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Regulator Warns Against Regulation

CFTC's Giancarlo plans to describe his federal colleagues' 'unmitigated failure' in a Tuesday speech.

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Could Washington's reaction to the financial crisis end up doing more harm than the crisis itself? Commissioner Christopher Giancarlo of the U.S. Commodity Futures Trading Commission will assail the work of his federal colleagues in a Tuesday speech entitled, "The New Mediocre Is Not Good Enough." Mr. Giancarlo plans to finger financial regulations, including those enacted by his CFTC colleagues, for contributing to sluggish U.S. economic growth and job creation. And he will say that such regulation, sold as a way to reduce systemic risk, is in fact increasing the risks in U.S. capital markets.

"Regulators often claim they are acting to avoid a repeat of the last crisis. Today, they may be laying the seeds of the next crisis," says Mr. Giancarlo in remarks prepared for delivery today at the libertarian Cato Institute in Washington. He will note that while the government-created problems in the mortgage market that triggered the 2008 crisis have been largely ignored, new regulation of derivatives has reduced liquidity in U.S. markets, making these markets more volatile and less able to absorb financial shocks in the future.

Mr. Giancarlo is a Republican and former business executive on the commission. But as a supporter of the Dodd-Frank law's provisions governing derivatives, his criticisms are not so easily dismissed. Also, his message echoes a recent report from the Financial Stability Oversight Council (FSOC), which admitted that a number of rising marketplace risks are in fact the result of regulations intended to reduce them.

Speaking of the council, which includes a representative of his own agency, Mr. Giancarlo plans to say that it "has been an unmitigated failure as a coordinator of regulatory reform. Rather than moderate the impact of liquidity draining regulations, FSOC has spent its time designating Wall Street banks and insurance companies as 'too big to fail' so that someday they can be bailed out by taxpayers and regulated by" the Federal Reserve.

In his prepared remarks Mr. Giancarlo adds, "One thing is certain: when a liquidity crisis hits, FSOC will be the first to point fingers, blame financial markets, banks and large market participants and demand more control over them. FSOC may even use its new powers and taxpayer money to bail out more U.S. and foreign financial institutions."

Mr. Giancarlo may begin to change the Beltway debate about financial regulation—and not just by focusing on the risks created by regulation itself. While he favors many Dodd-Frank changes that we do not, such as pushing more derivatives contracts into central counterparties, Mr. Giancarlo is also the rare Washington regulator who will acknowledge and can articulate the economic value that derivatives provide. "We all take for granted an abundance of food on the shelves week after week, year after year," he intends to say this morning. He will describe how, unlike in the developing world where one bad harvest can bankrupt farmers and prevent them from planting the next year, hedging instruments like futures and swaps allow U.S. producers to lay off the risks of such disasters and reliably provide food to consumers at relatively stable prices. "In short, derivatives serve the needs of society to help moderate price, supply and other commercial risks" and "free up capital for other purposes and boost economic growth, job creation and prosperity."

But Mr. Giancarlo sees U.S. prosperity threatened by "flawed and ad hoc implementation of regulatory reform" that "is increasing the systemic risk that the Dodd Frank Act promised to reduce."

As the authors of that law promised, regulators are warning us about rising financial risks—and lately those risks all seem to be created in Washington.