U.S. COMMODITY FUTURES TRADING COMMISSION
ENSURING THE INTEGRITY OF THE FUTURES & OPTIONS MARKETS

SPEECHES & TESTIMONY

Commissioner Sharon Bowen FIA Expo Inaugural Speech

November 5, 2014

Thank you for that kind introduction. It's an honor and a privilege to come here to FIA's 2014 Expo for my inaugural speech as a Commissioner of the Commodity Futures Trading Commission. Chicago has a special place in my heart and gave me my first glimpse about futures and commodity trading. In many respects, I've come full circle, not unlike what sometimes happens to markets. As a business student at Kellogg, I got exposure to the financial markets. While spending a summer at an investment bank, I first learned about the world of commodities. It intrigued me enough to seek and obtain a summer internship at the Chicago Board of Trade. At Northwestern's law school and CBOT, I learned about the rules and regulations governing commodity futures trading. Who would have thought, almost thirty-five years later, I would be a Commissioner of the CFTC.

The futures industry has lain at the heart of the CFTC since its founding, and Chicago itself is the ancestral home of commodities trading. Sorry New York! I am delighted to give my inaugural address to this group in a place that is so intimately connected to the CFTC and its mission.

The futures industry allows market participants of all types to hedge their risk, lowering their potential costs and increasing the growth of our economy. It allows financial actors to better craft investment strategies for their investors. And it allows end-users and consumers to gain access to critical commodities in a cost-effective, efficient manner.

Given our shared history, I can skip a detailed recitation of the history of the Commission and its jurisdiction and instead focus this morning on the Commission's path forward. As I said at my swearing in, the CFTC has now entered the post-financial crisis world – every sitting Commissioner was confirmed by the Senate after Lehman crashed, after the unemployment rate hit 10%, and after Dodd-Frank was enacted into law, giving the CFTC new powers and responsibilities.

In this speech, I will lay out how I view this moment at the CFTC and the broad principles that will guide my decisionmaking as Commissioner. First, I am going to briefly discuss a few issues we're considering at present, and then I will share a few principles that will guide me during my term as Commissioner. While this list will not be exhaustive, I hope that you will be able to glean the core of my perspective from them.

As many of you know, the CFTC has largely completed the rules required by Dodd-Frank. Of the 60 required rules, 50 have been finalized. I am proud to say that we have completed a higher percentage of our mandatory rules than any other domestic financial regulator. Still, several major rules have yet to be completed. One of these is the rule regarding margins on uncleared swaps. The CFTC released a new proposal on this rule in September, and I look forward to reviewing the many comments we have received on it and finalizing it in the near future. This is an important rule for protecting customers and addressing financial risks; so the industry and the public will both benefit from getting the final rule done.

We have also recently announced proposals to exclude certain end-users from some recording requirements under Rule 1.35(a). And, we have tweaked the compliance deadline of the residual interest rule. In both instances, we took a common-sense, practical approach to address concerns about unnecessary costs and burdens raised by market participants.

Another rule that needs to be finalized is position limits. Initially finalized in late 2011, the rule was vacated by a federal district court in late 2012. Commission staff has been hard at work on this rule, and the Commission issued a new proposed rule in 2013 that sought to fix the issues flagged by the court. Now, because we want this done right, we reopened the comment period on this proposal for a short while this summer. But, we now need to work to complete a final rule. These rules have been discussed for years now, and it is time for the Commission to make the decisions it needs to make to get the rules finalized. I hope we can finalize this rule in a way that both realizes Congressional intent in mandating position limits and maintains companies' ability to manage their commercial risks. Judging from the past course of these debates, I know it will be an interesting process.

On cross-border issues, we also need to cement an approach that allows our markets,

which are inherently global, to operate competitively and efficiently. We need to do so, while also guarding against dangers that may start outside our borders, but flow back to our shores.

Additionally, the Commission continues to face a crisis that has lasted for years: chronic under-funding compared to the scope of its mission. The scope of the markets overseen by the CFTC has expanded massively over the past decades. The futures and options markets have grown to over $41 trillion in notional value as of June this year in North America. And, at the same time, we are now also the primary U.S. regulator for the vast majority of swaps. In fact, it's my understanding that the size of the markets we regulate totals approximately $400 trillion dollars. Yet, we were tasked with regulating such a massive set of markets with a budget that was just $215 million in fiscal year 2014. Our budget is insufficient, and the Commission and staff consistently have to make difficult choices about how to allocate scarce resources amongst our many regulatory priorities. This situation jeopardizes our ability to effectively fulfill our vastly increased responsibilities.

Chairman Massad has stressed that we don't have enough funding to engage in the needed comprehensive oversight of our markets. If you want a well-functioning agency and markets, sufficient funding is necessary. I fully and unconditionally support the Chairman's efforts to get us sufficient funding.

Finally, the CFTC is also facing a number of issues that were not fully visible until recently, and were therefore not addressed by Dodd-Frank. One of these is the changing role of technology in markets, a trend that has received the most play in the media as coverage of high frequency trading and colocation. Another is the rising role of pension funds, and other entities not directly connected to the use of commodities, making speculative investments in futures and options. Now, none of these changes is inherently bad – we should welcome efforts to try and craft new financial products and to use technology in new ways. But we at the CFTC have an obligation to make sure that these new practices are regulated appropriately.

As Sponsor of the Market Risk Advisory Committee, I look forward to hearing from market participants and regulators about their thoughts of the most pressing risks facing our markets. I, and my staff, have already engaged in many helpful discussions about possible priorities for MRAC, and we plan to publish a Federal Register release asking for further suggestions. So far, we've heard some common themes, including cybersecurity, clearinghouse resolution and recovery, accurate reporting, and the prominence of unregulated third-party service providers. We look forward to getting even more input from the public.

Now, we come to the future. It should go without saying that none of us can perfectly predict what will happen in either the economy or the markets. If you think you can, I congratulate you and encourage you to try and use that power for good. And, hey, why didn't you tell us ahead of time about some of those little problems in 2008.

History has shown us it is difficult to see the next "big thing" when it comes to financial risks. That means we have to pay special attention, as regulators, to how we identify, address, and manage risk. I want to offer a few thoughts on how I think about the task.

First, it is critical that we allow financial actors to take reasonable risks. Our financial markets are the wellspring of capitalism – they allow new, useful ideas to receive the resources they need. They don't do this perfectly – we can all think of times where the markets killed a promising concept while at the same time devoting significant resources toward tired or nonsensical business plans. Yet, our markets do a pretty good job. We need to make sure that the market is free enough to allow a firm to take a chance on an idea, and even sometimes to allow one financial firm to take a risk that, if it fails, it could mean the end of that firm.

But, we cannot allow firms to take risks that endanger the entire financial system or the broader economy. These risks can come from a large company failing and then sucking others down with it because of the interconnectedness of the financial system, or because a particular kind of financial product or activity becomes systemically risky. When a company or companies make bets that endanger the entire economy, they're not just putting their money on the line, they're putting everyone else's on the hook too-- unrelated companies as well as citizens who may have no idea why their investments just plummeted. That does violence to the ideals of capitalism.

We need protections in place, whether that is position limits, margin requirements, or well-run clearinghouses, to ensure that one company's risky bet doesn't throw the entire system into chaos. And as we promulgate new rules or tinker with our existing rules, we should be very careful that we do not do something that carries with it unintended consequences.

Now, it's worth pausing to note that the core markets that the CFTC regulated back in 2008, the futures markets, held up very well during the financial crisis. In other words, for the most part, futures trading pretty much kept working in 2008. This is, to me, evidence of the virtues of exchange trading. I firmly believe that transparency is a positive good. Wherever possible, we should be more transparent and try to get financial markets "out of the shadows". The liquidity and transparency of futures markets benefits small and large participants alike in their ability to manage their commercial risks as effectively as possible. Also, the benefits of central clearing are substantial, in making risks more visible and therefore more capable of being managed.

Second, we have to mind the gaps – the regulatory gaps. One of the reasons the financial crisis occurred is that regulators were unable to address a new sector of the economy, one that even some financial professionals may not have fully understood. There was, in other words, a gap between the regulators and between regulations. The existence of that gap allowed a huge amount of financial risk to accumulate, unseen by regulators and most market participants.

We now know that allowing the unregulated swaps market to fall into a regulatory gap was a huge mistake.

We don't need the CFTC to personally approve each trade or set of trades – that's preposterous. But we need to know what's going on in each sector of the financial industry. We can't have systemically significant markets developing in the dark, unseen by regulators. Thankfully, given the events of the last decade, I believe that very few people still want massive numbers of trades to occur in the shadows.

Third, we have to try and ensure that the rules and guidance we communicate are as easy to understand as possible and don't drown financial actors in unnecessary paperwork. Now, as you all know, regulation of futures, swaps, and derivatives isn't necessarily simple. The idea that we can issue a rule governing the operation of a commodity pool that fits on a single page of paper isn't realistic.

But, we should try to make sure our rules are as clear as possible and that they don't impose unnecessary cost and burdens. Where possible, they should accommodate existing industry practices and streamline paperwork for registrants.

If we can make rules clear and easier to implement, we can reduce overhead compliance costs for financial actors, make the markets more accessible to the average investor, and hopefully reduce the risk that a financial actor inadvertently breaks one of these rules. At heart, I'm a practical person, and I will approach all problems from a practical perspective.

Fourth, rules released by the CFTC must fix the problems they were crafted to solve. It is not uncommon in either government or the private sector for a solution to be devised to address a problem that sometimes doesn't actually fix the problem. We need to resist that inclination. We owe it to our staff, market participants, and especially consumers not to spin our wheels and simply put something out to say we did something. When faced with a problem, we need to work until we identify a solution that fixes that problem in the most practical and cost-effective way possible.

Fifth, we have to be focused on how we can identify the next potential crisis while still cleaning up from the last one. We've mostly fulfilled the mandatory obligations of Dodd-Frank. But the progress we have made trying to fix the problems that caused the last crisis does not mean we are yet prepared to address future potential threats. We cannot become complacent.

It's an inherent part of finance that there will be people who push the limits and make risky investments; it's one of the best attributes of our dynamic markets. But we at the Commission have to be just as fast so that we don't remain one step behind. It is not a duty that is easily met – there are billions of dollars in profit motive and some of the smartest people around trying to find new innovations in the futures and derivatives spaces. All that the CFTC has is a small budget, a staff of a few hundred people, and a mission of protecting the markets and enforcing the rules. To live up to that mission, we have to be eternally on the lookout for where the next crisis may come, and be ready to act to prevent it.

Finally, and perhaps most importantly, no one is above the law. If someone steals, we trust they will be prosecuted and face criminal sanction. If someone engages in a complex effort to deliberately manipulate the oil market, to run an illegal swaps dealer or to rig an interest rate market, citizens need to be confident that those individuals will be held accountable, including criminally where appropriate. The Commission does not have criminal law enforcement authority, but we can and do make criminal referrals to the Department of Justice and state and local authorities. I think it is crucial that the Commission has the necessary resources and tools it needs to catch and prosecute lawbreaking when it occurs.

We need the public to have confidence in our ability to be the cop on the beat, and we need the public to be confident in our abilities as well. If people ever lack that trust in us, we need to redouble our efforts.

Those are six of my core guiding principles that I will look to constantly, as I help us chart our course forward at the Commission.

But I would like to leave you with one final thought that will always be in the back of my mind. We've been through a lot the last six years, and the biggest fear I have is that we won't do enough to stop a future crisis. We at the Commission need to act in such a way that the 2008 financial crisis and its effects are remembered as an extraordinary break from typical financial stability and not as the first in a series of financial crises. If, at the end of my time as Commissioner, the average investor or end-user says that markets were far more stable and protected from when she left than when she arrived, that will be more than enough praise. Thank you, and I look forward to working with all of you as we leave these years of extraordinary events behind and chart our course forward.

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