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The Digital Fin-Tech Revolution Continues

Dickson Chin, Tim Nagle, & Phil Lookadoo

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Panel Participants

Timothy J. Nagle, Senior Vice President | Associate General Counsel | Data Privacy and Governance
Chief Privacy Officer
U.S. Bancorp Center
800 Nicollet Mall, BC-MN-H21N
Minneapolis, MN 55402-7020
612.303.4895 (direct) 612.508.7723 (mobile)
Email: timothy.nagle@usbank.com

Dickson C. Chin, Partner
JONES DAY® - One Firm Worldwide℠
250 Vesey Street
New York, NY 10281-1047
Office: +1.212.326.7893
Mobile: +1.917.833.9840
Email: dchin@jonesday.com

Phil Lookadoo, Partner
Haynes and Boone, LLP
800 17th Street, NW
Suite 500
Washington, DC 20006
Direct: 202-654-4510
Mobile: 571-235-1321
Email: phil.lookadoo@haynesboone.com

The Digital Fin-Tech Revolution Continues

- *In September 2018, gas and power companies, their customers, their suppliers, their lenders and their regulators, all participate (compete?) in a financial business environment that finds most of us simply trying to keep up with the pace of a continuing digital fin-tech revolution.*
- *Few among us can say with complete confidence (and candor) that we fully understand the meaning of, let alone the risks of, cyber-security concerns, blockchain applications, smart contracts, virtual currencies, new data privacy standards (e.g., EU's GDPR), high-frequency trading, algorithmic trading, artificial intelligence, smartphone commerce, and communications tools.*
- *Fin-tech architects, speaking at a CFTC public meeting, urged the regulator to collaborate with the architects/program-writers to provide "regulatory nodes" to give the government windows of real-time transparency into smart contracts, blockchains and commodity trading. Said one panelist: "Isn't that like inviting a vampire into your house?" (Once invited-in, a vampire never leaves…)*

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- Capturing the Benefits and Efficiencies
- In a time of rising interest rates, asset valuation bubbles, and shrinking profit margins, ***embracing and harnessing the responsible and sustainable benefits and efficiencies of fin-tech innovation*** could be the difference between a profitable future and bankruptcy.
- As the IMF's Managing Director, Christine Lagarde, tells it: In the 19th century, when Alexander Graham Bell was awarded a patent for the telephone, the only way to communicate rapidly over long distances was by telegraph. The dominant company in that market dismissed Bell's invention as a useless toy and rejected an opportunity to buy the patent.
- Assessing the potential benefits/efficiencies of fin-tech innovation is essential to your future success.

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- <u>Identifying and Remediating Risks</u>
- Failure to ***identify and remediate emerging risks*** of one or multiple fin-tech innovations could be destructive. Assessing the risks is equally required.
- Consider the following: In August 1998, a major U.S. law firm branded itself as the "Y2K Law Firm," hoping to be the legal resource hundreds of businesses turned to for solutions to remedy what was perceived as an enormous risk facing our economy at that time.
- At about that same time, in September 1998, following the Russian government default on its debt in August of 1998, the Federal Reserve Bank of New York (FRB-NY) and U.S. Treasury representatives met with counterparties of Long-Term Capital Management, L.P., and its fund Long-Term Capital Portfolio, L.P. (collectively, "LTCM"), which was then the largest, and most highly leveraged, hedge fund reporting to the CFTC.[1/]
- 1/ See Long-Term Capital Management: A Retrospective-Part I, by Paul L. Lee, in The Banking Law Journal, September 2018, which is the primary source for LTCM information in these slides.

The Digital Fin-Tech Revolution Continues

- <u>Identifying and Remediating Risks (cont.)</u>
- In order to avoid a disorderly close-out of its very large derivatives position by LTCM's counterparties, a consortium of 14 firms agreed on September 23, 1998, to invest $3.65 billion in new equity in the LTCM fund (i.e., a "bail-in" by LTCM's counterparties/creditors with no use of taxpayer funds) in return for a 90% equity stake and operational control. The investment was fully repaid by January 2000 and the LTCM fund was closed.
- This LTCM episode appears to have provided a source of "false confidence" to regulators and the financial industry that the risks presented by the financial crisis at LTCM could be managed and remediated without using taxpayer funds.

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