Innovation, Regulation and de minimis

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4 min read · Oct 28, 2017

"As students of financial markets are aware, much of the phenomenal growth in financial innovation over the last two decades has occurred in the derivatives arena. Paralleling this success has been an equally impressive amount of regulatory attention. While some of this attention has focused on economic issues such as financial and market integrity and concerns over customer protection, we suspect that much of the interest stems from bureaucratic incentives and simple anti-competitive behavior mixed with a misunderstanding of derivatives.

For example, rather than seeing an honest debate over the appropriate regulation for these markets, we observe instead government agencies attempting to expand their jurisdiction by trying to expropriate other agencies turf. Exchanges, and established firms call for "level playing fields", which can be a euphemism for banning, regulating, or otherwise imposing costs on the innovator before the potential customer becomes too successful." — Wendy L. Gramm (former chairman of the CFTC), Journal of Derivatives, Spring 1994

History has proven its hard to underestimate regulatory support for innovation.

The recent decision by the CFTC to delay the reduction in the *de minimis* threshold for swap dealers gives markets hope that this might be the commission that moves toward a more 'principled' regulatory environment. [1]

Why have a *de minimis* threshold?

By providing registration relief to companies with activity not exceeding a certain gross notional, the *de minimis* rule intends to differentiate those companies that may pose a systematic risk to US markets. In recognizing that regulations and registrations can be burdensome, why limit the scope of *de minimis* exemptions to just swap dealers? With many other registration classifications beneath federal regulators, the potential benefits of a *de minimis* exemption need to be examined in each case. The diminutive stature of innovators and start-ups surely does not pose the same systematic risks as the implicitly institutionalized organizations that control the lions share of industrial power.

The financial landscape is changing. The CFTC recognizes this. As the thousands of institutions and governments touting the pervasive shift forthcoming by blockchain, the cloud and 'Fintech' identify; technology is compelling organizations to truly identify their value add. The days of intermediaries for sake of custom is coming to an end.

The true revolution though is not in new techniques for old institutions, but rather in the question of whether we need to have institutions at all. Decentralized networks have already automated clearing, are building volume on automated, decentralized exchanges and with the help of the Decentralized Derivatives Association, will have custom financial products that have no middle man, custodian or point of failure. These products and programs are developed on the principle of zero trust between counterparties and zero ability of any intermediary to interfere with the contract. The old perils of broken promises, contractual disputes and unfunded liabilities do not appertain to this new system.

A truly principled approach to regulation would create a risk based regulatory framework and registration requirements that coincide. By forcing companies such as Ledger X to go through a gargantuan regulatory approval process to list a product with zero systematic or counterparty risk has not only hindered US innovation but has also pushed countless companies overseas. Risks can be calculated. Minimum net capital requirements, compliance mandates, membership fees and registration requirements in general should not be calculated on the no longer applicable registration classification, but rather on the systematic and individual risks stemming from the innovation or product.

As Mrs. Gramm stated in an unfortunately timeless fashion, incumbent institutions will seek to use the CFTC as a regulatory guardian angel to further solidify the rigidity of the current system. By touting these firms or technologies as too risky, small or unproven for regulatory approval, but yet classifying their overarching product line under CFTC purview, the fledging companies are forced to cede all but the clandestine markets to the registered class.

Fortunately, there is hope. With recent statements by Chairman Giancarlo, the efforts of my former colleagues through LabCFTC and the efforts of regulatory sandboxes and innovator hubs worldwide, now may be the time that regulators recognize that the benefits from these new technologies outweigh any potential benefit to protecting the familiar of the status quo. US regulators and the innovator community should continue to talk about the *de minimis* threshold and should not limit the potential of this conversation.

The Decentralized Derivatives Association (DDA) is creating fundamentally new products for the financial ecosystem. Using decentralized platforms such as Ethereum, DDA seeks to provide the same reliability and functionality as the traditional system but with full collateralization, complete privacy and no intermediaries. Decentralized risk transfer is coming and DDA feels confident that the CFTC will use this opportunity to create a truly transparent, risk averse and common-sense model for financial derivatives.

[1] http://www.cftc.gov/PressRoom/PressReleases/pr7632-17

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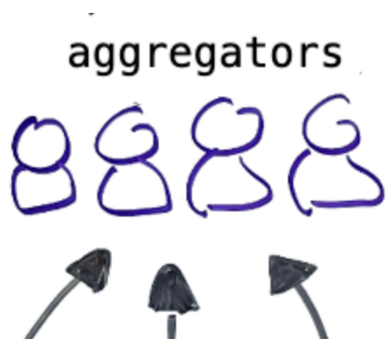

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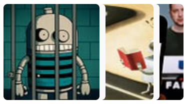

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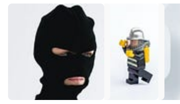

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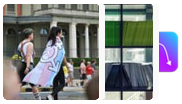

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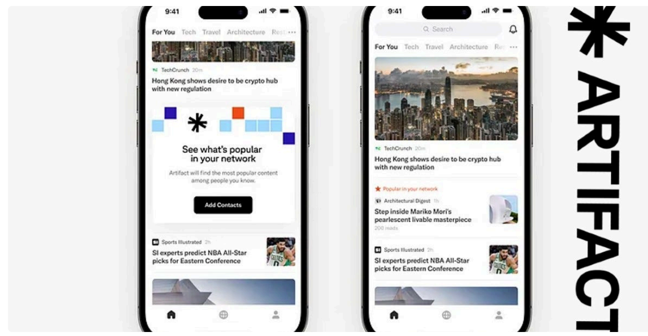

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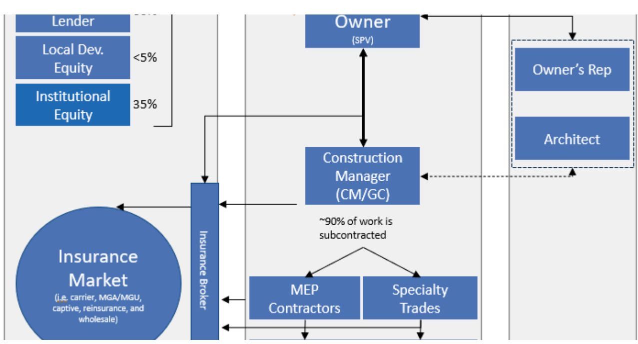

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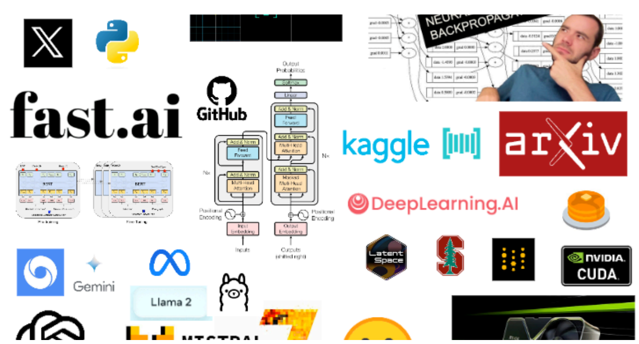

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