

CFTC set to gain greater prominence

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The CFTC's likely new clout is a coup for Gary Gensler, its chairman, who has infuriated Wall Street

New **US financial legislation** will turn a regulator established in the 1970s to police American corn and wheat trading into the world's leading derivatives watchdog.

The Commodity Futures Trading Commission (CFTC) will emerge from the financial reform bill, which is close to completion, with a large new remit, authorised to look beyond futures exchanges to the \$615,000bn privately traded over-the-counter derivatives markets.

The CFTC's likely new clout is a coup for Gary Gensler, a former Goldman Sachs partner who, since assuming the CFTC chairmanship in May 2009, has infuriated Wall Street with his push for drastic derivatives reform and unrelenting criticism of banks and their profit motive.

The new law is also likely to elevate the CFTC's profile among regulators in the US, particularly the much bigger Securities and Exchange Commission. The SEC will also gain new derivatives powers, but will regulate security-based derivatives, a much smaller piece of the market than the CFTC's swaps mandate.

"The bill is a big win for the CFTC, and a big win for the chairman of the CFTC," said Richard Schetman, partner at Cadwalader, Wickersham & Taft. "Gensler will, arguably, be the most powerful derivatives regulator."

With the House and Senate finalising the financial reform bill, debate turns to whether the CFTC, with a staff of only 600, has the capacity to oversee the swaps markets that Mr Gensler says were at the centre of the financial crisis.

The new laws create **a dramatic landscape for OTC derivatives**, which grew into one of the largest and most profitable sectors of finance in the past two decades. A 2000 law backed by Mr Gensler in a former role barred the CFTC from regulating derivatives.

The need for the \$180bn government bail-out of AIG after a small division of the insurance company accumulated – undetected – positions in credit default swaps, catapulted derivatives into the political spotlight. The risks of a chain of defaults among dealers exposed to each other through derivatives contracts also fuelled a drive to give these instruments stricter oversight.

Under the new bill the CFTC would for the first time regulate swaps, financial instruments whose value is typically tied to fluctuations in interest and exchange rates, credit quality or commodity prices. They are widely used by banks, companies and investors to hedge or bet on risks.

Big swap traders, including Wall Street banks, would have to register with the commission, expose details of their deals and potentially limit trading at the agency's request. Many derivatives would also be processed by clearing houses, which the CFTC would regulate. Trading would shift from behind the scenes activity among banks to

electronic platforms where prices are more transparent, potentially robbing banks of an important profit centre.

The global nature of the derivatives markets and their size means the CFTC will play a greater role abroad too, not least at the growing number of international regulatory panels set up to track systemic risks in the financial market.

But the commission faces challenges as many of the details on how the vast **OTC market will be transformed** into a simpler, more streamlined one remain to be worked out. The CFTC will be responsible for hammering out rules, with as many as 50 needed within a year.

Among key questions are how it will define which swaps will or will not be cleared, and what would count as a suitable trading venue.

The CFTC's enforcement staff have struggled to keep up with fraud cases, and antiquated technology has left it reliant on exchanges and clearing houses to examine traders, Mr Gensler has said.

He has requested more funding and more people to tackle the derivatives mandate, but CFTC insiders say a Congressional election year leaves adequate funding up in the air. Hiring is also difficult, with Wall Street and big investors also chasing derivatives experts as they strive to comply with rules.

"It does not have the human capital or other resources necessary to regulate OTC derivatives properly, especially the more complex instruments," said Craig Pirrong, a University of Houston finance professor who researches derivatives. "Moreover, there are always growing pains when dramatically increasing the scale and scope of an organisation, especially a bureaucratic one. This is an accident waiting to happen".

Inside the CFTC, there are questions whether regulating derivatives will succeed in heading off another crisis, as derivatives were only one facet of the collapsing housing bubble that dragged down banks exposed through purchases of mortgage-backed debts.

"I think we can safely say we will be bringing OTC derivatives under a regulatory microscope. Whether or not the last crisis was caused specifically by OTC derivatives is questionable," Jill Sommers, a CFTC commissioner, told the FT.

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