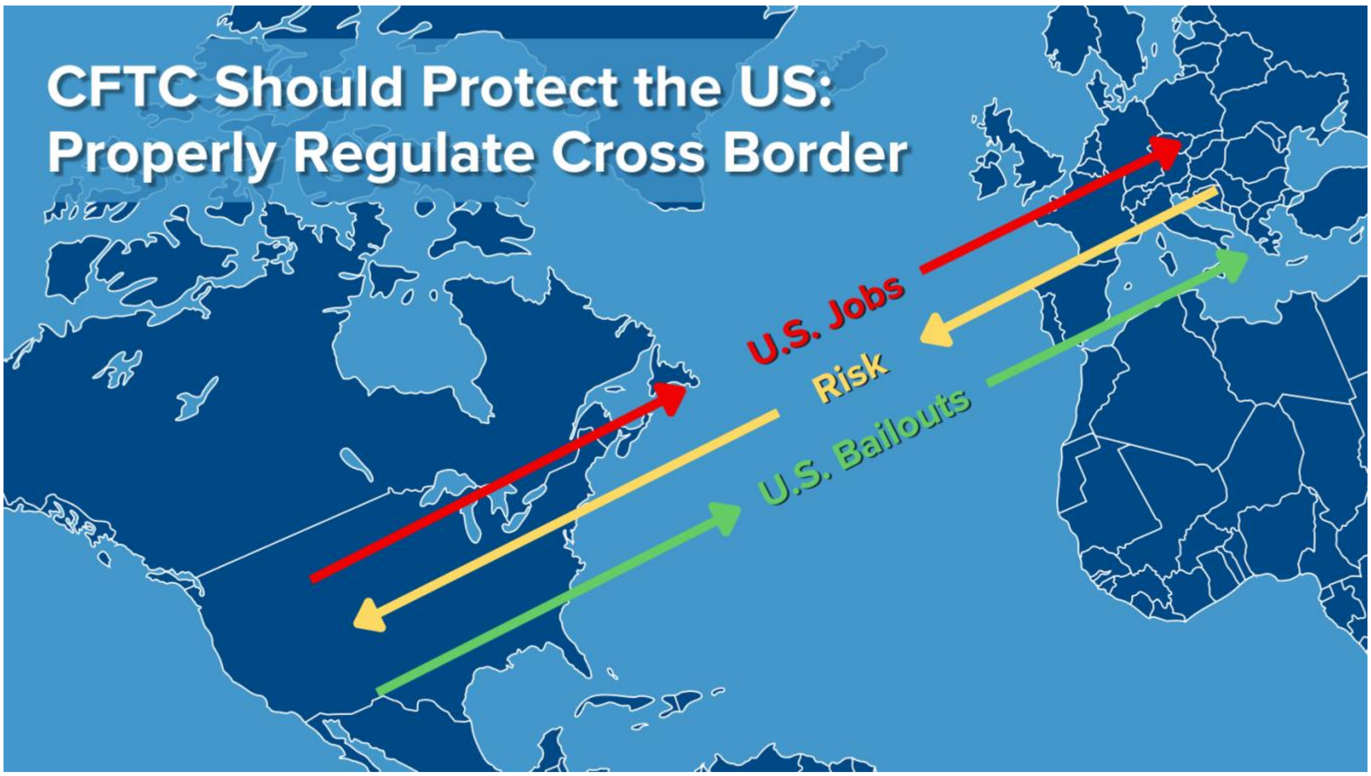
CFTC

FACT SHEET

The CFTC Must Not Rely on Failed Foreign Regulators to Protect Americans

June 18, 2024



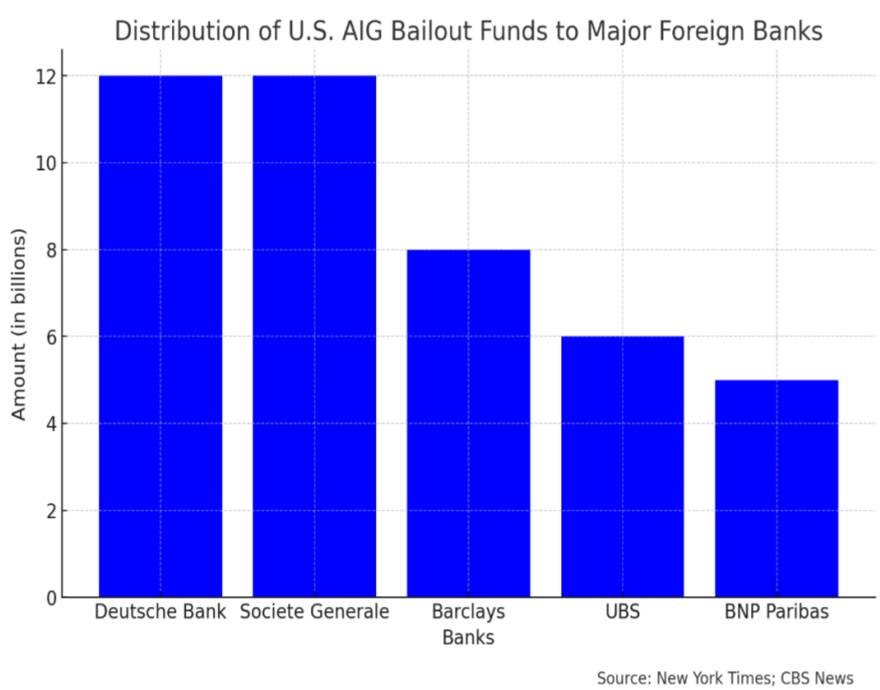
Much of the damage inflicted on the U.S. during the 2008 financial crash resulted from the overseas activities of the largest U.S. financial firms. These U.S.-based global firms often locate some of their most high-risk operations overseas to avoid investor, consumer, and financial stability protection rules, a practice known as "regulatory arbitrage." This happened frequently before the 2008 crash and would be acceptable if the costs and consequences of overseas activities stayed overseas. However, that's not what happens. When a giant U.S. financial firm gets into trouble or fails, even if from its overseas activities, it is always the home country that suffers the most. That's what gave rise to the saying "banks live globally but die locally."

Regulatory arbitrage was a key factor when the [unregulated derivative markets] invisibly incubated and ignited the 2008 crash by acting as a conveyor belt of risk that transmitted financial risks worldwide. This caused a catastrophic feedback loop, undermining global financial institutions, entire financial systems, and ultimately the economies of the world, including in the U.S. This conveyor belt was facilitated by a global race to the regulatory bottom in the years leading up to the crash, where countries competed to attract financial firms with promises of so-called “light touch” regulation, which often meant little if any real regulation, supervision, oversight, or enforcement.

Before 2008, the United Kingdom "won" the race to attract global derivatives dealers, including Lehman Brothers and AIG, to London. This achievement brought jobs, tax revenue, and prestige to London's financial district, transforming it into a largely unregulated global finance hub. However, this prosperity was short-lived, as London, the U.K., and the world suffered immense losses when the 2008 financial crisis erupted.

The aftermath of the 2008 crash further illustrated the interconnectedness of global finance. The U.S. launched multiple bailout programs (including the high-profile $700 billion TARP program) in response to the global economic meltdown, many of which bailed out overseas firms, taxpayers, and countries, unlike other countries' more localized efforts. The U.S. programs injected money into numerous financial firms, including those with extensive operations abroad, aiming to stabilize the financial system. By contrast, most other countries concentrated their financial rescue efforts on domestic banks, which generally had limited non-domestic operations.

For example, major French and German banks were among the primary beneficiaries of the U.S. efforts to save AIG. The U.S. government assumed the full risk associated with rescuing AIG, with a considerable portion of the $182 billion in federal aid to AIG being used to settle obligations to its trading partners through credit default swaps. This included significant payments to French banks such as Societe Generale, which received $11.9 billion, and BNP Paribas, which received $4.9 billion, as well as Germany's Deutsche Bank, which received $11.8 billion. Additionally, Barclays received $8.5 billion and UBS $5 billion (as reflected in the chart below). Of the 87 banks and financial entities that indirectly benefited from U.S. aid to AIG, 43 were foreign, highlighting the global ripple effects of the U.S. financial rescue measures to foreign banks.



In addition to the many billions of US dollars used to bailout foreign banks, there were also significant and costly failures in the financial regulations of other countries. These regulatory failures led to many European banks being nationalized or bailed out by their governments during the crisis.

EU Banks rescued by their governments during the crisis

U.K.	Germany
Northern Rock *	West LB
Royal Bank of Scotland *	Landesbank Baden Wurttemberg
Lloyds Banking Group	IKB
Bradford and Bingley *	Hypo Real Estate *
HBOS	Nord LB
	Commerzbank AG
Belgium	
	Netherlands
Dexia *	
KBC Group	ING
Fortis	SNS REAAL
France	Sweden
Caisse d'Espargne/Bansque Populaire	Carnegie Bank *
Ireland	Switzerland
Anglo Irish Bank *	UBS

Source: Centre for European Policy Studies (2010), Bank State Aid in the Financial Crisis, October

*government majority ownership

These many actions would clearly indicate that foreign regulators failed to protect their own citizens, taxpayers, banks, financial systems, and economies. Given that, why would the U.S. outsource the protection of US citizens, taxpayers, etc., to the very foreign regulators who failed so spectacularly to protect their own people? The short answer is that the U.S. would not and did not – the U.S. enacted the Dodd-Frank Act to protect the American people, including from failed foreign regulators by requiring, for example, robust comparability determinations.

It's important to remember that the costs and consequences of these failures are long lasting. For example, at the start of 2024, Ireland's citizens still owned almost 40% of AIB. The United Kingdom retains a significant ownership share in NatWest Group (formerly Royal Bank of Scotland), having reduced its stake to slightly less than 40% in November 2023. These examples underscore that, despite substantial recovery efforts and economic stabilization measures, the legacy of the crisis remains evident in the ownership structures of major financial institutions. The interconnectedness of the global financial system means that the consequences of the 2008 crash are still being felt more than a decade later, both in the U.S. and abroad.

The global ripple effects of the U.S. financial rescue measures were extensive, but the domestic impact in the U.S. was worse. The 2008 crash affected virtually every American: tens of millions were thrown out of work, and countless more lost their homes, life savings, and future prospects for education and retirement. The crash eroded standards of living, undermined a sense of security, and, in many ways, led to what could be described as a lost generation. The financial cost to the U.S. economy was staggering, running into the tens of trillions of dollars, a sum that barely begins to account for the full scope of the devastation.

While the global and domestic impacts of the 2008 financial crisis were devastating, it is important to recognize that derivatives markets, the cross-border activities of derivatives dealers, and global regulatory arbitrage were key drivers of the turmoil. In response to these challenges, the Dodd-Frank Act provided the Commodity Futures Trading Commission (CFTC) with enhanced powers, authority, mandate, and duty to regulate derivatives more effectively. This legislative action was specifically designed to ensure that the American public would not again be victimized by unregulated and underregulated derivatives markets, both domestically and globally. The CFTC was particularly directed to prevent a global race to the regulatory bottom and to curtail regulatory arbitrage, underscoring the importance of cross-border regulation and comparability mandates in safeguarding U.S. derivatives laws and regulations.

The CFTC was given this critical responsibility because, to varying degrees, other countries face inherent conflicts of interest when it comes to enforcing effective regulations on foreign financial firms, including derivatives dealers operating within their jurisdictions. Weak or ineffective regulation can attract financial firms, leading to high-paying jobs and significant tax revenues, as well as adding to the prestige and bragging rights of an area like London and its politicians. These short-term gains, however, may be prioritized over the long-term risks of a future financial crisis, which might occur under someone else's watch. Politicians may also speculate that other nations, like the U.S., will end up paying the costs from damage done by the next crash.

This isn't just a reflection of the past or mere speculation about the future, but a recurring theme seen across various nations post-economic downturns. In the aftermath of the global financial crisis of 2008, many countries have struggled to recover from self-inflicted economic challenges, such as those arising from significant political or economic shifts. These nations strive to rejuvenate their financial centers, which may have suffered due to the relocation of businesses or shifts in economic policies. Political parties often compete vigorously during election periods, each promising to vigorously support their financial sectors. They commonly use euphemisms and innocuous terms like "competitiveness" to frame these promises. However, the underlying strategy frequently involves proposals for deregulation and the encouragement of regulatory arbitrage, echoing past financial practices.

In light of these regulatory challenges and the devastating consequences of past financial crises, the CFTC's comparability determinations are extremely important. They are important because these determinations effectively outsource the protection of U.S. taxpayers and the stability of its financial system and economy to foreign governments and regulators. The law requires that the CFTC ensure that such determinations are robust in form, substance, enforcement, and over time. They must be comparable in fact, not artificially constructed after the fact.[1]

[1] The history, need, and consequences of this are spelled out in prior Better Markets materials listed and linked here: https://bettermarkets.org/newsroom/cftcs-regulation-wall-streets-high-risk-global-derivatives-bets-must-protect-us-taxpayers/.

The CFTC has proposed four capital and financial reporting comparability determination orders for nonbank swap dealers in Japan, Mexico, the European Union (specifically Germany and France), and the United Kingdom. These proposed orders resulted from applications submitted on behalf of nonbank swap dealers under the jurisdiction of those foreign countries. As suggested above, the importance of the CFTC's responsibility and duty to undertake these determinations cannot be overstated. That's because if foreign laws are found to be comparable to U.S. laws, those firms only have to comply with the foreign laws, ***not*** the U.S. laws.

Nevertheless, there are very significant concerns about the actual execution of these comparability determinations by the CFTC, as we have detailed. [2] This is due, in part, because it is an exceedingly difficult test to administer reliably, partly because it calls upon the CFTC to make predictions about the eventual impact of different sets of regulatory requirements. To properly undertake such a comparability test, the CFTC would have to articulate how it makes such predictions as a general matter and then apply that test in each country's case. Unfortunately, the CFTC has done neither. Instead, they make conclusory assertions without disclosing sufficient facts, data, or detailed analysis to support their findings.

Furthermore, these proposed determinations cannot reasonably be made due to the many material differences in the respective regulatory frameworks, the extensive array of conditions that the CFTC has deemed necessary to impose, and the lack of a sufficiently detailed analysis explaining how the outcomes under different frameworks could be considered "comparable." Thus, the CFTC did not do a comparability analysis. The CFTC is substituting assertion for analysis.

For example, the minimum initial capital requirement for nonbank swap dealers in the U.S. is **2000% more than** in the United Kingdom. To remedy this indisputable non-comparability, the CFTC proposed to require nonbank swap dealers in the United Kingdom to dramatically increase their initial minimum capital to match U.S. rules. Furthermore, all four proposed orders impose over a dozen requirements that the foreign jurisdictions must meet as a condition for the comparability determination. The fact that the CFTC requires these conditions objectively proves that the foreign jurisdictions' regulations are **not** comparable. The CFTC's attempt to rewrite the foreign rules by imposing multiple, substantive, and material conditions does not change that fact. Therefore, the law compels the CFTC to deny all four comparability requests.

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[2] See Better Markets' four comment letters detailing opposition to the four pending CFTC comparability determinations: (Japan) https://bettermarkets.org/wp-content/uploads/2022/10/Better_Markets_Comment_Letter_Application_for_Capital-Comparability_Determination_From_the_Financial_Services_Agency_of_Japan.pdf; (Mexico) https://bettermarkets.org/wp-content/uploads/2023/02/Better_Markets_Comment_Letter_Mexico_Comparability_Determination.pdf; (EU) https://bettermarkets.org/wp-content/uploads/2023/08/Better_Markets_Comment_Letter_Capital_Comparability_Determination.pdf; (UK) https://bettermarkets.org/wp-content/uploads/2024/03/Better-Markets-Comment-Letter-Comparability-Determination-UK.pdf

The consequences of denying the application for a comparability order must be clearly understood. Some firms might argue that withholding a comparability determination, especially given the proposed conditions, represents an overly stringent approach and may advocate for a more flexible interpretation of comparability. However, these arguments lack merit and do not align with legal standards. They should not influence the CFTC's decision-making for at least three key reasons.

First, the law requires that comparability be assessed based on truly comparable regulatory requirements, viewed in light of the statutory purposes to safeguard market stability and transparency. This ensures any foreign regime can in fact protect U.S. entities, markets, and the economy from future financial crises as if they were following the analogous U.S. laws and rules. The CFTC is legally bound to follow this standard.

Second, the absence of a comparability determination doesn't spell disaster for foreign firms. They can continue operating if they comply with U.S. regulations under the Commodity Exchange Act and the CFTC's rules on derivatives trading to access U.S. markets. This approach ensures fairness and a level playing field, preventing regulatory arbitrage, and protects the American people as mandated by the law.

Finally, the compliance challenges facing firms are neither unreasonable nor overly burdensome. Congress has determined that these requirements are necessary. Moreover, many nonbank swap dealers seeking comparability determinations, such as affiliates of major banks like Goldman Sachs, Bank of America, Citigroup, and Morgan Stanley, are well-acquainted with and capable of adhering to U.S. derivatives regulations, as they already comply with them daily.

The CFTC's longstanding commitment to working with foreign regulators and promoting international harmony (referred to as “comity”) is important. However, this cannot impact much less override the need for the proper regulation and oversight because that’s what the law requires. In the complex and high-risk international derivatives markets, it is crucial to maintain the appropriately strong regulatory measures that the U.S. government determined were necessary to protect U.S. citizens, investors, markets, taxpayers, the financial system, and the economy. The financial stability stakes are too high to risk any compromise on these essential standards.

The CFTC's approach to comparability determinations requires a complete reevaluation of its current misguided determinations of comparability to ensure that foreign regulatory standards are truly comparable to those in the U.S. The integrity of the U.S. financial system directly impacts the economic security of every American—from safeguarding retirement funds to securing stable jobs. It is vital for the CFTC to not rely on assertions of comparability without first disclosing sufficient facts, data, or analysis supporting such findings, not only for the protection of the global markets but for the financial well-being of every American household. This is why the CFTC needs to reject its current inadequate approach to determining whether foreign rules are sufficient to meet U.S. standards. The CFTC must base its decisions on facts and granular evidence, not baseless assertions and guesswork, to protect America's economic future.

Better Banks | Better Businesses

Better Jobs | Better Economic Growth

Better Lives | Better Communities

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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