

SPEECHES & TESTIMONY

Opening Statement of Commissioner Brian Quintenz before the Technology Advisory Committee

February 14, 2018

Good morning and welcome to the first 2018 meeting of the Technology Advisory Committee (TAC or Committee). I want to take a moment to thank you all very much for taking the time to be here today, particularly those of you traveling from across the country. I would also like to thank Dan Gorfine, the Acting Chair of the Committee and the Director of LabCFTC, as well as Jorge Herrada, for their hard work in planning this meeting and putting together such a robust agenda for our discussion.

Before we begin, let me first extend a very warm welcome to all of our new members. We are delighted that each of you so generously chose to volunteer your time to participate. I look forward to hearing from you, along with all of the other Committee members, as we discuss the crucial issues before the TAC today. I also wanted to take a moment to express my regret that Columbia Business School Professor R.A. Farrokhnia will not be able to join us today. I hope he is able to come down for a future meeting.

With that, I would now like to recognize Chairman Giancarlo and Commissioner Benham to make their opening remarks.

Technological changes in the derivatives markets have rapidly evolved since this Committee last met over 22 months ago. I am hopeful that we can build upon the extensive work of past TAC meetings to address the issues and challenges currently emerging in our financial markets. The Committee will explore five key areas today, each of which exemplifies how technology is impacting the functionality of global derivatives markets and how traders participate in them. These are also areas where the CFTC can demonstrate leadership and provide effective oversight that fosters the integrity, strength, and liquidity of our markets.

My intent is for the Committee to use this meeting to identify the issues within each of these areas that it wishes to explore in greater detail, with the ultimate goal of providing the Commission with actionable, practical advice. In many cases, I anticipate that subcommittees may need to be formed to enable the kind of focused review and thoughtful consideration necessary to arrive at those recommendations.

Blockchain and the Potential Application of Distributed Ledger Technology to the Derivatives Markets

The first area the Committee will discuss is blockchain and the potential application of distributed ledger technology, otherwise known as DLT, to the derivatives markets. DLT has the potential to transform how firms handle the execution, processing, reporting, and recordkeeping of derivatives transactions. Market participants may find that using DLT to satisfy their regulatory obligations results in greater accuracy, greater efficiency, and less cost. They may also find that, like many new opportunities, DLT also presents challenges. Much work remains to be done in order to realize the full promise of DLT. From scalability issues, to the complete digitalization of derivative contracts, to DLT's compatibility with existing CFTC regulations, there are many facets of DLT for the TAC to consider.

Market and Regulatory Developments Involving Virtual Currencies and Related Futures Products

Next, the Committee will discuss market and regulatory developments involving virtual currencies and related futures products. The proliferation of virtual currencies over the course of the past year, while exciting from an innovation standpoint, raises a multitude of legal and regulatory questions and challenges. Definitional questions about whether a particular virtual currency or token is a security or a commodity continue to be debated. In addition to these foundational legal questions, the growing demand to trade virtual currencies also elevates the risks to consumers posed by potential fraud and manipulation on spot platforms.

I share Chairman Giancarlo's view that we should respect the enthusiasm of investors for new digital currencies and meet that enthusiasm with thoughtful, balanced regulation. The CFTC should not attempt to make value judgments about which new products are

worthwhile and which are not – the markets, investors, and consumers need to decide that for themselves. However, the CFTC should aggressively target fraudulent and manipulative behavior, whether in the derivatives markets or in the underlying cash markets. I commend the Division of Enforcement’s relentless efforts on that front to protect investors and the integrity of the marketplace.

The current regulatory framework of virtual currencies is a patchwork of state and federal jurisdictions. As the markets for virtual currencies mature, the Commission, along with its fellow state, federal, and international regulators, should ensure a rational approach to regulatory oversight, not one based on fear or inexperience. Jurisdictional gaps should be identified and addressed. In conjunction with those efforts, and as I said at last week’s Yahoo Finance All Markets Summit, I think a self-regulatory organization, or SRO, for cryptocurrency exchanges could spur the development of standards around cybersecurity policies, data retention, protection of customer accounts, trading practices, and other issues. Self-regulation has a long history in derivatives markets. In the 19th century, futures exchanges took the initiative to develop formal rules and disciplinary procedures to enforce fair trade practices and curb manipulation before comprehensive federal regulation was enacted. It is worth exploring whether an SRO model could assist cryptocurrency exchanges establish and enforce standards that protect investors and deter fraud. I look forward to hearing from the Committee about the possibility of such an SRO.

These are only a few of the novel issues that the Commission will grapple with as this nascent, but burgeoning, asset class continues to evolve. I hope the Committee’s expertise can assist the Commission in developing smart policies that address the unique risks and opportunities presented by virtual currencies and related financial products.

Future of Machine Learning, Artificial Intelligence, and Computing Power

The Committee will also address machine learning, artificial intelligence, or AI, and computing power. We will have the pleasure of hearing from Mr. Tim Estes, President and Founder of Digital Reasoning. Digital Reasoning developed a product that uses machine learning to facilitate electronic communications surveillance. The product uses machine learning to determine the meaning of words in emails and chats based on their context. The program is also designed to flag potentially problematic behavior patterns of employees and mark those communications for further review. Mr. Estes will speak with us today about advances in machine learning technology and their future impact on the financial markets.

Developments and Challenges with Automated Trading Technologies

Fourth, the Committee will examine the developments in, and challenges posed by, automated trading technologies. In the past, I have expressed my view that Regulation Automated Trading or “Reg AT” was a missed opportunity by the Commission to explore the real risks of the modern trading environment. I believe the Commission should only pursue additional regulation in this space after it has identified specific risks associated with automated trading, examined how those risks are being addressed through the market’s incentive structure, and then determined if regulation can play a proper role in alleviating those risks. Once that threshold determination has been made, the Commission must work to thoughtfully calibrate the costs and scope of the regulation with the specific risk it is meant to target. The Commission should not adopt automated trading regulations to address amorphous, hypothetical concerns or simply for the sake of having them on the book.

The TAC can serve as a forum to reconsider the risks of automated trading with a fresh eye. To the extent automated trading risks can be addressed through regulation, the Committee can explore what form that regulation should take. Reg AT essentially proposed a registration scheme to address automated trading risks, but there are other possible approaches. For example, the Commission could pursue a principles-based approach that enables best practices to evolve over time. I am hopeful these kinds of conversations can better inform the Commission about the true risks posed by automated trading and how the Commission can best respond to them.

Cybersecurity Developments and Best Practices

Lastly, the Committee will discuss cybersecurity developments. I expect this discussion will begin an ongoing dialogue between the industry and the CFTC about what constitutes cybersecurity best practices. The TAC can facilitate discussions about how the Commission and market participants alike can improve data transmission, storage, archiving, and disposal processes to protect against cyber threats.

Thank you to all of our members and presenters for taking the time to be here with us today and for their flexibility with rescheduling this meeting on such short notice. I am very excited to hear from you. Let's get started.

Last Updated: February 14, 2018