Commodity Futures Trading Commission
Office of External Affairs
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
202.418.5080

Remarks

Remarks of Acting Chairman Michael V. Dunn before FIA Conference, Boca Raton, FL

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Thank you very much for inviting me to speak with you. John, this event is always a great opportunity for our industry to come together with our friends from here at home and abroad to discuss issues facing the futures industry. Given the present state of global financial markets, this forum is a welcome opportunity to talk about the causes of and solutions for our current economic troubles. I am grateful to you and FIA for bringing us together yet again.

As you know, I am a place holder for Gary Gensler, who has been nominated by President Obama to be the Chair of the Commission. I have had the opportunity to get to know Gary, and I believe he will be an effective chairman and advocate for the CFTC. Believe me, no one is wishing harder than me for Gary's speedy confirmation. I would be remiss if I did not recognize the job that Acting Chairman Walt Lukken did during one of the most tumultuous times in the CFTC's history. It is a tribute to Walt's leadership and the industry's self regulatory efforts that no customer has lost invested funds as a result of defaults by an intermediary on the markets we regulate. I would also like to recognize the dedicated men and women who work at the CFTC. Would those in attendance please stand and would the audience please join me in expressing our thanks for all that they and all the employees of the CFTC do on behalf of the futures industry.

As Acting Chairman, I have been blessed with Walt's support and the sage counsel of my fellow commissioners. Commissioner Sommers, who chairs our Global Markets Advisory Committee and yesterday chaired the International Regulators Meeting, has been a great source of wisdom and direction for me, especially in the international arena. My long time friend Bart Chilton has worked tirelessly to protect consumers during his tenure at the CFTC. Bart's ideas regarding consumer protection have been invaluable to me during my tenure as Acting Chair. It gives me great pleasure to announce that, last Friday, the Commission elected Commissioner Chilton as the new Chair of the Energy Markets Advisory Committee to the Commission. The energy markets we regulate have a tremendous impact on our economy and the quality of daily life for our citizens. I wish Bart the best of luck as he undertakes this most important endeavor.

As I began preparing my remarks, I was struck by what a difference a year makes. At this point last year, we were still discussing who would be the presidential candidates. We were experiencing record high commodity prices across the board and the growth of the industry seemed to have no limit. Those of us who attended this conference last year will remember discussing the massive losses by single traders at MF Global and Societe Generale and wondering how they went undetected, for even short periods of time. You also remember hearing then-Acting Chairman Walt Lukken discuss the CFTC's need for additional resources to keep up with the massive increase in trading volume that our industry has experienced over the last decade. In that regard, some things haven't changed. As the current Acting Chairman, I can tell you that today our staffing needs are still great and may become greater as Congress works to repair a regulatory system that failed the American people. I'll speak more about the CFTC funding later.

I don't have to quantify the magnitude of the economic collapse that our country has experienced in the last year for anyone in this room. The explosive growth our industry experienced since 2002 has begun to subside and even though 2008 showed overall increases, the pace of growth has slowed. The country's financial situation is well known and I won't endeavor to make you more aware than you have already been forced to become.

More important than the position in which we find ourselves, is the course we traveled to arrive here – and, the path we must take to find our way back to stable ground. What we know today is that last year exposed many problems in our financial regulatory system and that 2009 must be a year that seeks solutions.

I believe that all of us, regulators and market participants both here in the United States and abroad, were laboring under the belief that we could guard against systemic financial risks by relying on sophisticated investors and institutions to monitor their own counterparty risk. This theory was proven false with tragic consequences and untold hardship for many Americans who are now making hard choices while watching the nest egg they have spent their lives building rapidly fall apart.

Congress and the Administration are now examining what went wrong, what needs to be done to stabilize and stimulate our economy, and what changes need to take place in our financial regulatory systems to ensure that we are never placed in this situation again. Many theories are developing as to what financial regulatory regime is needed, both domestically and internationally, to address the current crisis. These proposals will certainly be the topic of conversation during many sessions at this conference and will undoubtedly be discussed and debated during breaks, lunches, dinners and probably most vehemently during receptions.

As Acting Chairman of the CFTC, I have taken a pragmatic approach to ensure that the critical markets the CFTC regulates remain reliable and well regulated throughout this turmoil, and will continue to do so within any new financial regulatory structure that may emerge. As an independent regulatory agency, I don't believe that the CFTC must wait for congress or the administration to tell us to start addressing key issues. I have set five goals at the CFTC to guide the agency during my tenure. These key goals are as follows: Consumer Protection, Oversight of Risk, Interagency Collaboration, Hedge Exemption Review and Increased Market Transparency, and Adequate CFTC Funding.

Consumer protection

A primary mission of the Commission is to protect consumers and the public.

The CFTC's Enforcement Division has been involved in several high profile matters recently, where we have brought cases alleging schemes to defraud investors of sums totaling over a billion dollars. Every case we bring, regardless of the size of an individual's lost investment, is critical to our mission of protecting the investing public from fraudulent schemes. An investor who loses a life-savings of $30,000 is as important to me as a pension fund that has lost $300 million. Once aware of potential fraud, we have moved rapidly as an agency, often in collaboration with the NFA, SEC and DOJ, to bring wrongdoers to justice and protect investor funds to the best of our ability.

Off-exchange retail forex markets continue to be significant sources of fraud that both the CFTC and NFA fight against daily. I think Congress should require these retail forex futures markets to trade on-exchange, just as all other retail futures contracts do. It does not make sense that consumers trading forex should have any less protection than consumers trading futures in other commodities. These contracts should be on-exchange so we can effectively monitor and police their sale.

There also remains a real risk that white-collar criminals are escaping our jurisdiction through cleverly drafted futures contracts masquerading as spot contracts – as soon as Congress closed the forex loophole evidence suggests that former forex dealers simply moved into energy and metal sales. Congress should once and for all cut off all avenues for these crooks to perpetuate their fraudulent schemes. While the CFTC reauthorization bill passed last year by Congress clarified the CFTC's jurisdiction over these contracts for forex, it did not provide a similar fix for other commodities. The evidence is growing that a fix is needed and I implore Congress to act before consumers are further adversely affected by inaction.

In all the concern we have faced regarding the legal certainty of institutionally traded derivatives, I think we sometimes lose sight of the critical importance of legal certainty for the CFTC's ability to protect consumers. I hope we can change that this year.

Oversight of risk

Oversight of risk in regulated derivatives markets is critical for protecting the public and ensuring the integrity of our markets. The CFTC needs to ensure it is able to identify and manage risks associated with new types of derivative markets and products.

Our current regulatory model has worked well to ensure the financial integrity of exchange traded instruments, but we must be looking ahead for potential trouble spots and risks that may arise in the future. We need to make sure we have plans in place to address significant market events.

To do this, I am moving ahead on two fronts and looking internally and externally to make sure we address potential risks. First, staff from all parts of the agency is participating in a lessons learned exercise that looked back at the events of the last year and made specific recommendations to prepare the agency going forward. I have asked staff to move forward with developing procedures and contingency plans that will ensure the agency is prepared should another crisis present itself.

Second, I am encouraging the Agency to establish a Risk Advisory Committee to assist the CFTC in identifying and addressing areas where improvement in its oversight will be critical to fulfilling the agency's mission. This Committee will provide a forum for industry and market groups to aid the Commission in reviewing and evaluating its oversight of risk and keeping abreast of changes in the markets and industry that may impact the Commission's oversight.

I envision that this Risk Advisory Committee would focus on 3 core areas:

1. Agency Risk
2. Systemic Risk; and
3. Product Risk.

Regarding agency risk, it's axiomatic to say we don't know what we don't know, but it is undoubtedly true. The CFTC needs to look at what we are doing and how we can do it better and more efficiently. We need to speak with those we regulate to ensure their needs are being met and that we are aware of what market users believe is required for the market to function properly. This collaboration will ensure that we are protecting market integrity and assessing and quantifying the impact of risk in the market. Perhaps the lesson that we can draw most clearly from our current financial crisis is how inextricably linked markets have become. As such, closely monitoring system-wide risk will be a critically important component of the Risk Advisory Committee. Lastly, we must look generally at product risk. The best example of my concern, and certainly the most referenced, is credit default swaps (CDSs). Determining the next product that poses a similar significant risk to our economy will be a charge of the Risk Advisory Committee as well.

Collaboration with other regulatory agencies

We as regulators must do a far better job of working together to ensure that customers and the markets we regulate are protected while simultaneously avoiding unnecessarily duplicative regulatory regimes. The framework for collaboration already exists at our agency. CFTC staff is currently participating in 50 intergovernmental domestic and international committees, meetings and task forces. However, meeting participation and a willingness to collaborate in and of itself is not enough. Market conditions move rapidly and when called to do so we must be able to respond quickly. Just last month, we received a referral that was over a year old. In order to stay one step ahead of those who are trying to game the market, we need to perfect our lines of communications and put in place processes to ensure that collaborative efforts lead to efficient actions.

The CFTC has made progress in signing Memorandums of Understanding with several agencies governing the sharing of information, but we need to look for further opportunities to enhance cooperation and collaboration. I've asked our enforcement division to implement a formal process for referrals to the Department of Justice. Such a process would help ensure that information doesn't fall through the cracks and that the proper authorities pursue criminal actions and fraudsters go to jail.

Whether trying to streamline the approval and regulation of hybrid products, or coordinating enforcement actions, U.S. regulators must leverage their resources and expertise to promote innovation, close regulatory gaps, and make sure laws and regulations are enforced.

Instead of fighting over who regulates what, we need a renewed focus on making sure underlying financial and market risks are addressed in the most efficient way possible. We may need to establish interagency task forces to develop new models for cooperative regulation, for instance between the CFTC and the SEC or the CFTC and the FERC. Shortly after becoming Acting Chairman, I wrote a letter to SEC Chair Mary Schapiro to ensure that staff members at the agencies were meeting the obligations set forth in the March 2008 MOU to coordinate regularly on issues of mutual regulatory concern. Last week, senior staff members held such a meeting. There was a robust discussion of a number of matters facing the agencies. Congress mandated that the agencies work together on several issues when it passed the Farm Bill last year. Specifically, the Farm Bill requires the agencies to take action under existing agency authorities by **June 30, 2009** to permit the trading of futures on certain security indexes by resolving issues related to foreign security indexes and by **September 30, 2009** to permit risk-based portfolio margining for security options and security futures products. These have been ongoing issues for our agencies, and I encourage any of you with an interest in the outcome of either of them to contact staff at the SEC and the CFTC and share your views.

I know that some have pushed for a merger of financial agencies. However, merger, in and of itself is not a solution, it's just an activity. The real solution is harmonizing financial regulatory approaches. Whether we merge the agencies or develop new cooperative regulatory models, the bottom line is that we need to figure out how to mesh regulatory approaches. Merger may be one avenue for accomplishing that, but it may not be the most effective or efficient.

As we discussed in Wednesday's international regulators meeting, not only must we coordinate within the U.S., we must also work to improve collaboration with international regulators. What happens in the U.S. affects markets and market participants around the world. Derivatives markets clearly cut across both domestic agency jurisdictions and international lines. The CFTC finds that during this time of global financial crisis, there has never been a greater need to coordinate with our international regulatory counterparts. All countries are confronting a need to rethink regulation and the investing world is expecting a united regulatory front. The great relationships that the CFTC has built over time are evidenced by the many international regulators present during our international regulators meeting on Wednesday.

As you know, there has been global concern about the volatility in commodity market prices. Therefore I was pleased when the International Organization of Securities Commissions (IOSCO) formed a Task Force co-chaired by the CFTC and UK Financial Services Authority to consider whether supervisory approaches are keeping pace with developments in the market and whether regulators are cooperating sufficiently to deal with the increasing globalization of the markets. The Task Force's report was just published last week. I was gratified that among the Task Force's practical recommendations were steps to improve the quality of data on commodity markets – OTC and cash – as a means to facilitate our understanding of price formation in the futures markets. Additionally, the Task Force recommended that futures regulators meet regularly to share surveillance and enforcement trends and techniques.

This audience is also well aware of the number of hybrid products such as securities futures, exchange traded funds, or swap contracts that involve the jurisdiction of several domestic agencies. Resolving jurisdictional boundaries has bedeviled the derivatives industry for decades.

I expect that many of these issues will ultimately be considered by the President's Working Group of which the CFTC Chair is a member. We have had one meeting of the principals of the PWG and several meetings of staff to begin discussions on the financial issues facing our markets, and we look forward to further work with our PWG colleagues.

Review of hedge exemption policies and increasing market transparency

Increasing market transparency is critical given that the past year has seen record price swings in commodities coinciding with a huge influx of money from new classes of investors such as index funds. Justifiably these events have inspired questions and significant concern from the public and Congress.

In the coming weeks, the Commission will be issuing a concept release seeking public comments on how the Commission should consider revising the way it classifies commercial and speculative traders and how it issues exemptions to speculative position limits for hedgers. The CFTC's September 2008 staff report on Index Traders and Swap Dealers made recommendations, including that the agency review the bona fide hedge exemptions for swap dealers. The report's recommendations included considering a limited risk management exemption for swap dealers with reporting requirements and position limits.

Also, in an effort to increase market transparency, the CFTC announced last month that it had launched, on a six-month trial basis, a new monthly report called "This Month in Futures Markets." The report, produced by the Commission's Office of the Chief Economist, adds transparency to the information the Commission provides the public concerning regulated futures markets by providing graphical and tabular displays on the Commission's website.

The report draws from the Commission's Commitment of Traders data and displays various market statistics for 22 actively-traded commodity markets including, in the energy markets, natural gas, crude oil, heating oil, and RBOB gasoline.

Even looking at the historical data contained in these new reports, it is clear there is no easy answer that explains the wild price swings experienced in many commodities over the last year. No easy answer exists to explain how the price of oil can fall from $147 a barrel to the low $40's in just months.

There are no generally accepted models that answer the question of whether speculative trading, easy credit, or “irrational exuberance” led to long term price distortions or a “bubble” last year. Unfortunately, it seems that bubbles are like recessions, you only firmly identify you are in one months after it has already begun. We still do not fully understand, even with all the data the CFTC has collected and analyzed, exactly how these factors worked together and how individual factors contributed to the overall problem.

We do know the data we collect and the studies we have done thus far have not conclusively shown that investment by speculative or index traders is directly driving prices. We look for those types of relationships on a daily basis—but we do it in a limited way. We look at whether current market conditions or market structures are leading to problems with price discovery or price distortions. Where we see problems, we intervene, working with the exchanges and traders to address those problems. Where we see fraud or manipulation, we bring enforcement cases.

As we continue to examine last year’s events, I believe that we can, and must, take pragmatic steps to address serious concerns. We must increase transparency in markets so both the CFTC and the public have a clear window into the potential factors driving price discovery. More transparency in supplies and storage and more transparency into market makeup will help market participants make better decisions.

Given the high percentage of open interest attributable to noncommercial positions speculative trading in some of our markets, I believe that a careful review speculative positions limits is required.

In some of our markets, particularly agricultural markets, we have noted potential structural problems. These problems, such as lack of convergence, weak basis, and high margin requirements jeopardize the futures markets’ effectiveness as a risk management tool for the agricultural sector.

Congress has been very active in this area—considering legislation that would impose speculative position limits for energy futures contracts, redefine allowable hedging activity, impose stiffer penalties for manipulation, just to name a few things.

Two bills, one by Senator Harkin and one by Representative Peterson, Chairmen of the Senate and House Agriculture Committees, respectively, would provide the CFTC additional oversight authority over OTC markets. Senator Harkin’s bill eliminates many of the exclusions and exemptions for OTC trading that were contained in the CFMA. His intent appears to be to require OTC transactions to be moved onto regulated futures exchanges.

Representative Peterson’s bill seeks, among other things, to mandate clearing of OTC transactions, require CFTC mandated position limits, establish conditions for granting hedge exemptions, require increased recordkeeping and reporting, and provide additional requirements on foreign boards of trade, index traders, and swap dealers.

These are good steps, and I encourage all of you to share your thoughts, concerns and suggestions with the Commission and with Congress on these matters.

Adequate CFTC funding

Finally, the CFTC continues to face significant resource challenges and without additional resources, the CFTC will be unable to fulfill its regulatory charge. Each day the CFTC oversees markets whose traded contracts have a notional value of $5 trillion. President Obama's 2010 budget for the entire year is $3.5 trillion. Again, we oversee $5 trillion in notional value of trading each day. We also are working with fewer people at a time when the markets we regulate have grown exponentially. In 1992, the CFTC had 592 full-time employees, today we have 490 employees. Though technology has helped us become more efficient in the work we do, we can no longer sustain our current level of work without an infusion of human and fiscal capital. Fortunately, help may be on the way.

The omnibus appropriations bill signed into law yesterday by President Obama included a much needed boost—approximately 31%—in funding for the CFTC's critical mission areas. President Obama's 2010 budget calls for another 10% increase in the CFTC budget for a total increase of 41% over our present day operating budget. I am very thankful to the Appropriations Committees in both the House and Senate for recognizing this need, and in particular to Senator Durbin who continues to show his commitment to a successful and robust CFTC. I am hopeful that this increase in funds will enable the CFTC to fulfill its responsibilities without Congress resorting to new funding streams, such as user fees.

While we are pleased with the outcome of the appropriations process, more resources are needed as the financial crisis and desperate economic times continue to uncover fraudulent behavior throughout the markets. I will continue to call on Congress and the Office of Management and Budget at the White House to ensure we have enough resources and personnel to carry out the agency's many essential mandates. There has never been a more important time in the CFTC's history for thorough and unwavering oversight of the futures markets, and having the people and the technology to collect, analyze, oversee, and enforce the Commodity Exchange Act is the key to our success.

Thank you again for having me here today. I'm grateful to have had the opportunity to share my vision for reforms and I look forward to your feedback during the course of this valuable conference.