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Former SEC Chair Jay Clayton and Former CFTC Chair Chris Giancarlo Talk Effective Regulation at GMM

The pandemic-related market turmoil of March 2020 and the responses to it among financial markets and regulators will undoubtedly weigh heavily on regulators as they make adjustments over the coming years. At ICI's 2021 General Membership Meeting, ICI President and CEO Eric J. Pan sat down with former Securities and Exchange Commission (SEC) chair Jay Clayton and former Commodity Futures Trading Commission (CFTC) chair J. Christopher Giancarlo for a wide-ranging discussion about the progress the two made in reforming their agencies and the potential for unintended consequences from short-sighted regulatory changes.

Breaking Down Washington's Silo Mentality

Clayton said it was a pleasant surprise to find that the group of federal financial regulators with whom he worked during his tenure were able to cooperate effectively and function at a high level. "We came out of the business sector—we had an expectation that government agencies should work together, so we didn't have any patience for that silo mentality," Giancarlo explained.

The ability to break those walls down and cooperate smoothly became critical in March and April 2020, when the team found themselves working together on an emergency basis to deal with the economic shutdown and what it meant for the financial markets.

Some of that capability came from an intentional effort to open lines of communication across agencies in ways that had never existed previously. Giancarlo recalled getting to the CFTC and being surprised at a lack of market intelligence data available to the enforcement branch. In response, one of his first actions was to create this capability at the CFTC so that he and his team could get a better understanding of daily, weekly, and monthly market dynamics.

When Clayton heard about the effort, he took the idea further, creating a regular call among all the federal regulators to review market conditions more broadly.

The Lessons of 2020

Clayton credited that familiarity and collegiality across regulators for the government's ability to respond to the pandemic-related economic crisis in March 2020. At the same time, however, both he and Giancarlo saw disconnects in the way regulators have historically thought about markets.

“Dodd-Frank was meant to reduce risk in the system, but risk is a funny thing,” said Giancarlo. “You can’t actually extinguish it—what you can do is move it around.” Following the 2008–2009 financial crisis, that meant requiring financial institutions to put more capital on their balance sheets. That solved for solvency risk, but it created a risk to market liquidity that was realized as the Treasury market came under stress.

To Clayton, the lesson regulators need to take out of this situation is that liquidity risk and capital risk are connected. “Money market funds backed by Treasuries are different from money market funds backed by commercial paper, are different from money market funds backed by municipal securities,” he said. “I think that we’ve now understood that, and we need to take a much more nuanced review of just, for example, money market funds.”

The Role of Regulators

Both former chairmen agreed that effective regulatory action must account in part for the increasing presence of retail investors in financial markets. “The more people who have a more comfortable financial retirement, the more capital flowing into the system on a regular basis, all of those things contribute to the engine of growth,” said Clayton. On the other hand, regulators do need to focus on educating retail investors about the risks of short-term trading in speculative instruments.

Clayton pointed to capital formation outside public equity markets as another area of concern. Removing impediments to capital formation in public equity markets should be a priority because it offers a broader opportunity for participation than private equity or venture capital markets.

Giancarlo also pointed out the dangers of overemphasizing risk protection, rather than focusing on measures related to disclosure and suitability. “Risk is inherent to a market-based economy and if we try to de-risk the market-based economy, you won’t have economic growth,” he said.