Remarks of Commissioner Brian Quintenz at the Technology and Standards: Unlocking Value in Derivatives Markets Conference

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Introduction

Thank you for that very kind introduction.

Before I begin, let me quickly say that the views contained in this speech are my own and do not represent the views of the Commission.

I am pleased to be with you in London to focus on the power of technology to transform our financial markets. And I am mindful of our location. We are near Spitalfields, which has been a center of commerce and trade for hundreds of years. It is a landmark of innovation. New products came here from oceangoing ships and British highways and canals. New ideas were planted here and flourished here. Even now, we see innovation and trade changing the London landscape and bringing more commerce to the East End.

Innovation is the ever-present theme of our time. Change is all around us, motivating us, challenging us: new technologies result in new products, new processes, even new commodities in the global marketplace. Indeed, Spitalfields is an appropriate place for this discussion as any.

We often prize innovations and celebrate the visionaries. As far back as ancient Greece, Prometheus was immortalized as the one who commanded man "to see the sky and raise his high eyes to the stars."[1] More recently, innovators like Alan Turing and Steve Jobs have been lionized in popular culture, their personalities becoming almost as important as their inventions.

But innovation has not always been a value that societies have openly embraced. Galileo's contributions to science were extraordinary, but his intentions and conclusions were fiercely condemned and led to protracted house arrest where he spent the remainder of his life.[2] Throughout history, it has often taken time for society to recognize the value of truly transformative technologies.

The Realization of Distributed Ledger Technology's Promise

However, I believe we live in a time of remarkable promise, as both technological advancements and their widespread acceptance and adoption are occurring with such rapidity that the "efficiency horizon" is shifting further out every day. Nowhere is that horizon's advancement more evident than in the initial, but yet concrete, applications of distributed ledger technology, otherwise known as DLT. DLT's promise to transform how firms handle trade execution, processing, and reporting and recordkeeping of derivatives is already starting to take shape. For example, the Depository Trust Clearing Corporation (DTCC) has announced that it is transferring records for more than $11 trillion of cleared and bilateral credit derivatives transactions to its own DLT platform.[3] The platform is expected to go live in early 2018 and will provide market participants with real-time access to a single recordkeeping system for their swap transactions.

The further actualization of DLT in the derivatives space will depend on the ability of market participants to digitize all aspects of their financial transactions. Once the terms of a swap can be reduced to a completely digital, industry-accepted standard, then automatic trade reporting, centralized recordkeeping, and, ultimately, smart contracts become possible. ISDA's common domain model, which aims to capture all post-execution trade lifecycle events in a digital format, is an indispensable step toward the fulfillment of blockchain's full potential.[4]

Regulatory Framework

Given the current velocity of financial innovation, it can be difficult to distinguish between nascent technologies that may disrupt and change the trajectory of global financial markets from those that once appeared genuinely innovative, but ultimately are not.

How then do we create a workable and appropriate regulatory framework that facilitates market-enhancing innovation?

I believe it starts with leadership and engagement, imagination, vision, clarity, and cooperation. We need regulation that is fair and does not stifle positive innovations. Through an active, ongoing dialogue with the FinTech community, the CFTC and other regulators, can provide greater regulatory certainty to support innovation that promotes competition, vibrancy, and growth in our financial markets. To initiate this dialogue, this past spring, Chairman Giancarlo and the agency launched an initiative called LabCFTC.

Twenty-First Century Regulator: LabCFTC

The LabCFTC initiative is designed to position the CFTC as a modern, twenty-first century regulator of rapidly evolving, digital markets. It has three core components.

The first is what we call "GuidePoint." GuidePoint aims to make the CFTC more accessible to FinTech innovators by providing them with a direct point of contact for timely and meaningful feedback on new ideas. The LabCFTC team, led by our Chief Innovation Officer Daniel Gorfine, has met with over 100 market participants since LabCFTC's inception in May. Through early engagement during the development process, LabCFTC hopes to offer clarity and guidance that will save innovators time and money.

For example, in some instances, an innovation may achieve the desired outcome of a regulation, but not fit within the letter of the rule. In such cases, instead of a complete rethink of the technology in question, LabCFTC can advise the agency on whether relief should be provided on that innovation or, more broadly, that any applicable rules be re-written.

Paradoxically, regulations which seek to promote a certain innovation can actually hinder further development of alternative, and perhaps better, innovations. LabCFTC's knowledge and expertise gained from its dialogue can promote technology-neutral regulations—ones which mandate a particular result but not the means by which the result is achieved. It can also engender a principles-based approach to the regulation of emerging technology without compromising market integrity or capitalism.

The second component of LabCFTC, called CFTC 2.0, is the agency's proactive effort to understand, stimulate, or adopt technologies that are beneficial to the derivatives markets or the way the CFTC oversees them. While GuidePoint is driven by market participants seeking out guidance from us, CFTC 2.0 is our own internal campaign to drive technological change within the agency.

The final component of LabCFTC is coordination with other U.S. and international regulatory authorities. We have a mutual interest in promoting market-enhancing innovation. Through formal and informal relationships, LabCFTC seeks to collaborate with, and learn from, the experience of fellow regulators to develop best practices and recognize emerging trends. For example, Dubai intends to conduct the majority of the emirate's business using blockchain by 2020, which would make it the first blockchain-powered

government in the world.5 Smart Dubai, a government office tasked with facilitating innovation in the emirate, is working on the transition.6 We look forward to learning from Smart Dubai's experiences in pioneering blockchain through public and private sector outreach.

Switching to something closer to Britain, LabCFTC has also benefited greatly from the examples set by the Financial Conduct Authority's FinTech initiative "Project Innovate," which was established in 2014, and the Bank of England's "FinTech Accelerator" launched last year.

Consider the FCA's regulatory sandbox, which celebrated its first anniversary in October. In the first year of its operation, early indicators are that the sandbox initiative has reduced the time and cost of getting innovative ideas to market:

- 75% of firms that participated in the sandbox successfully completed testing, and
- 90% of those firms are preparing for a wider market launch.7

Although U.S. regulators may not have the same authorities to establish regulatory sandboxes in the U.S. markets, LabCFTC plans to host a series of prize competitions in 2018. These competitions are meant to encourage the development of beneficial technologies within the private sector. We anticipate issuing a Request for Information by year's end to solicit input from the general public regarding the topics the first prize competitions should address. Prize competitions, in conjunction with the agency's ability to provide no-action relief when necessary, are two powerful tools the agency has at its disposal to promote innovation. All of the above initiatives advance the CFTC's larger objective to stay informed of novel FinTech developments and their potential impacts on the derivatives markets.

Bitcoin Futures Products

Perhaps one of the most prominent ideas associated with FinTech are digital currencies, led by bitcoin. Recently, the Chicago Mercantile Exchange Inc. (CME) and the CBOE Futures Exchange (CFE) began discussions with the CFTC about listing new bitcoin futures products. Bitcoin futures would provide a new platform to gain or hedge exposure to bitcoin's volatility. Given their novelty, I want to spend a few minutes discussing the CFTC's oversight over bitcoin futures products.

Prior to listing a new futures contract, the Commodity Exchange Act (CEA) provides exchanges with the option to either (i) submit a written self-certification to the CFTC that the contract complies with the CEA and CFTC regulations, or (ii) voluntarily submit the contract for Commission approval.8 The two processes are similar in that unless the Commission finds that a new product would violate the CEA or Commission regulations, the exchange may list the new contract.9

As a matter of practice, exchanges bring the vast majority of new products to market through the self-certification process. Sometimes in the case of novel products, the exchanges voluntarily provide the Commission staff with advanced draft contract terms and conditions for their proposed futures contracts. This has been the case for bitcoin futures, where although the exchanges plan to use the self-certification process, staff has had the opportunity to review information provided by CME and CFE, engage in many discussions, and evaluate whether any aspects of the contracts raise questions regarding compliance with the CEA and Commission regulations.

One noteworthy CEA provision is that an exchange may not list a contract that is readily susceptible to manipulation.10 Further, exchanges have a duty to monitor market activity on an ongoing basis to detect and prevent manipulation, price distortions, and, where possible, disruptions in the cash-settlement process.11 CME and CFE will use the tools at their disposal, through a combination of real-time monitoring, position limits, and information sharing agreements with the underlying cash exchanges, to prevent and detect manipulative practices. In addition to the exchanges' efforts, the CFTC has its own anti-fraud12 and anti-manipulation authority.13 Although there will always be bad actors willing to engage in manipulative or fraudulent practices, the launch of the bitcoin futures contract provides investors with an opportunity to trade bitcoin exposure in a regulated market.

With respect to clearing, the relevant registered derivatives clearing organizations (DCOs) have been providing Commission staff with information about how they intend to manage risks associated with bitcoin futures. Commission staff has been reviewing this information, including examining how the DCOs will satisfy their obligation to establish initial margin requirements that are commensurate with the risks of the contracts.

After any contact is launched, Commission staff will engage in a variety of oversight activities. These activities include monitoring and analyzing open interest, initial margin, and variation payments, as well as stress testing positions. Commission staff also will conduct reviews of exchanges, clearing firms, and individual traders involved in the trading and clearing of bitcoin futures. Further, if the Commission determines that the margin the DCOs hold against bitcoin futures positions is inadequate, it can take measures to require that the margin levels be increased.

Of course, the Commission does not endorse any particular futures contract, including bitcoin. It is incumbent on market participants to conduct appropriate due diligence to determine whether these products, which have at times exhibited extreme volatility, are appropriate for them.

International Coordination

While in London, I would be remiss if I did not highlight the importance of the CFTC's coordination with other international regulators, not just on novel FinTech issues, but more generally on the myriad of issues that impact our global derivatives markets. For example, most imminent among those, the CFTC and the European Commission are on track to issue their respective comparability and equivalence determinations regarding trading venues in early December—ahead of the January 3 deadline. That may be a first for the CFTC and EU, a standard I hope we can match in the future.

For over three years the CFTC has also worked with our EU counterparts and other international regulators to harmonize data standards for swaps trade reporting. More work and discussions are necessary, especially around governance issues, but I am encouraged at the dialogue that has been occurring.

While progress is being made on these and other fronts, agreement in other areas is proving more challenging. The supervision of cross-border CCPs is of paramount importance to both the EU and the CFTC. The European Commission and the CFTC agreed to a common approach on this topic in 2016 which promoted the vibrancy and liquidity of our global derivatives markets. It sought to avoid the fragmentation of those markets and reflected our mutual commitment to regulatory deference and to ensuring that CCPs on both sides of the Atlantic are held to rigorous standards.

Through the CFTC's constructive working relationships with regulators in the UK, EU, and elsewhere, I am optimistic we will find a path forward that recognizes our shared interest in the effective supervision of cross-border CCPs that is also consistent with the common approach agreed to in 2016.

The final form of Brexit is a crucial political decision that European officials must make with great care. I do not presume to tell our European friends and allies what to do or what outcome they should seek. However, we should all remember that market participants will always look to engage in the most well-designed regulatory frameworks. Trading counterparties seek neither the least nor the most regulated marketplaces, but rather marketplaces that have the best balance of sensible, objective, and reliable regulation.

Conclusion

I am optimistic about our cross border dialogue, about the future of financial technology, and about our markets in general. That's because the results of optimism exist constantly all around us, but especially right here in Spitalfields. A few years ago, Spitalfields' glory had dimmed, and it fell upon hard times. Then, it was rejuvenated, resurrected, and reborn. Now, it has reclaimed its rightful place in a thriving and exciting city. Families come here; children play here; commerce thrives here.

That is the joint promise of innovation and optimism. That is the future that we can accelerate. With the right outlook, we can help guide advancement…promote it...and capture it. The opportunities, as well as the challenges, ahead of us are immense. But, through gatherings like this, on-going dialogue, partnerships, and trust, we will find the wisdom, commitment, and vision to benefit innovators, consumers, and the markets with thoughtful and appropriate regulation.

Thank you.

1 Ovid, Metamorphoses (David Raeburn trans., Penguin Books) (2004).

2 David Zax, *Galileo's Revolutionary Vision Helped Usher in Modern Astronomy*, Smithsonian Magazine, August 2009, https://www.smithsonianmag.com/science-nature/Galileos-Revolutionary-Vision-Helped-Usher-In-Modern-Astronomy-34545274/.

3 Robert Mackenzie Smith, *DTCC's Bodson on Blockchain, SDRs and Repo Clearing*, Risk.Net, Nov. 15, 2017, https://www.risk.net/risk-management/5354751/dtccs-bodson-on-blockchain-sdrs-and-repo-clearing.

4 International Swaps and Derivatives Association, ISDA Common Domain Model Version 1.0 Design Definition Document (Oct. 16, 2017), https://www.isda.org/a/gVKDE/CDM-FINAL.pdf.

5 Nikhil Lohade, *Dubai Aims to Be a City Built on Blockchain*,Wall St. J., April 24, 2017, https://www.wsj.com/articles/dubai-aims-to-be-a-city-built-on-blockchain-1493086080.

6 Smart Dubai, Dubai Blockchain Strategy (Dec. 2016), http://smartdubai.ae/dubai_blockchain.php.

7 Financial Conduct Authority, Regulatory Sandbox Lessons Learned Report 5 (Oct. 2017), https://www.fca.org.uk/publication/research-and-data/regulatory-sandbox-lessons-learned-report.pdf. These statistics refer to firms accepted into the first cohort of testing.

8 17 C.F.R. § 38.4. In this case, we use the term exchange to refer to a designated contract market.

9 When an exchange self-certifies a new contract, it must determine – as the Commission does when reviewing a product for approval – that the offering complies with the CEA and Commission regulations.

10 17 C.F.R. § 38.200.

11 17 C.F.R. § 38.251.

12 Section 6(c)(1) of the CEA, 7 U.S.C. § 9(c)(1).

13 Section 9(a)(2) of the CEA, 7 U.S.C. § 13(a)(2).

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