



Commodity Futures Trading Commission

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Speech

Not Your Father's Regulator

**Speech by Commissioner Bart Chilton
United States Commodity Futures Trading Commission
before the
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Thank you very much for asking me to join you today. Let me assure you that you are well-represented by your president and hard-working staff in Washington—they do a terrific job on your behalf. There is tremendous excitement about this dynamic industry. Today I want to discuss the important linkage between the CFTC, as your regulator, and this industry.

REGULATORY REVOLUTION

When I say the word, “government,” many people think: bureaucratic, slow, cumbersome, red tape. That is all too often true. Well, I can tell you, that is not your regulator today. We are not your father's regulator.

In 2000, Congress passed the Commodity Futures Modernization Act (CFMA) that made a fundamental change in the way the CFTC works. It is what I call a “regulatory revolution.” What the CFMA did was move to a form of “principles-based regulation,” which means that we set broad principles for which we expect industry adherence. If industry goes too far, we will tell you, but this principles-based approach allows enormous flexibility. It allows the industry and the CFTC to look around the corner, to be nimble and quick and to react – in real time – to changes or potential changes in the marketplace.

Principles-based regulation is in stark contrast to the top down, command and control type of regulator that every other agency in United States government – the SEC, USDA and every other agency or department – and indeed, around the world, uses.

In real life what this means is that instead of, for example, a new product taking six to nine months for approval, exchanges can certify new products and they can be up and running the next day. This allows industry to capture the value of new products without long delays. Which, in turn, helps hedgers, speculators and consumers. And it has helped foster the incredible growth we have seen in the futures industry. For example, the BIS Quarterly Review for September 2007 indicates a remarkable growth in derivative financial instruments traded on organized exchanges in North America—from 82.8 million futures in December 2005 to 121.8 million futures in June 2007 (an increase of 47.4%), and from 43.7 million options in December 2005 to 87.3 million options in June 2007, an incredible increase of 100%. In addition, the CFTC's regulatory structure has helped foster a tectonic plate shift in the fundamental way markets are organized: from the traditional, member-owned entities of the former century to the demutualized shareholder-owned businesses of today. And the fruits of that can be seen in the exchanges' market capitalization figures, which, if you're not already aware of them, may astound you: as of today, the market cap of the CME Group is \$34.41 billion, compared to the market cap of the New York Stock Exchange at \$22.26 billion and the NASDAQ at \$4.7 billion. That's right: the market capitalization of the CME Group dwarfs the combined mcap of the two largest stock exchanges in the world. It's no wonder that the financial world looks to the United States as a global leader in this industry, and that your markets have contributed so greatly to the economic engine of our democracy. What you do is critically important to the economic health and well-being of our nation, and the CFTC's principles-based regulation has helped to foster that innovation, competition, and remarkable growth.

We have essentially gone from a Rambler station wagon to a Corvette. We are faster, smoother, and more efficient – and we are also a lot more fun.

STABLE MARKETS AND THE CFTC

Your markets work best when they are free of fraud and abuse and manipulation, and we are the Federal agency – the cops on the beat, if you will – that has that responsibility. If market users are skittish about using these markets because of concerns about the deck being stacked or anything else, we have a market failure and nobody benefits.

That is why it is so vitally important that we are strong on the enforcement front. I can tell you that we meet each Friday and get a briefing on what is happening in the markets. We are not some “Andy Griffith” operation. We are more like “Elliot Ness” or “James Bond,” or in the case of crooked operations we are shutting down; we are more like the “Terminator.”

We are the 21st century cops on the beat. Every day, since these are really 24-7 worldwide trading markets now, we are mining the internet, e-mails and instant messages in an effort to gather critical evidence in very high tech, complicated cases – both domestically and internationally. In fact, at any one time, we are investigating approximately 750 to 1000 individuals and entities. Some are under suspicion of fraud, some for manipulation, and some for a large variety of other potential violations under the Commodity Exchange Act. That's more than two for every CFTC employee.

ZELENER CASE

One area that particularly concerns me is the rampant retail forex bucket shop fraud that has proliferated in the United States in the past few years. The CFTC continues to be extremely aggressively in prosecuting cases in this area, despite the setback that we received from Judge Easterbrook in the Zelener case. Zelener was the archetype of what we see in this area: this guy set up shot targeting unsuspecting folks with good hearts and limited incomes; over 200 customers lost more than \$4 million dollars in this fraud scam. Zelener and his cronies essentially guaranteed their victims a profit, and then took their money. It's doubtful whether Zelener actually invested in foreign currencies or anything else. Meanwhile he shipped their money offshore.

Our Division of Enforcement, in 48 hours, tracked the money through three countries and into 38 bank accounts. We caught them, and we prosecuted them. The 7th Circuit's opinion finding that these contracts were not futures was a real blow to us, but we continue to aggressively litigate around the country, and we're not taking this lying down. We also work with NFA in actively going after these bad actors, and I'm confident that, with the work of our enforcement division, and possibly some legislative amendments during our next reauthorization, the CFTC will continue to make a significant dent in the battle against off-exchange retail forex fraud.

ENERGY MARKET MANIPULATIONS

Likewise we continue to guard against manipulation. We've seen the tragedies and scandals in Enron, and cases in Amaranth and British Petroleum, and the CFTC has vigorously pursued actions in these areas. You all remember what we did in Enron? In that case, the Commission vigorously went after predatory and unlawful conduct that harmed American consumers—specifically, a pre-arranged buying spree in natural gas in the Henry Hub spot market, which had a direct and adverse effect on the NYMEX futures price—and ultimately settled with Enron for \$35 million. Since that time, the agency has charged a total of 63 companies and individuals for violations of the CEA in the energy sector, and obtained over \$300 million in civil monetary penalties in settlements. In addition, we continue to assist other members of the President's Corporate Fraud Task Force in their respective prosecutions of misconduct in the energy arena. In other words, if you manipulate these markets, we're watching, and we're going to get you. It's like those commercials for drunk drivers: don't even try it, because the road blocks are set up, the sobriety check points are in place, and we'll make you walk the line. And if you stumble, we'll make you pay the price.

In this vein, I also want to mention the Exempt Commercial Markets provision in the CEA – otherwise known as the Enron Loophole – that was put into the CFMA. I think this is the only real flaw in that law. It was inserted, literally, at the eleventh hour at the behest of Enron's attorneys. There was never a hearing or any open, public discussions on this provision. The good thing it did was increase competition; for example, it helped foster the incredible growth of the InterContinental Exchange (ICE). But the provision has resulted in some significant unintended consequences that need to be addressed now.

It is very difficult for the CFTC to achieve our mandate when we have look-alike energy markets operating “in the dark,” that are not subject to the same rules and regulations as other risk management markets. The good government approach to this is not to wait for another economic

calamity to occur. We have seen what can happen with the hedge fund Amaranth. So for me the question isn't "if" but "how" and when something should be done to address the Enron Loophole, and I think the sooner the better.

JURISDICTION

Speaking of energy markets, the Amaranth case, as you know, is currently being litigated. And as you know, (FIA having filed an amicus in this matter), the Federal Energy Regulatory Commission (FERC) has also filed a suit, which brings me to the issue of jurisdiction.

When the Commodity Exchange Act was written in 1974 Congress did so to ensure that there was someone with oversight who actually understood the futures and options markets. That's why the CFTC was created. And Congress wanted to ensure that one expert regulator's oversight preempted not only other federal regulators, but also state regulators. It wanted a sole agency in charge of all these risk management markets. Congress knew that if others claimed jurisdiction, the CFTC would soon be rendered toothless and so the CEA specifically states that we have this exclusive jurisdiction. And that exclusive jurisdiction has been upheld over the years in seminal and hotly contested matters, such as the Ginnie Mae case, the IPs case and the Dow Jones cases.

Santayana – the Spanish philosopher – said, "Those who cannot remember the past are doomed to repeat it." Well, we remember our history in this area and we will continue to assert our exclusive jurisdiction to ensure that the CEA is implemented as intended.

CONCLUSION

Once again, I'm pleased to be a part of this dynamic industry. Let me just say that everyone at the CFTC will continue to work hard every day to ensure that we do all we can to protect price discovery, to guard against fraud, abuse and manipulation, and to ensure that the futures and options markets remain viable efficient and effective tools not only for hedgers and speculators, but also for consumers. It is important to your industry and it is important to our country. Thank you.