Scoring the October 18, 2011 CFTC Open Meeting

By Douglas Ashburn
Editor-at-Large
John Lothian News
Email: dougashburn@johnlothian.com

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Normally, one would not list CFTC meetings among top choices in televisual entertainment, but the October 18, 2011 open meeting was a relatively raucous affair. The final rules on position limits, which required the cancellation of two prior meetings in order to give the commission extra time to hammer out the specifics, squeaked by on the narrowest of margins, clearly the result of some last-minute "horse-trading" back stage. A final rule covering derivative clearing organizations (DCOs), which also passed 3-2, was equally contentious. Additionally, the commission voted to extend the effective date for certain Dodd-Frank provisions until July 16, 2012. Commissioner Chilton quoted "Huggy Bear" from Starsky & Hutch. And, at one point, the room joined together in a song, which was led by Commissioner Dunn.

No; they did not sing "Kum-ba-yah" - they sang "Happy Birthday" to Chairman Gensler, who turned 54 the day of the meeting. Under normal circumstances, upon hearing Mr. Dunn's rendition, I would have suggested he not quit his day job. However, as his time with the commission is done, pending the confirmation of his successor, it seems as if he has already quit his day job. Chilton's Huggy Bear reference, by the way, was the line, "I lay it out, so you can play it out," meaning the commission must follow the mandates laid out by Congress in the Dodd-Frank Act.

The position limits rulemaking has easily been the most controversial issue thus far in the 20 Dodd-Frank-related meetings. With Gensler and Bart Chilton in clear support, and Commissioners Jill Sommers and Scott O'Malia firmly against, Dunn held the swing vote. He has clearly been torn on the issue. In his opening statement, he says, "No one has proven that the looming specter of excessive speculation in the futures markets we regulate even exists, let alone played any role whatsoever in the financial crisis of 2008." In the end, he grudgingly votes to approve the rule, stating, "the [Dodd-Frank] law is clear, and I will follow the law."

In exchange for his vote, Dunn was able to extract a few "guarantees," in the public record, from the chairman. In what he called his "colloquy," Dunn received assurances that the commission would closely study the imposed limits, address any unintended negative consequences, and remain open to granting relief to "legitimate businesses" that may be impacted. The rule passed, but Dunn was allowed to wash his hands of the outcome.

In stark contrast, Chilton says, in defense of position limits, "while I'd have an even tougher rule in many respects if I were the only author, this is nonetheless a very strong, needed and imperative rule to ensure more efficient and effective markets devoid of fraud, abuse and importantly, manipulation. This rule balances the needs of consumers and market participants alike." The man is consistent.

I expected fireworks from the position limits debate. The pleasant surprise of the morning, however, was the controversy surrounding the DCO rulemaking. Sommers brought up an excellent point, one in which no one had a good answer. Swaps transactions are being brought under CFTC jurisdiction because of their "economic equivalence" to futures contracts. Yet, many of these rules, the DCO rule included, offer separate sets of standards for swaps and futures. For example, letters of credit, which are allowed to be used as a financial resource in futures markets, will not be allowed for swaps; “a distinction,” she says, “ that is not legally or factually justifiable.”

O’Malia, who was also opposed to the DCO rules, highlights two major sticking points. First, there is a provision whereby DCOs are prohibited from requiring more than $50 million in capital from any entity seeking to clear swaps. This is one example of the commission’s deviation from a principles-based approach to an overly prescriptive approach. “One size does not fit all,” said the commissioner. The second provision highlighted by O’Malia is another example of the double-standard for swaps rules. Margin on futures and agricultural swaps is calculated assuming a one-day liquidation; all other swaps assume a five-day liquidation - requiring significantly higher margin. This number is set to go even higher if DCM Core Principle 9 (the dreaded 85/15 percent rule) withstands the final rulemaking. Under the ruling, if less than 85 percent of a contract’s volume is traded on a central order book, it may need to reclassify as a swap, and be subject to higher collateralization requirements.

It appears that we are in store for another fun-filled meeting next month when the commission considers the DCM rules.

For more information, see the meeting summary page on MarketsReformWiki.