



Commodity Futures Trading Commission

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Speech

“Years That Answer”

Speech by Commissioner Bart Chilton before the International Quality Productivity Center’s, 3rd Carbon Trading Conference, New York, New York

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Thank you for the opportunity to be with you today.

Some of you have heard me speak before about the issue of energy independence and climate change—about carbon trading. I’ve said it is “the most important thing we have never done,” and that carbon markets have the potential of being the biggest commodity markets traded in the future. These issues are clearly some of the most critical things we can be working on, and you are to be commended for your efforts—for being part of this exciting, and yes, extremely important endeavor.

Here is the great part, as you all have been discussing at this conference: we are on our way. That is not to say it has been easy. It has been a struggle and will continue to be in many respects. The important question, it seems to me, is how will we go forward. What will things look like in six months or a year? How about in two, five or ten years from now?

Fortune Telling

Fortune-telling isn’t my forte, but having been in and around government over the last 25 years, there are some insights I’d like to share with you about how to go forward and what we might expect.

Marshall McLuhan, the philosopher, talked about how you can’t go forward looking only in your rear view mirror. However, to get a sense of where to go, it is important to know where we have been—otherwise we may end up driving over the same roads, and even making the same wrong turns.

Where we have been over the last year or so is in a very uncomfortable place. It was hard for most Americans, and many people around the globe, not to have been a little

depressed about things going on, in general, around the world in 2008—the war, the economy, a topsy-turvy election.

Last Halloween, there was a cartoon in the newspaper that pictured a youngster dressed in a costume. He had two posters on each side of his body, sort of like a sandwich board. The posters had a bunch of numbers on them. On the very bottom it read, “Your 401K statement.” With all that was going on last year, it wasn’t only scary for many of us, but unsettling. A lot of folks were asking questions about what was to come. In what direction were we going to head? What about our retirement accounts?

What would the U.S. election bring? How would the economy perform? Would the government bailout dollars get where they needed to stabilize the economy? Would bank CEO’s continue to be rewarded for risky business behavior? Would average citizens see any change? Would the poor economy lead to an abandonment of environmental goals? After seeing record high energy prices would those lower costs of oil and gasoline diminish the effort for additional oversight and regulation of energy markets? Would lower prices place less emphasis on becoming more energy independent for the United States? Lots of people were asking lots of good and important questions—questions about how they and their families would be impacted, how the world would be impacted.

A Year That Answers

Zora Neale Hurston, the American author and folklorist once said, “There are years that ask questions and years that answer.” Well, last year certainly did raise questions. The good news is that this year will provide answers. We turned a corner with the election and are now moving forward with vigor—and in some cases vengeance—to right some of the wrongs.

From my perspective, we are going to see a lot of progress on many fronts. President Obama is up to the challenge. Some of you, however, may not be convinced. Some still may have doubts. It is understandable to be cynical about Washington. Some say that the Obama campaign rhetoric won’t match what he does as President. Others say that the entrenched interest in Washington will grind progress to a halt on energy policy, climate change and a cap-and-trade bill. There is an old adage among lobbyists in D.C., “If you are not part the solution, there is plenty of money to be made prolonging the problem.” It has worked for decades and some think it will stall progress on these important issues.

It would also be easy to say, “Well, when gasoline was over \$4 a gallon it made sense to move toward renewables and bio-fuels, but not now—not when oil is \$30-some dollars a barrel and gas is a buck eighty four a gallon. We should use the most convenient and least costly fuels from anywhere around the world.”

Some make the argument that the economic situation requires that we put any grand visions about addressing global warming on the shelf for now, at least they say, until we get our economy or our federal fiscal house in order. I can see where some might think that argument has merit. President George W. Bush made that exact case in 2001 when he said, “The United States opposes Kyoto because it exempts many countries from compliance and would cause serious harm to the American Economy.” In another speech President Bush said, “Kyoto is, in many ways, unrealistic. Many countries

cannot meet their Kyoto targets. The targets themselves were arbitrary and not based upon science. For America, complying with those mandates would have a negative economic impact, with layoffs of workers and price increases for consumers. And when you evaluate all these flaws, most reasonable people will understand that it's not sound public policy"

Yes, there are many reasons to say to ourselves, "Hold on a minute, let's take another look at what we are about to do." Politically, there is a real defense for scaling back on what Barack Obama has said about energy and climate.

The Real Deal

But everything I see says that's not where we are headed. Despite the credit crisis, recessionary pressures, and a slight drop-off in the 4th quarter, green-tech venture capital funding soared last year, aided by mega-deals in solar companies, according to preliminary figures released January 6, 2008 by the Cleantech Group (a global marketing research firm). During 2008, green-tech venture investments jumped to \$8.4 billion, a 38 percent increase, according to Cleantech. Following solar-energy firms in attracting VC dollars were companies specializing in biofuels such as ethanol, biodiesel, synthetic biology, and algae. United States-based companies raised the most green-tech venture funding, landing \$5.8 billion among 241 disclosed investments. This group also posted the largest gain last year, making a 58 percent funding increase over the previous period.

For those who question the new President's resolve, I don't think it will take too long for you to be convinced that Barack Obama is the real deal. Even before he was inaugurated, the then President-Elect said, when speaking about the economy, "A new economic turbocharger is going to have to be found, and there is no better potential driver that pervades all aspects of our economy than a new energy economy." He has said that after the war and the economy, his number one priority is energy independence and climate change.

In his inaugural speech last week, he spoke about the importance of moving forward, about how he wants to harness the sun and the wind and the soil to fuel cars and run factories. He has spoken about his desire to create millions of new jobs and make significant strategic investments to catalyze private efforts to build a clean energy future. He wants to use the tax code to give American families an immediate energy rebate, and he wants to close energy industry market loopholes and increase transparency to prevent traders from unfairly lining their pockets at the expense of American consumers. He wants to put more hybrid cars on the road, and increase fuel standards. And yes, as you all know, he seeks to reduce our greenhouse gas emissions by 80 percent by 2050 and implement a cap-and-trade program.

The Obama cap-and-trade policy will require all pollution credits to be auctioned, and proceeds will go to investments in a clean energy future, habitat protections, and rebates and other transition relief for families.

While the U.S. was MIA (missing in action) on climate change during the Bush Administration, the Obama Administration will work to re-engage the world. That may seem presumptuous at the current time, given where the U.S. has been for the last

eight years, but the new President has been more than clear about his vision and has shown no signs whatsoever of backing off from his desire to do what he can on these critical issues. He wants the U.S. to renew efforts to again be a world leader on climate change. He wants to work with the U.N. Framework Convention on Climate Change (UNFCCC)—the main international forum addressing global warming and the agency that shared the 2007 Nobel Prize with former-Vice President Al Gore. He also intends on creating a Global Energy Forum comprised of the world's largest emitters. The GEF will focus exclusively on world-wide energy and environmental issues.

On energy, we all know that the challenges our country faces are longstanding and severe. The addiction to foreign oil undermines national security, the environment, and the economy. That is why I believe we are going to see a comprehensive Obama energy plan that integrates a climate change plan—parts of which I'm hopeful will be included as part of the stimulus package.

On Monday, the President, with some strokes of a pen, said the government would review California's and other States car emissions reduction proposals. As you know, the Bush Administration had rejected the California proposal. He also said he would seek tougher fuel efficiency standards for vehicles. And Secretary of State Clinton announced that Todd Stern, the former U.S. Kyoto negotiator during the Clinton-Gore Administration would serve as the Obama Administrations special envoy on Climate Change. All that happened Monday --- before breakfast, I think.

Markets and Oversight

At the CFTC, I'm hopeful that my colleagues will agree with the President that we need to crack down on excessive energy speculation. This would be in stark contrast to policies supported by the Bush Administration, which, for example, even though the House of Representatives passed legislation addressing excessive speculation with wide bipartisan support, 288 votes, did not see the need to support the measure.

Government clearly veered too far to the right during the last decade by letting the Free Marketeers rule the financial road without proper oversight, rules and regulations. The desire to over-steer will be great. But just like driving on ice, we need to be careful not to over-steer and veer too far to the left and over-regulate. That's why President Obama has called for common-sense rules of the road—rules that protect consumers but don't send business to dark markets or overseas to less-regulated markets.

If we are going to do the job that consumers and businesses should expect of government when regulating a cap-and-trade program, we first certainly need to get financial service sector regulation right. For example, the CFTC only sees a small percentage of the futures trades going on in the United States—about \$4 trillion. That leaves trillions of dollars in over-the-counter (OTC) trades left unchecked. Credit Default Swaps (CDSs) alone are a major problem. Swaps like CDSs were excluded from regulation by law in 2000 as part of the deregulatory fervor taking place at the time. These bets that someone will default on a loan or bundled loan package—bundled loans permitted as a result of the deregulation of the banking industry in 1999—were, get this, estimated to be \$55 to \$60 trillion. That's \$55 to \$60 trillion in unregulated trades that clearly had a negative and contributing impact on our economy in the wake of the sub-prime mortgage fiasco. We are feeling the results of those poor

policy choices right now, right here in this city and all across the nation and in fact the world, today.

That's why I continue to outline some decisive steps that Congress should consider immediately to provide legal certainty that the financial sector requires to help create stability. These changes can set the stage, from a derivatives regulatory perspective, for moving out of this mess. Those steps are:

1) Require OTC reporting and recordkeeping. This will enable the CFTC to examine trading information, particularly information about sizable or look-alike trades that could impact regulated markets—markets that have a bearing on what consumers pay for products like gasoline;

2) Oversee mandatory clearing of OTC Credit Default Swap transactions, and encourage clearing for other OTC products as appropriate. We can significantly improve the stability and safety of our financial system by enhancing clearing systems for CDSs—in a manner that does not lead to cross-border arbitrage—as well as for other OTC derivatives. It's important to note, however, that by only pursuing clearing and not doing the other things I'm outlining we won't get to where we need to be.

Clearing alone should not be seen as a panacea for all our market woes; it cannot and should not take the place of statutory changes to ensure appropriate oversight of these currently dark markets. Clearing can, however, provide needed transparency and address counterparty risk issues, and we certainly should be aggressively pursuing avenues to foster the clearing of OTC transactions.

3) Regulate OTC transactions if the Commission determines that certain trades are problematic. To be precise, the CFTC should be given the authority to determine and set position limits (aggregated with exchange positions, and eliminate bona fide hedge exemptions) should we determine there is a need to do so to protect consumers.

Congress should also extend CFTC anti-fraud, anti-manipulation and emergency authorities to OTC transactions to allow greater openness, transparency and oversight of our financial markets.

4) Congress should appropriate immediate full funding (\$157 million for Fiscal Year 2009) in additional resources and staff to the agency to ensure that we can properly effectuate our duties. I noticed that last week, several Senators joined together to call for increased resources for the Securities and Exchange Commission (SEC). By comparison, the CFTC oversees exchanges with significantly greater market capitalization than the SEC. The SEC has 3,450 employees, while the CFTC struggles with about less than 500 people. It is not a popular thing to call for more money for federal employees, but without cops on the beat, crimes can take place. The CFTC needs additional resources and we need them now.

It is the CFTC's mantra, mandate and mission to guard against fraud, abuse and manipulation. We have actually done a pretty good job upholding the law. The problem was the law took swaps regulation and oversight off the CFTC radar screen. While the CFTC was certainly not at the epicenter of the financial meltdown, we need to be afforded the legislative and regulatory tools to be nimble and quick public servants to address possibly manipulative or fraudulent activity that may affect U.S. financial markets. We need to be able to look around the corner. We shouldn't be like the fire

department and react to emergencies. We should be proactive, like the police, looking out for potential problems. To do that, we need to be able to see OTC data and have the authority to address problems or potential problems before they impact consumers, businesses, or our economy.

Once we get that right, confidence will be rebuilt in market integrity. We can again do what we at the CFTC are very good at—regulating risk management products. We can then be fully ready to regulate carbon markets, just like we have been regulating various environmental markets for decades.

In this regard, I'm particularly pleased with the initiative that Congressman Collin Peterson, the Chairman of the House Committee on Agriculture, the Committee with jurisdiction over the CFTC, is introducing to reassert the CFTC's mandate to oversee environmental markets.

There is a lot of enthusiasm at the agency for moving forward on carbon trading. I'm hopeful that the Administration and Congress will soon reach an agreement on what the cap-and-trade legislation will look like.

I'm confident that that this year will answer the question, "When will the U.S. finally get on board with addressing global warming?" I think it will be this year. We will have a new law that will clearly make a shift to do the right thing for our economy, our country and the world.

After the new law passes, the agencies involved will develop the rules and regulations. Regulated trading will begin after that.

We've already seen advances in regional carbon trading initiatives, and I expect that trend to continue. In addition, I believe that venture capitalists will see the benefits of "green investing," and that this will further enable innovation and development in these markets.

In five years, I think these markets will be monolithic in the commodity sector. As I have said, I can see carbon trading being a \$2 trillion market. The largest commodity market in the world. Within a decade, speeches like this one will be totally obsolete. There won't be any discussion about "if" or "when" there will be a green economy or sure-footed efforts to reduce carbon emissions. Nope, it will simply be the way of the world—commonplace.

On January 20th we officially made a major change. The comprehensive and aggressive nature of the Obama agenda should send us all a strong signal that he is not only serious about these issues, but willing to fly in the face of conventional wisdom to achieve the goals of greater energy independence, of a new green economy and of a world not hampered by the environmental risks associated with global warming.

Resolve in our Footsteps

As we leave here today, we should be optimistic. This is a year that will answer many of the questions we have had for the last year, or more. There is every reason to have

a firm resolve in our footsteps, to be confident in our direction and positive about the changes we can make together.

I'm inspired by your attendance here today. To me, each of you represents the optimism behind overcoming this global challenge and I hope you take away from my remarks that you're government—independent agencies like the CFTC and the Administration—are ready to stand beside you in your efforts.

Thank you.