

Stimulus and Equities, Working in Government, Detecting Bullshit
What Happens Next – 8.8.2021
Bruce Tuckman QA

Larry Bernstein:

I wasn't planning to talk about this, I wrote a public letter to the CFTC about a rule change. Here was the background, the CME wanted to change the definition of an existing Eurodollar futures contract.. Previously the CME defined LIBOR, which is this a London interbank offering short-term interest rate. And The CME asked 40 banks to set the rate and the CME was going to replace it with the BBA rate, which was the British Bankers Association's LIBOR rate which was an average of 16 banks, after dropping the four highs and lows and leaving it with just eight banks. I wrote a letter with Marcy Engel, the general counsel at Salomon, to the CFTC saying that you can't change an existing contract. And that the rule change was opening up a possibility for abuse and cheating for the LIBOR set rate.

And I wrote that letter with Marcy in 1996. And then sure enough, there was a LIBOR scandal that was caused by cheating in 2008. But when I sent that letter to the CFTC, asking them to look into the matter and put in the public discussion, there was an expectation from my work colleagues that very little would be done. And in fact, nothing was done even though eventually I happened to have been right on that issue. How do you think of that process working? Why do you think that if people write letters to an independent agency who are in industry, who actually know a little bit about what's going on, why isn't that stuff taken seriously? Why should we think that is an effective check on the agency's discretion?

Bruce Tuckman:

From my experience, Larry, there were some crank letters, but putting that aside, all letters that come in are read. In other words, a proposal goes out, there's a certain notice and comment period that passes, then letters come in and the people who are in charge of that rule-making do read all of the letters and they send out a memo that describes what categorizing letters and what they say and what the arguments are, and then address those in the final rule-making. A lot of people joke, and this is also something I didn't understand before I was there, a lot of people about big rule-makings on that there's several hundred pages, all of these rule-makings. But the truth is the rule itself is actually quite small. The rule might be 30 pages, and then it might be 200 pages of discussion, which includes things like the summary of the comments and responses, if any.

It's not that they're going to necessarily listen to you or give weight to what you say, but they will have read it. And if they think it's material, they will address it. And that's all you could ask for to be heard. It's not that you can... Now, of course, there's also this notice and comment period includes groups of people, whether it's banks who are affected, whether it's public interest groups who are affected, their various consumer groups will come in. After a proposal has been made and the notice period is finished, people can come in and face the people who

are doing the proposals and talk about them. And it's not that hard to get an appointment. One thing my first week or two people said, "We're the government, our job is to listen. We're supposed to listen to when people come with comments." My experience is that process happened. Even as an individual, if you want a meeting with the people who are writing the rules to make your points, I believe that will be scheduled. Whether you get your way or not, is a completely different question.

Robin Greenwood:

Bruce, Robin here asking a question. I would love to get your take on how effective cost benefit analysis is with respect to rule-making. I've often found that, especially in financial matters, it's not about... We're not asking a factory to make an investment to curb pollution. But in financial matters, just as an example, suppose you were to ask a bank to increase its capital overall capital ratio. It seems like the costs and benefits seem very difficult to measure. And I was just wondering in your experience, how effective and on-point you found the cost benefit analysis.

Bruce Tuckman:

Excellent. That goes to the heart of the matter. The answers are that in some places we have data in some places we don't. One of the difficulties with Dodd-Frank rulemaking is you're moving from one set of managing the derivatives markets to another. And how are you going to do any analysis on that when there's no data? But as the years have gone by, more and more data are available to the CFTC. For example, when the first Dodd-Frank rules were passed, there was no data at all about swaps trading. Swaps hadn't been reporting. But then in, I think it's 2014, data started to be collected. When you had the next round of rulemakings in 2018 or 2019, there was a lot of data around to say, "Hey, this is who's trading what and this is at what prices. This is how the markets have reacted to this."

Bruce Tuckman:

There was a lot to say. It really does depend on the situation, but I think it's still... I think it's still a good discipline to go through and try to do with whatever data you can. Let's take another example, like position limits has been around for a long time, but we have a lot of data on that. It's a very tricky rule-making in a lot of ways, but we do have data. Robin, I think the answer is there are some places we have a lot of data at some places we don't, especially conceptually when we're changing the way things are done dramatically, it's hard to do it. But I'll also give one other kind of data that's available. Let's say like a capital, which I think you mentioned, we can at least try to figure out how the rule will affect people. How much extra capital would be in that example? Or we tell people have to behave in this way, how many people will be affected by that rule? One of the larger contributions I made actually when I was sitting in that seat was that these new margin rules were coming into place. Dodd-Frank requires that you either clear, or you have to post margin on uncleared trade. And there were a few rounds of companies, large companies, starting to post margin on their unclear trades. And then there was going to be a time when a lot of smaller entities needed to do it. And the industry was kind of going crazy. They said there were just too many entities that need to do this at the same time. There are only a few people to work out the documents, only a few people to be collateral services, et

cetera. And we had the data to go through and see exactly how many it was and what options were available to the agency. If you, do it this way, you can make the effect more gradual. So again, Robin, you're exactly right. But I would say that there is a whole spectrum of things that we can say and things that we cannot say, but I personally thought that discipline was useful to have in place.

Larry Bernstein:

Bruce, how do you motivate the bureaucracy to achieve the political party's goals. I just imagined that there's these lifetime workers and then there's workers like you who are there for a couple of years to get some stuff done, but they know they're going to outlast you by decades. How do you successfully motivate them to achieve your objectives?

Bruce Tuckman:

So let me just make the question a little harder before I try to answer it. I'll make it a little harder by saying I had never really worked with the civil servant protections and also in a union shop, which the CFTC became actually during the early stages of Dodd-Frank rule-making. So that's another thing that you have to get used to, and I would say I really do think people say, "Oh, it's so much easier in the private sector because the private sector, it's only money. And if you pay people money, they'll go do things." But I've found in my experience, it's not actually true. People are motivated by a lot of things. Of course, money is important in the private sector, but there are other things. In the agency, just for example, giving people time in front of the commissioners when they have something to say, of course, letting people present at public meetings.

Bruce Tuckman:

There are a lot of things that people want to do and feel like they're contributing to what the commission is doing and what government service is supposed to be like. There are the ways to motivate people aside from what we in the private sector immediately think. I also think that there... It's not universal as I think I hinted at, but it's a little different feeling working in government for a chair then is working for your boss in private industry. But you worked for your boss in private industry and the idea is, "Oh, that person's there now, but who knows, maybe there'll be knocked off. Maybe they'll be knocked off soon. Maybe they'll have an unsuccessful time. Maybe something will happen." And their authority is kind of dependent on what you think their prospects are and how they'll help you. And it's different in the public sector because the chair and the other commissioners were appointed by the Senate. And that gives them a power and authority that's quite strong. And I think most people who are in government feel that keenly and are not nilly willy willing to replace their judgment with the judgment of a Senate confirmed appointee and chair. The only last thing I'll say is, I think it's hard to say, but it's just the general management thing, which is you've got some people who are willing to work and you've got to figure out the way to motivate them. And some people are not willing to work. And you have to decide as a manager how are you going to deal with that. I don't know that's so much different in the public and private sectors. And again, I don't have

any private sector experience in a union shop or, again, with civil servants where firing is so much more difficult.

Larry Bernstein:

George Stigler won the Nobel prize in economics, and one of his major ideas was that government agencies could be co-opted by industry even though these agencies were meant to regulate industry, it turns out that industry is very good at co-opting these agencies to work on behalf of them to create monopolies and benefits to existing firms. How do you think about Stigler's work after your time in an independent agency?

Bruce Tuckman:

That's a great point too. And I have thought about that a lot. The people in the agency do very well to follow markets and what's going on compared to most people in the universe. They know what's going on in markets. There are specialists. If you want to know about what's going on in cattle, if someone will sit down and talk to you for three hours about what's happening in cattle markets. There's a lot of knowledge in the industry, but that's not exactly the same kind of knowledge of someone who was sitting in trading all day. It's different, right? I mean that people think government will have a better idea of institutional structure in which you worked, but the trader will know more about markets, et cetera. the problem is that you're making rules about this industry, but the people who know the most about it is the people in the industry. If you want to do your job well in that seat in the government, you have to go and you have to ask the industry questions and ask what's going on. And you have to take everything appropriately, listen to what they say, but realize where people are coming from and what their self-interest is. I will say also there are a number of entities that are designed to represent consumers or people not in the industry, also all these end-user groups, et cetera, but it is true that I think the people you're talking about "capturing the agency," those people are kind of better funded. They've got more people. They've got full-time people coming in to talk to the agency all the time.

Larry Bernstein:

They really know the implications of these rules?

Bruce Tuckman:

Right. To me, the real tension is how do you navigate really wanting to understand what's going in the market and not over-weighting the opinion that follow from those facts, from the people who are coming in. The chairman who appointed me, Chris John Carlo, I really admired him in a lot of ways. And he went around saying that he is market friendly not industry friendly. I think is something that was something that you have to aspire to. But again, the knowledge thing is just tricky and you have to work to navigate that. But I will say just, maybe just to finish up, I did not feel that the people in the agency were bullied. They stood their ground when they believe something. When people came in, they asked questions, they wanted to learn, but I think they on the whole they held the line where they thought it was important to do so.

Larry Bernstein:

You opened your talk by talking about discretion and power and that these rules are very vague and the people in the agency could sort of do what they wanted or follow what they thought was right. And there were all sorts of checks on those power, but at the end of the day, it's really about discretion. How should we think about vague rules and discretion when the power is so great in the hands of so few?

Bruce Tuckman:

These are all great questions, Larry. Why don't I just give one example that we can talk about it in the context. Dodd-Frank says that swaps have to be traded on swap execution facilities, some sort of exchange. The statute says the trading has to be done by multiple participants by any means of interstate commerce. That's what the statute says. The early years of Dodd-Frank rule-making, the CFTC interpreted that to mean that these SAFs, these swaps execution facilities, have to set up a central limit order book, or they have to have a request for quote from three dealers.

Or they have to have a request for quotes from three dealers. I'm not going to get into what those things are, but those are very, very specific kinds of trading mechanisms. The question is, well where does that come from? The statute said any means of interstate commerce and you have those things. And that is the CFTC rule now, by the way, and I don't think that's being challenged anymore. But that's an example of a few things, right? It's an example of Congress deciding not to get into the weeds and not make that tough call about what it meant. So general things they want to do about swap facilities, but they didn't go into the weeds of the statute. So how far should they go? A lot of people, and I don't know if I know enough to really have a strong opinion myself about this, but a lot of people think that Congress sends way too much to the agencies without being specific enough laws. So, the fault is not the agencies. They get this broad thing, and they need to do something they do that they feel is in the spirit of the statute. But it's sort of Congress's issue that they haven't been much more specific about things.

Larry Bernstein:

I want to ask a question now about this Chevron decision. There was a Supreme Court case, I think Scalia wrote the majority opinion in Chevron, but the idea was that Congress can delegate to the bureaucracy to do rulemaking. It almost appears to be almost lawmaking. And then there's been significant pushback in the courts against Chevron, to your point, pushing rulemaking back to Congress and getting discretion and rulemaking away from the agencies. And I think Kavanaugh and Gorsuch are the leaders on the Supreme court in this opposition to Chevron from a constitutional perspective. What were the thoughts inside the agencies about Chevron coming under attack?

Bruce Tuckman:

I'm not a lawyer. I can't be too specific about Chevron. I think about Chevron as, how much you will defer to the agency's decision about interpreting statutes? How far can they go in some sense and still be judged to say, hey, you're following Congress's will? And the only thing I would say is I think the agency is very sensitive. They don't want their rules overturned in court. And that has happened. It's happened to both the SEC and the CFTC on certain matters.

And that's why they have the army of APA lawyers, because they don't want that to happen. That means that there's always an APA person on a rulemaking to say, "Hey, we have to address these comments. We have to address Larry's comment on this and this, or we're going to be in trouble in the courts." Or "We have to establish this fact. It's not enough to go say it. The analysis has got to be stronger here and there." The agency is very sensitive about that. So what Chevron is doing is it's kind of changing a little bit the work that needs to be done to get the proposals to pass muster should they be challenged. But I don't remember anything particular about people viewing how that line is going to shift. Take the CDC's eviction rule, extending the no eviction period. And the thing that I found striking about that episode given my experience is that the CFTC, was just how incredibly concerned about being overturned, whereas this CDC eviction was very different. This was saying, yeah, it will be overturned, but we can push off the date in a way that will benefit the public interest. So that's a very different kind of calculation. It's not the point of this call to decide if that's right or wrong, but that's very different from saying, "Hey, we can only do things that are going to survive a challenge in court because that's the extent of our power."

Larry Bernstein:

Well, when you distinguish that, in this example, it went all the way to the president, and the president decided to act on this sort of thing. The agency itself wasn't on the line so much as it joined an executive political decision.

Bruce Tuckman:

I don't think I agree with that, Larry. I mean, again, in the CFTC, the president can't order the CFTC to do something, that's not the way the system works. And I try to give the feel of all the processes we have, and the agency has to put together a rule by rule. There are rules in making rules, and those have to be followed. And if the president comes to agencies to say, "Hey, you've got to do something." Say, "Well, no. We got to follow these APA rules." There's no exception to the APA rules from a direct mandate from the president. I'm not a lawyer, but that's the way I see it.