



Commodity Futures Trading Commission

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Remarks

“Properties of Bamboo”

Remarks of Commissioner Bart Chilton Before the Futures Industry Association of Asia Hong Kong February 27th, 2008

Thank you for the opportunity to be with you today.

We have all become increasingly aware of the global, interconnected nature of our financial markets; as Thomas Friedman put it in his book on the rapid modernization of our world in the last few years, our world is flat—and becoming flatter every nano-second. While I don't agree with all of his conclusions, I agree that markets have migrated with rapidity and seemingly with great ease into the far-flung corners of our world, pulling the edges of our communal tapestry closer together, while at the same time we have been faced with the obvious differences in cultures, in laws and regulations, in customs, in languages. We have many barriers to divide us, but we have many more common desires that unite us.

Certainly, one of those common desires is for open, transparent, and honest markets. Each of our separate jurisdictions has in place methods and systems of protecting customers and markets, and no one is naïve enough to argue that they have found the only correct way of regulation and oversight. These are complex, interdependent markets, and the problems and concerns encountered are just as complicated as the markets themselves.

Regulators need to exchange information, ideas, concepts, and thoughts, about how to address these issues, in order to ensure that our global markets and market participants can benefit from the advances in technology and financial innovation that cross all borders, languages, customs and legal boundaries.

One of the primary reasons for my trip to the Far East was to learn, to listen, to better understand your markets and your way of regulation, and also to share some of the experiences of the U.S. system of regulation with you. In this way, I believe we can continue to harmonize and to cooperate with each other internationally, to reach common goals: protection of investors, promotion of foreign market access, in addition to the advancement of greater coordination and harmonization globally of regulatory rules, procedures and policies. These are the goals that I like to think we should keep foremost in mind in our efforts to foster global communications among regulators.

And we have made some solid successes. Our Commission has actively engaged in international fora, the International Organization of Securities Commissions, for example, on such diverse issues as hedge fund valuation and accounting standards, and we meet regularly with financial market regulators from around the world to address issues of mutual interest and concern.

Just a few weeks ago, we held meetings in Washington with Chairman Shang Fulin of the China Securities Regulatory Commission, and signed an agreement to promote enhanced collaboration and cooperation. During my trip, I have traveled to Tokyo, Singapore and now, of course Hong Kong. I have made it a priority to schedule visits with exchanges, regulators, and members of the media in those countries as well. This has been an excellent opportunity to review the regulatory systems of various countries, and to take a look at how they compare to the U.S. system, as well as to other countries around the world. I have learned a lot, shared much, and built relationships that I hope will continue for years to come. In all respects, this has been an incredibly valuable experience.

One of the things I have learned is that our regulatory structures are diverse. But more importantly, what I've also learned is that we have more things in common than we have differences—particularly from a regulatory standpoint. All regulators share the desire in the derivatives sector to protect price discovery; to guard against fraud, abuse and manipulation; and to ensure that these risk management markets remain viable tools for not only hedger and speculators, but for consumers.

One can not travel in Asia without encountering bamboo. It is an amazing plant. Most Americans don't realize the versatility of bamboo and its many uses. Here in Asia and in other parts of the world, it is used in foods and beverages and medicines; in products and clothing; and in structures—everything from fences and bridges to the scaffolding we see around Hong Kong. Bamboo is strong, yet light and flexible. It has elasticity, resilience and endurance at the same time. And, I like to think that our regulatory structure for derivative in the U.S. is rather like bamboo.

I know, I need to get a life, but the comparison is true.

In 2000, the legislation that authorizes the CFTC was amended. The new law gave us principles-based regulatory authority. This means that we are different from every other agency in the U.S. government and from almost all of those around the world. After spending more than two decades in government, I can tell you that it is a monumental shift in the way the work of government is applied. Gone from our agency are the prescriptive rules and regulations that hinder regulators and citizens alike. Instead, we have a more flexible approach, one that is strong and adheres to the rule of law, yet able to provide the ability to adapt to changing circumstances in an ever-changing world.

In most of the rest of government, one is either in compliance or not, within the guidelines of the so-called “box” or “out of the box.” Bureaucracies tend not to like the “out of the box” part so much. Principles-based regulation allows the regulator to be flexible, however, to let those that are being regulated to think “outside of the box,” as long as the activity or conduct complies with the basic guidelines that protects consumers and markets against fraud and manipulation.

Here is an example of how it has worked in practice in the U.S.: it used to take, before we had principles-based regulation, six to nine months for the CFTC to approve a new product for trading on an exchange. We did all sorts of analysis and study, and we would—finally—approve the product for trading. Now, it can happen in one day.

Think about it from a cost-benefit point of view: we were spending a lot of taxpayer dollars to review a product that, in all likelihood, did not require that much governmental oversight. In addition, the principles-based system allows the government still to retain review prerogatives, but allows products to get to market faster. In a sense, we're also relying on the self-interest of the exchange: it wouldn't be asking for the new product if they didn't think there was a market for it, and it certainly doesn't want to introduce a product that is tainted with the possibility of fraud, abuse or manipulation.

The exchange has very good reasons—market reasons—to ensure that its products are viable tools for traders. Principles-based regulation provides the best of both worlds: it allows the market place to innovate quickly, and still gives the government the ability to step in if it sees something is amiss. This

allows our exchanges to capture a competitive advantage both domestically and internationally for good ideas.

In fact, while the derivatives industry worldwide has doubled in the last five years, derivatives trading in the United States has more than tripled, and the market capitalization of the largest U.S. futures exchange \$28.3 billion (which, by comparison, is \$10 billion larger than the largest U.S. equities exchange). I don't think it's a coincidence that the incredible growth corresponds to the adoption of our principles-based regulatory regime.

Did government grow our futures industry? Of course not. It was the private sector. But, I do think government helped foster that innovation and growth through our regulatory approach, we allowed industry to be industrious, and to be nimble and quick. And it has grown the economic engine of our nation.

So, I'm a big fan of this approach to regulation. I'm certainly not suggesting that the U.S. approach to derivatives regulation be adopted by others. In fact, what I have learned on this trip is that the climate for business is very good in Asia, and you've clearly got a very good regulatory model here. However, as I mentioned at the outset, this trip is about learning, sharing and relationship building. So that is why I'm taking the time to tell you about our principles-based regulation—an approach that, as I said, reminds me of the properties of bamboo—not to proselytize, but to inform. Bamboo doesn't grow everywhere, in the right climate can grow up to a foot a day—same thing with our industry, I think. We need to find the right “climate,” or regulatory system, that allows the industry in our particular jurisdictions to flourish and grow like the bamboo. And principles-based regulation is clearly working in the U.S.

That said, I will tell you that we still have issues in the states. I certainly can see the advantage, for example, of a single regulator for derivatives and securities as practiced here and in Singapore. In fact, if I were beginning to put together a regulatory structure in the United States, I'd probably do the same—have a single regulator. And it may interest you to learn that the U.S. Department of Treasury is currently undertaking a review of our financial services regulatory structure. One of the specific things they sought comments upon was the wisdom of a single regulator for futures and securities, that is, whether the CFTC and the SEC should be merged.

While I admire the approach that many nations have with a single regulator, and I might design something similar if we started from the beginning, that is not where the United States is right now. We are not at the beginning. The SEC does not have a principles-based approach, and would need an act of Congress to allow them to pursue such policies. Were the two agencies to merge, I would hate to see the progress the CFTC has made, and the concomitant growth of the U.S. derivatives industry, go by the wayside due to the more cumbersome rules-based approach of the SEC.

Granted, there are products that implicate both securities and futures laws—such as futures on foreign securities indexes, or portfolio margining of certain products—that can only be addressed by better coordination between the CFTC and the SEC. That is why I have called for action on those matters and public accountability sessions between the two commissions. But I certainly think it is the wrong approach to simply merge two agencies for the sake of merging. There must be a competitive advantage for industry to justify such a costly undertaking.

Finally, I get asked what we do with all of the time we save by using principles-based regulations. The answer is simple: enforcement. This is one area that helps guard against fraud, abuse and manipulations. As you know, this is a global 24/7/365 global industry. Our enforcement staff is therefore constantly mining the internet, looking at e-mails and instant message all in an effort to gain critical evidence in very complex, often highly technical cases both domestically and in cooperation with our regulatory counterparts across the globe. In fact, at any one time, we are investigating between 750 and 1,000 individuals or companies for violations to our Commodity Exchange Act. So, not only do our flexible regulations help foster innovation and growth, but we are able to be even stronger on the enforcement front because of it.

In addition, we engage in significant cooperative global enforcement efforts. In 2007, we either propounded or responded to 157 requests for assistance with 47 authorities around the world, including the China Securities Regulatory Commission, the Hong Kong Securities and Futures Commission, India's CFTC

Forward Markets Commission, the Securities and Exchange Board of India, the Japanese Financial Supervisory Agency, the Japanese Securities and Exchange Surveillance Commission, and the Monetary Authority of Singapore. Further, the CFTC is one of 46 signatories to the IOSCO Multilateral Memorandum of Understanding and in addition has over 25 bilateral arrangements with various jurisdictions to facilitate the exchange of information for enforcement purposes. These cooperative efforts help to ensure that our global, interconnected markets are policed for fraud and manipulation, and that we take appropriate steps to see that these markets are safe, sound and secure for consumers around the world.

Finally, I'm told that in Chinese, the purple bamboo (we call it black bamboo in the states) is grown not only for its beauty, but for good luck—as a barrier to bad fortune. I'm pleased that

our regulatory structure for derivatives in the U.S. is like bamboo, and since it is so strong, we may not even need the luck—but we will take it.

Thank you again for the invitation to speak with you today.