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Speech

"Wicked Awesome" Financial Regulation
(As Prepared for Delivery)

Speech by Commissioner Bart Chilton of the Commodity Futures Trading Commission before the National Futures Association, Boston, Massachusetts

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Thanks very much for the opportunity to be with you here today. Let me say at the outset that your organization is one of the finest I have encountered in my two decades-plus of government service. Your staff and management are superlative in carrying out the mission of the NFA, to safeguard market integrity, protect customers, and help your members meet their responsibilities. As they say here in Boston, you guys are "wicked awesome" regulators, and I commend you for your excellent service.

As you know, the NFA and CFTC have a great working relationship; our combined efforts truly exemplify the old adage, "the whole is greater than the sum of its parts." Working together, we help ensure that U.S. futures and options markets are safe, sound and secure, and that American consumers and markets are protected from fraud and manipulation. I am extremely proud of the work we all do to ensure the integrity of these markets, and I compliment you on your fine efforts in carrying out your mission.

Together, we truly are the "Cops on the Beat" in these critically important, and increasingly global markets. Your efforts in the areas of registration, compliance and examination, and enforcement are excellent, and the regulatory services that you provide to market participants in trade practice and surveillance are extremely useful and beneficial. The CFTC could not do all it does to protect customers and markets without your help.

And we're working together to make even more and better progress in several areas. The joint efforts of the NFA and CFTC have been significant in working to find solutions to some ongoing and intractable problems. In the forex arena, an issue of particular concern to me, the NFA has worked tirelessly to adopt rules that will help address the

problems we see in these markets. In addition, you've provided invaluable insight and suggestions in how these concerns might be addressed legislatively. The same holds true for your comments and ideas on fixing the "Enron Loophole"; NFA's suggestions helped shape the legislative requests ultimately made by the Commission to address these "dark markets," and I'm confident that the additional reporting, recordkeeping, SRO responsibility and emergency authority will, if enacted by Congress, appropriately address regulatory concerns in this area. In that vein, we don't know when or in what precise form a reauthorization of the CFTC will take (although it looks like we might actually be getting close to passage of a Farm Bill), but I am confident that we've made good progress in developing solutions to these, and other problem areas, and I thank you again for your input and advice. In sum, you all really are wicked awesome regulators, and we couldn't do our jobs half so well without your help.

Being in Boston reminds me of the Paul Revere myth – for those of you who didn't know this already, Revere didn't make that ride alone on April 18, 1775, to warn the colonists of the British troop movements toward Lexington and Concord. There were actually two other riders with Revere that night, William Dawes (a Boston tanner, active in the colonial militia), and Samuel Prescott (a Massachusetts doctor who just happened to be hanging around Lexington when Revere and Dawes came charging through). Revere's actions on that famous night are ignominious, in some respects: after being detained by the British (along with Dawes and Prescott) in Lincoln, Revere had his horse confiscated, while Dawes and Prescott escaped and continued onward. Ultimately, Prescott was the only one to complete the ride to Concord (Dawes fell off his horse somewhere along the way). Revere ended up walking, sans horse, back to Lexington, and arrived the next morning just in time to witness the famous battle there, which started the American Revolution.

The reason I'm taking some time to go through a bit of American history with you is to point out the fact that, just because something is repeated over and over (even from so noteworthy a source as Henry Wadsworth Longfellow), that doesn't make it true. And that is what I am concerned about with Secretary Paulson's Blueprint released last month. (You knew I'd have a point in here somewhere.) The story that I'm concerned about deals with the Treasury Department's Blueprint and what I think people maybe gleaning from it. Some think that what Treasury is saying is that the creation of one super-regulator, along with merging the CFTC and SEC, will result in desirable efficiencies. From my perspective, nothing could be farther from the truth.

As I have noted previously, there is something to be gained in this discussion by looking at the experience of others. In the U.K., for example, it's equivocal (at best) whether there have been any market efficiencies gained from their 2000 regulatory consolidation. Nor is there any persuasive evidence that the merger resulted in competitive advantages for the marketplace. We should only be considering such a costly reorganization if data as to both efficiency and competition provide solid, unambiguous proof that a regulatory merger would be desirable. Treasury (nor anyone else, for that matter) has simply not made that case.

While we're on this topic, I'd like to make another observation. I've heard opposition to the merger from certain sectors of the securities world, but for different reasons than I've outlined. The basic premise for these securities folks seems to be that merger, with adoption of a principles-based approach, would somehow weaken the SEC's

enforcement authority. The implicit assumption here is that principles-based regulation is somehow antithetical to strong enforcement. I couldn't disagree more strongly. The CFTC is, first and foremost, an enforcement agency. Our core mission, as mandated by Congress, is to protect consumers and markets from fraud and manipulation, and to ensure the integrity of the marketplace. A brief review of our enforcement record in the years 2002 to 2007 shows a remarkable increase in the average number of cases filed, with an even greater increase in the penalties levied, as compared to the previous 15 years. And we've done this with a 28% reduction in enforcement staff! I've previously made the point that another one of the great advantages of principles-based regulation is that it allows the agency to better allocate use of its scarce staff resources to go after the bad guys in this industry, and our numbers certainly support that notion. I note that the SEC has recently come under fire for decreased enforcement statistics; perhaps, if it adopted a principles-based approach, it might result in similar increases in the enforcement arena. Just a thought.

Lastly, it seems to me that the banking regulators in the U.S. have more pressing issues to deal with right now than engaging in Ivory Tower musings over regulatory realignments. The subprime fiasco, and trying to stem the tide of bankruptcies and foreclosures, should be much higher on their "to do" list than pursuing a CFTC/SEC merger. Thankfully, the commodities markets appear to have been essentially neutral in this crisis; the CFTC maintained, and continues to maintain, appropriate surveillance and oversight of the markets under its Congressional mandate to ensure their safety and integrity. From what I hear across the country, I think that's what Americans want—not some bureaucratic re-shuffling of regulatory boxes—but real oversight and regulatory intervention as necessary. In sum, consumers and markets just want us to do our jobs.

That's not to say that debate and deliberation on this issue is inappropriate; to the contrary, I believe that Secretary Paulson's initiative to bring a new focus and a fresh look at the U.S. financial market oversight can be useful. My disagreement is with the conclusions drawn and recommendations made in the Blueprint. The SEC and CFTC are fundamentally different for a reason: they regulate fundamentally different markets. Congress got it right in 1974 when it determined to create an independent federal regulatory agency for risk management markets. As markets change and evolve, it is incumbent upon regulators to do the same, and that is where we as regulators need to focus our efforts. That's why I suggested, and with the leadership of Acting CFTC Chairman Lukken and SEC Chairman Cox, the agencies recently signed, a "Regulatory Memorandum of Understanding"; basically, this is our "blueprint" for how to address issues of mutual concern. I believe firmly in Thomas Jefferson's instruction to "never trouble another for what you can do for yourself." The CFTC and SEC can address issues of new products, portfolio margining, dually-regulated products, for example, by ourselves; we need not trouble Congress, or other regulators for intervention to address these issues.

At the same time, I don't want to simply give Nancy Reagan line to Treasury and "Just Say No." It is incumbent upon us as policy makers to think about other alternatives to the regulatory issues raised in the blueprint. As Congress considers possible alternatives to the current regulatory structure in the U.S., there are several ideas that might be preferable to a complete merger of the SEC and CFTC. One thought might be

to consolidate oversight of all risk management markets under the CFTC, including security options markets. Another idea, and I am certainly not the first to posit this idea, would be for Congress to eliminate the dual regulation of security futures products and put these markets under the sole jurisdiction of the CFTC.

As to security options, I would note that CBOE was created prior to the existence of the CFTC; had we been around in 1973, there is a good argument to be made that CBOE should have fallen under the risk management regulator's jurisdiction. But more importantly, this targeted, rational jurisdictional change would address many of the regulatory issues we face today. William Brodsky, Chairman and CEO of the Chicago Board Options Exchange, has made excellent points concerning the glacial pace of the SEC and CFTC in approving novel, cross-jurisdictional products. He is exactly right—those kind of governmental delays are unacceptable. Giving jurisdiction to the CFTC of all options markets would eliminate this duplicative regulatory oversight and put all options markets under a "certification" procedure for new products. This would allow novel products in the options area to get to market faster and promote innovation and competition between markets and market participants. As I have said before, the CFTC is "commodity blind"; that is, we oversee all derivative transactions in all commodities, whether in the financial, agricultural, metal, or energy sector. In that sense, securities are simply another commodity tranche underlying derivatives contracts, and the CFTC has proved to be the expert regulator of such markets. In addition, the CFTC's principles-based regulatory approach would, I believe, be welcomed by any regulatee.

With respect to security futures products, I think that we can all agree at this point that, despite the Herculean efforts of the exchanges set up to trade these products, the dual regulation of SFPs has not been a resounding success. In essence, they are utilized as risk management markets, and many have argued they should accordingly be regulated as such. Regulatory relief afforded this marketplace by getting it out from under an overly burdensome and unnecessary "double regulation" system, could allow it to grow, unimpeded by unnecessary regulatory burdens and unfair competitive advantages, and permit it to compete on a level playing field with other risk management markets. Indeed, under a single regulatory system, I believe more market platforms for SFPs would be developed; under the current system, there is a disincentive to create a new market that will, from the outset, be burdened by cumbersome and unnecessary rules and regulations.

It is clearly the province of Congress to decide whether these, or any, legislative changes are desirable to address issues raised by Treasury in its Blueprint. It is my hope and expectation that the ideas I've just discussed, as well as any others that might be put forward, will help focus debate on tailored responses to the specific concerns raised in the Blueprint. Rather than a leap to wholesale merger, which I think would ultimately be costly and inefficient, deliberation by Congress of more targeted solutions will, I believe, be more beneficial in the long run to markets and to consumers.

There are a host of issues out there relating to this topic, and the Blueprint will continue to provide ample grist for the legal and political mills in Washington. And frankly, that's all to the good. Self-evaluation is a beneficial exercise, for governments just as it is for individuals and businesses. But we need to keep clear about our mission, and keep our nose to the grindstone. We need to use our Congressionally-mandated expertise to

continue to protect American consumers and markets, and ensure the integrity of the important markets we oversee.

We need to stay wicked awesome.

Thank you, and I look forward to continuing to work with all of you in the future.