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Remarks

"Driving on Ice"

Remarks of Commissioner Bart Chilton Before the European Union Agriculture and Financial Market Attachés, French Embassy, Washington, D.C.

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Good morning and happy holidays. Thank you for the opportunity to be with you today. I particularly want to thank Christian Berger for the invitation. And I'd be remiss if I didn't thank First Secretary Clare Thorp from the Irish Embassy. Without Clare, I might not have met any of you. When we last spoke at the German Embassy in 2007 where Joachim Schaefer hosted us, I wore a different hat and had a different role. As Christian has explained, I've had many posts in Washington over the last quarter century. Let me say how much I appreciate your willingness to listen to someone who can't seem to hold a job. Your charity is appreciated, and befitting of the season.

Through all of the jobs, however, there has been a progressive discovery. It has been fascinating to learn about, and be part of, some very important national policy debates on issues that matter to people. At the CFTC, it has been no different. The staff is dedicated and smart, and they do an enormous and professional job. And yes, there has been a lot of learning.

I'm not so pleased to report that it has also been somewhat disappointing at times. None of that comes from the dedicated CFTC staff, but rather from our inability as a Commission, as leaders of the CFTC, to be more proactive and to look around the corner at potential problems—to be nimble and quick regulators. Although issues within the CFTC's regulatory purview were not in the epicenter of the past year's financial meltdown, we could have, and should have, done much better on some issues before and during this crisis. That is certainly not to say that we didn't do some very good work. We did. I am particularly impressed with our enforcement efforts and, as I'll mention later on, our clearing staff capabilities. In fact, overall, the CFTC did a better job than most of the other financial service sector regulators, but everything is relative, and we also fell short many times. We could have done better.

We could have been aggressive advocates for closing dark energy markets—particularly after we witnessed how consumers were impacted by the activity in the natural gas markets in 2006. We could have given exchanges timely guidance on governance rules that we promised in the first quarter of this year. We could have been quicker to see the problems of look-alike contracts traded on domestic and foreign exchanges—the Enron and London Loopholes—if you will. We could have done more and reacted better in looking at silver and gold trading. We also could have done better by looking at the role of new speculators—particularly non-traditional, non-commercial long traders—in the commodity markets. With gas prices over $4 a gallon this past summer, the CFTC's position that the markets were operating appropriately strained credibility, at best. We could have dealt better in handling with the issue of market prices vis-à-vis swaps dealers. We could have conducted the interagency task force looking at oil trading in a different fashion—perhaps one that didn't invite an Inspector General's investigation. We regulate only a small fraction of the on-exchange risk management derivative markets (about $4 trillion), while the much larger market derivatives market is traded over-the-counter (OTC). Yet there is still a reluctance on the part of the CFTC to even request legislative authority to get any information about OTC trading, let alone regulatory authority over these markets, in spite of the incontrovertible fact that the on- and off-exchange derivative markets are interdependent and frequently arbitrage and price off of each other. Even though the House of Representatives passed legislation in this regard with a wide bipartisan vote, the CFTC and the Bush Administration could not see fit to support the measure.

To be fair, as I said, we did some things right and the CFTC is just one of the many financial regulators in the U.S. and around the world that, looking back, may have done things differently. But let's face it, there has been, in the U.S., a general attitude that the free market should rule for the past decade. The Free Marketeers view any government regulation or oversight as an impediment to the natural and free flow of market forces. That is what happened when banking laws were deregulated in 1999 and it is what happened when the Commodity Futures Modernization Act (CFMA) was enacted in 2000. There were certainly good parts of CFMA, but the exempt commercial markets provision (ECM) and the swaps provision, in particular, certainly could have been drafted in a different manner that didn't leave open the possibility for abuse. As laws and regulations became less strict, it seems that regulators were less interested in what was taking place. The problem is, free markets may work well on a pristine test track, but not so much on the real road where there are bumps potholes and varying conditions. In essence, we veered too far to the right toward deregulation, and we have all witnessed a pretty nasty crash. Now, with the meltdown, we know government went too far.

The result is a global economy in disarray. Nearly every day we learn of a new low in this or a new high in that. Records are breaking all the time. Just this week I learned about the

Consumer Confidence Index, which is nearing an all-time low and consumer sentiment is lower than during the serious recessions in the 1970s and 1980s. Consumer retail sales have fallen dramatically for 5 straight months, highlighted by total U.S. auto sales reaching their lowest level since 1982. For U.S. domestic auto sales, the picture is even worse. Sales for U.S. manufacturers are at their lowest level since 1981 and closing in on 1970—when domestic sales reached their lowest level on record. Data that we've received from the Bureau of Economic Analysis shows the largest decline in our consumption numbers, or personal spending forecasts, since 1980. To top it off, it was reported Wednesday that even China will see a reduction in their number of exports for the first time in seven years, a direct correlation of the decline in consumer spending. We have all also seen what is happening with interest rates, some people are even paying just to have others hold their money.

As we move forward, one thing that seems more important than ever is the recognition that we are in a global economy. What we do in the U.S. impacts our neighbors in the world community. Markets are inter-related, operating nearly 24-7-365, or this year the extra day to 366. If one nation has weaker laws, business may gravitate there, but at what price? Global coordination and cooperation is going to be even more essential in the future. I'm hopeful that we all will take into account the interconnectedness of our economies, and that our rules and regulations will reflect that reality.

I was on a long road trip recently and it was snowing and made driving a challenge. I ran into some large ice patches. Most of you, I'm sure, have some experience driving on icy roads. The key to not making a mistake that causes an accident is to not over-steer. Don't over-correct. If the car slides to the right—like the Free Marketeers who have driven our laws rules and regulations too far to the right—there is an inclination to veer sharply to the left in the other direction. That inclination to over-steer can just as easily lead to an accident. Just as on an icy road, those of us in government need to be sure that any changes we seek or make don't veer too far left. An overcorrection, here or abroad, could create more problems than solutions. Becoming too overzealous may have the unintended consequence of moving the bad actors into darker markets outside regulatory reach.

Don't get me wrong, we need to do better. I'm not suggesting a "go slow" approach. To the contrary, we need to change and soon. We also, however, need to do it in an appropriate fashion. We don't want overzealous laws and regulations, nor do we want to continue in the current regulatory vacuum—we can see where that has gotten us. I believe Congress should act expeditiously to prevent the type of excessive speculation and leveraging we have seen in both the on- and off-exchange markets, and make both the regulators and the regulated more accountable and more responsible. Such legislation would help to ensure transparency, openness, and fair dealing in our financial markets, and make these critically important markets work as they should for consumers and businesses around the globe.

That's why today I'm outlining some decisive steps that I think Congress should take 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.

I am hopeful that the Congress will enact the following legislative changes and grant specific legal authority for the CFTC to:

1) Require OTC reporting and recordkeeping so that the CFTC can 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 Swaps (CDS) 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 today, 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.

That said, I'm not sure we've necessarily been going about tackling this in the most beneficial way. Currently, we're witnessed one platform sign up to become a bank, with a banking regulator overseeing the clearing function (a regulator, by the way, with no prior experience in regulating clearing), we've seen the Chicago Mercantile Exchange seeking to be regulated under the commodities laws as an OTC clearer (which, frankly, makes a lot of sense—the CFTC is the sole federal financial regulator with experience clearing swaps, and we have an excellent track record and comprehensive experience in clearing derivative products generally), and we've just heard that other entities from abroad will be clearing these products as well. Quite frankly, it seems like a bit of a mess to me. It appears the direction we are headed in presents a rather confusing set of issues from the outset. That's why there is a need for Congress to step in and legislatively mandate, under a uniform system of guidelines and pursuant to a regularized statutory scheme, how OTC clearing will be overseen. Until that time, I'm supportive of federal regulators doing what they can to promote clearing using their existing authorities, but we need to be careful. I think we need surefooted legal authority to regulate certain OTC products that could impact the regulated markets, including CDSs.

3) Regulate OTC transactions if the Commission determines that certain trades are problematic. To be clear, 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 oversight and transparency of these markets.

It is the CFTC's mantra, mandate and mission to guard against fraud, abuse and manipulation. If we see a problem with OTC trading, we certainly should have the tools necessary to address it. To accomplish this, it is time to eliminate the provisions of the Commodity Exchange Act that allow for full exemptions from regulation. Specifically, sections 2(d), 2(g), and 2(h) of the CEA should be eliminated and replaced with new provisions that allow for appropriate trading of OTC transactions, as I've outlined above. It goes without saying, by the way, that in order to carry out these new responsibilities, Congress will also need to authorize and appropriate additional resources and staff to the agency to ensure that we can properly effectuate our duties. In sum, our collective goal should be to enhance regulatory oversight, improve market integrity and customer protection, improve communication and oversight between regulators, and smooth the regulatory processes for regulatees. I believe these legislative changes would achieve those ends.

In addition to actions that require legislative changes, there are efforts that can be taken now—immediately—to improve oversight of our financial markets. Here, I'm not discussing anything that involves an increase in legislative authorities, but rather effective and appropriate use of authorities already granted by Congress. Indeed, from my perspective it is irresponsible that in some areas, action has not already been taken. I'm referring, for example, to issues relating to cross jurisdictional products, futures on foreign security indexes, security futures products, and portfolio margining. These are all outstanding issues that the Securities and Exchange Commission (SEC) and the CFTC can, and should, work to resolve. The CFTC and SEC have, here in the U.S., significant authority to protect markets and consumers, and to address each of these issues. The problem has been, not a lack of authority, but a failure to appropriately and aggressively utilize those authorities. I find it amazing that even since I became a Commissioner, in August of 2007, there has not been a joint meeting between these two financial regulators, let alone a joint meeting with the Federal Energy Regulatory Commission (FERC) or other appropriate regulatory entities.

I have an appetite for trying to solve these problems and think many of my financial regulatory colleagues—at the CFTC and elsewhere—do so as well. I also think there is support in Congress for the types of common sense legislative changes that which have been outlined—changes that would provide clarity and accountability to our laws. These changes would build functionality into our regulatory regime to protect consumers.

Just like driving on an icy road, I'm hopeful that we don't over-steer or over-correct—here in the U.S. or in other countries. We have recklessly veered to the right during the last decade. We have all witnessed the results, not just as gapers witnessing an ugly accident, but as unwilling participants of a crash. With these changes as proposed, we will have the tools to move forward again—this time, with the knowledge that regulators will have the necessary authorities to protect consumers and ensure market integrity, and that we will ensure against systemic economic risks in the future.

Thanks for your time. Happy Holidays.