June 28, 2017

Dear Senator,

On behalf of Americans for Financial Reform, we are writing to urge you to oppose the nomination of Christopher Giancarlo to chair the Commodity Futures Trading Commission.[1] Mr. Giancarlo has been a consistent opponent of stronger oversight of financial and commodity derivatives. The 2008 financial crisis made clear that such oversight is vital to both financial stability and competitive markets. As CFTC chair, Mr. Giancarlo would be the single most powerful regulator of U.S. derivatives markets. Congress should not confirm him in the position.

Mr. Giancarlo is a prominent critic of what he calls "the political narrative that the financial crisis was primarily about deregulated banks engaged in excessive trading leverage".[2] Yet the new responsibilities of the CFTC as the primary regulator of financial derivatives markets crucially involve the regulation of big bank derivatives dealers, including the control of risky and excessive leverage at such dealers. Confirming a CFTC chair who does not recognize the importance of this critical responsibility is a risk that we should not take.

Derivatives were at the heart of the 2008 financial crisis, in multiple ways. The insurance company AIG received the largest taxpayer bailout in U.S. history due to massive losses from its bets on some $400 billion in credit derivatives. The most toxic of so-called "toxic assets", synthetic subprime CDOs, were almost entirely made up of derivatives. This multi hundred billion dollar market lost over two thirds of its value.[3] Just as significant as these subprime derivatives losses were the paper losses on a broad range of derivatives held by major dealer banks. Credit exposure in derivatives markets increased by over $1 trillion in just six months from June to December 2008.[4] This sudden and unexpected growth in potential derivatives losses contributed significantly to the collapse of the global financial system.

Derivatives remain a key systemic risk concern. The top five U.S. derivatives dealers – all entities that could be considered "too big to fail" -- hold almost $200 trillion in notional derivatives contracts, about 90 percent of all derivatives held by financial holding companies in the U.S. They have far less than one-tenth of one percent of this amount in hard capital to absorb

[1] Americans for Financial Reform is an unprecedented coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.
[2] Giancarlo, Christopher, "Guest Lecture, Fidelity Guest Lecture Series on International Finance", December 1, 2015. Available at http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-11
[3] Cordell, Larry and Huang, Yilin and Williams, Meredith, Collateral Damage: Sizing and Assessing the Subprime CDO Crisis (August 1, 2011). FRB of Philadelphia Working Paper No. 11-30. Available at SSRN: https://ssrn.com/abstract=1907299
[4] Bank of International Settlements, Derivatives Statistics, Available at http://www.bis.org/statistics/derstats.htm

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potential derivatives losses. Experiences such as the London Whale incident in 2012, in which JP Morgan lost $6 billion on a single set of poorly managed derivatives trades, show the continuing potential for instability related to this market.

The Dodd-Frank Act mandated a range of common-sense reforms to derivatives markets. These include requirements that, where possible, derivatives should be exchange traded in transparent markets and that dealers hold adequate capital and margin to absorb potential losses on derivatives positions. Other elements included risk controls such as mandatory clearing and the proper oversight of cross-border derivatives transactions. In his position as CFTC Commissioner, Mr. Giancarlo has consistently opposed a wide range of these reforms, and has also opposed other key reforms such as position limits for commodity derivatives and stronger oversight of high-speed automated trading.

His opposition to mandates for the transparent exchange trading of derivatives has been especially notable. These transparency reforms are central to the Dodd-Frank Act and were enacted for multiple purposes, including improving the transparency of derivatives markets, attacking anti-competitive practices by the small oligopoly of big bank derivatives dealers at the center of the market, and lowering the dependence of the derivatives market on these "too big to fail" entities. Research has shown that even the initial and incomplete implementation of these transparency reforms has led to significant end user savings.[5]

Mr, Giancarlo has attacked these transparency reforms as misguided and running counter to the "natural" structure of the swaps market, recommending that any prescriptive trading rules be radically trimmed back in favor of an emphasis on ethics training for derivatives brokers.[6] This is despite evidence that the evolution of the swaps market has been far from natural and instead has been heavily shaped by the monopoly power of the largest Wall Street banks. Large derivatives dealers have recently paid out billions in settlements over these anti-competitive practices.[7]

Mr. Giancarlo has also consistently attacked increased limits on excessive leverage for the largest derivatives dealers, stating that these reforms "prioritize bank capital reserves over investment capital, balance sheet surplus over market-making and bank solvency over economic growth and opportunity".[8] This criticism makes little sense. Bank capital is not a "reserve" but is itself investment capital that ensures that banks can take risks without resorting to taxpayer

[5] Benos, Evangelos, Richard Payne, and Michalis Vasios, "Centralized Trading Transparency and Interest Rate Swap Market Liquidity: Evidence from the Dodd-Frank Act", Bank of England Staff Working Paper Number 580, January 15, 2016. Available at "http://www.bankofengland.co.uk/research/Pages/workingpapers/2016/swp580.aspx
[6] Giancarlo, Christopher, "White Paper: Pro-Reform Reconsideration of The CFTC Swaps Trading Rules", January 29, 2015. Available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf
[7] *In Re Credit Default Swaps Antitrust Litigation*, U.S. District Court SDNY (Oct. 16, 2015)
[8] Giancarlo, Christopher, "Changing Swaps Trading Liquidity, Market Fragmentation, and Regulatory Comity: Remarks Before the International Swaps and Derviatives Association 32nd Annual Meeting", May 10, 2017. Available at http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-22

bailouts in case of losses. Over ten trillion in economic damages suffered during the 2008 financial crisis demonstrates the short-sightedness of permitting the banking sector to become insolvent in the name of economic growth. Mr. Giancarlo's recent statement that today's better capitalized financial markets are "less supportive of economic growth" than pre-crisis markets also indicates that he has not fully appreciated the lessons of that crisis.[9]

These are hardly the only critical reforms that Mr. Giancarlo has opposed. He has been a prominent opponent of efforts to ensure that U.S. derivatives reforms apply to cross-border derivatives transactions involving dealers active in U.S. markets.[10] This is a critical protection given the ease with which major Wall Street banks can route their transactions through foreign subsidiaries, which typically handle over half of derivatives transactions of major Wall Street banks.[11] Such foreign subsidiary transactions were central to the failure of AIG and Bear Stearns during the financial crisis.

He has also opposed position limits to address price-distorting speculation in commodity derivatives markets central to the valuation of critical consumer products ranging from gasoline to bread.[12] In his role as sponsor of the Energy and Environmental Markets Advisory Committee, he undermined the Advisory Committee's statutory independence by colluding with industry consultants to direct the content and scope of a report recommending the evisceration of limits on speculative positions in oil and gas markets.[13]

Despite his stated belief in the importance of the oversight of high speed automated trading, Mr. Giancarlo has also opposed crucial elements of new rules designed to limit the risks such trading poses to the market. In particular, he has intensely criticized measures to ensure that government has access to the computer programs used in high-speed trading when necessary to prevent or investigate market disruptions.[14]

The nation needs a leader at the CFTC who recognizes the critical importance of strong oversight of financial and commodity derivatives markets. Mr. Giancarlo's record indicates he will not be such a leader. We urge you to vote against his confirmation.

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[9] Giancarlo, Christopher, "Transforming the CFTC: Remarks Before the 11th Annual Capital Markets Summit, U.S. Chamber of Commerce", March 30, 2017.
[10] See references above; also Giancarlo, Christopher, "Statement of Dissent on the Cross-Border Application of Margin Requirements", May 24, 2016.
[11] Brush, Silla, "Goldman Sachs Among Banks Fighting to Exempt Half of Swaps Books", Bloomberg News, January 30, 2012.
[12] Hill, Richard, "Trading, Position Limit Rules Could Be In Jeopardy Under Giancarlo", Bloomberg BNA, January 6, 2017. Available at https://www.bna.com/trading-position-limit-n73014449418/
[13] Letter from Elizabeth Warren to the Honorable J. Christopher Giancarlo, February 26, 2015. Available at https://www.warren.senate.gov/files/documents/2016-02-25_Letter_to_CFTC.pdf
[14] Giancarlo, Christopher, "Statement of Dissent Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading", November 4, 2016. Available at http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110416