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CFTC-SEC Merger Proposal May Have Hidden Costs

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The Commodity Futures Trading Commission (CFTC) is the federal regulatory agency for the futures and options markets, and the Securities Exchange Commission (SEC) is the federal regulatory agency for the securities markets. The markets they regulate serve different economic purposes, and the agencies have different regulatory missions and philosophies, receive oversight from different Congressional committees, and in most other respects have very little in common. Nevertheless, periodically there is a proposal to merge these two agencies, usually as a way to achieve "synergies," "efficiencies" or various other promised benefits.

The Treasury Department highlighted the differences between these two agencies in its 2008 "Blueprint for a Modernized Financial Regulatory Structure." It recommended a CFTC-SEC merger, but only as an intermediate-term goal, and said that for such a merger to be successful the SEC should abandon its rules-based regulatory approach and adopt the CFTC's principles-based approach. Congress also considered combining the CFTC and SEC as part of the Dodd-Frank Wall Street Reform & Consumer Protection Act. However, the final version of Dodd-Frank stopped well short of merging these two agencies, and instead mandated joint rulemaking and formal consultation such as swaps where both the CFTC and SEC share jurisdiction.

The latest call for a CFTC-SEC merger came from the House Subcommittee on Oversight & Investigations, in a staff report on MF Global dated November 15, 2012. This report cites several occasions during the final days of MF Global where the CFTC and SEC failed to coordinate efforts and share certain information. While better coordination would not have prevented MF Global's collapse, the report hypothesizes that a closer working relationship "might have" better protected the company's customers and investors. Based on this possibility, the Subcommittee recommends that Congress explore whether customers and investors would be better served if the SEC and CFTC were combined into a single regulatory agency.

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This was followed on November 21 by the Markets and Trading Reorganization Act, a bill introduced by Rep. Barney Frank of Dodd-Frank fame. This bill calls for the creation of a Securities and Derivatives Commission that it claims would “strengthen investor confidence in United States financial markets” and “ensure the efficiency and competitiveness of those markets.” Much of the language in this bill deals with mundane details such as the number, qualifications and terms of the commissioners, the transfer of existing employees to this new agency, and other administrative matters.

However, buried in this bill is language that would eliminate the current Congressional appropriations process for funding futures and options regulation, and replace it with a fee charged on each transaction. This fee would be set at a level “sufficient to cover the costs of the regulatory activities of the Commission related to such instruments for each fiscal year.” If, based on the fees collected during the first 5 months of the fiscal year, it appears that there will be a surplus or shortfall of 10% or more for the year – for example, if trading volume is running higher or lower than expected levels – there would be a mid-year adjustment in the fee.

Readers will recall from an earlier *farmdoc Daily* post [here](#) that a so-called user fee was contained in the Administration’s proposed budget for fiscal year 2013. Details were sketchy regarding the amount of this fee, but dividing the CFTC’s requested budget by total US futures and options trading volume for 2011 resulted in an estimated fee of 8.65 cents per round-turn. Although the proposed budget was never adopted, the transaction tax feature survives in this new legislation.

One concern is that the method for setting this fee would eliminate Congressional oversight of CFTC spending. Currently, the appropriations process forces the CFTC to justify its spending plans each year. In its place would be an open-ended funding mechanism in which the new Securities and Derivatives Commission would simply state how much funding it needs to regulate futures and options, and the annual fee would be set at that level.

Readers are reminded that all previous attempts at imposing a fee on futures and options trades have failed, as have all previous attempts at merging the CFTC and SEC into a single agency. However, the federal government has never faced so much pressure to find new sources of tax revenue, nor have the financial markets been in such disfavor with the general public. In an environment like this, anything is possible.