



25th IOSCO Annual Conference
Sydney, Australia

PLENARY 6

Markets

19th May 2000

William Rainer
Chairman
US Commodity Futures Trading Commission
United States of America

Remarks by William J. Rainer, Chairman, Commodity Futures Trading Commission

Before the Annual Conference of the International Organization of Securities Commissions (IOSCO) Sydney, Australia, May 19, 2000

This morning, I would like to share with you my thoughts on two issues. First, I will explore how changes in our financial markets which are driven by technology necessitate corresponding changes in our regulatory product. Second, I will discuss the related need for greater cooperation among international regulators.

Advances in technology are the most important forces shaping the structure of capital and risk management markets today. For the first time in many years, we at the CFTC are seeing new entities interested in starting futures exchanges. This development, among others, has influenced existing markets to restructure and to consider new alliances.

Let me illustrate. Between 1986 and 1997, the CFTC designated only two new exchanges - neither of which ever began trading. Within the past six months, however, the CFTC has received serious inquiries from six startup electronic exchanges, which may file applications with the CFTC in the near future. In addition, the National Futures Association, an independent U.S. self-regulatory organization, also has had discussions with three other electronic markets. And, within the last nine months, the CFTC allowed direct access from terminals in the U.S. to markets in Australia, France, Germany, New Zealand, Singapore, and the UK. Applications from Hong Kong, Sweden and Switzerland are pending.

We also expect that certain business-to-business (BtoB) electronic cash markets will evolve eventually into new electronic futures markets. Our traditional pit trading markets are responding aggressively to this competition by planning to demutualize and by forming strategic alliances with exchanges in other countries.

The consolidation of our brokerage industry similarly reflects the impact of technology. From 1990 through the first quarter of 2000, the number of registered futures brokers decreased 43 percent from 359 to 203. Meanwhile, technology has facilitated the ability of offshore brokers to gain access to the U.S. customer base. The Commission first permitted firms licensed in other countries to sell non-U.S. futures products directly to U.S. customers in 1989. By the end of April 2000, there were 181 such firms.

The nature of access to markets also is changing. Eventually, it will be possible to sell corn futures, buy bond futures and hedge weather risk from one screen. This capability need not reflect the migration of a traditional futures exchange to an electronic environment; it just as easily might be a collection of unrelated trading platforms located in different jurisdictions linked through a network.

* * *

These dramatic changes mean we must revisit long-standing systems of regulation originally designed for a handful of domestic markets where trading occurred through domestic brokers. We must re-examine the assumptions underlying the regulation of futures markets.

As you may be aware, this re-examination is now underway at the CFTC, where we are developing a new regulatory framework for our futures markets. While developing a framework consistent with the objectives of financial and market integrity and customer protection, we believe that the following considerations are important:

- Regulators must remove unnecessary burdens and thereby create the most space for markets to develop;
- Regulation should reflect that competition can be our ally; and
- Regulation should be sufficiently flexible to accommodate innovation and the evolution of new market structures.

Consequently, we are proposing to move from prescriptive rules to performance-based standards and from a one-size-fits-all approach to one that takes into account the susceptibility to manipulation of the product traded and

whether the market has retail participants. We also are strengthening our framework for clearing organizations. We expect that our proposals will be published for comment by the end of this month.

In designing a new regulatory architecture, it no longer is enough for us to focus only on the domestic perspective. The same types of changes that I have discussed with regard to the U.S. futures industry are happening in markets around the world. Our initiative cannot ignore the global dimension.

Therefore, in meeting structural change with corresponding regulatory responses, we must think carefully about the relationship between the growing electronic integration of our markets and international cooperation. National regulators have a limited capacity to reach outside their geographic boundaries. This is a fact of all regulators' lives. During the opening sessions of this conference, a vote was taken on whether, in view of globalization, national regulation was sufficient. A resounding 379 participants voted "no" - only 24 voted "yes" - and 12 abstained.

When markets, market users, intermediaries, and back office providers are located in different countries, our lack of jurisdiction over all entities requires that we cooperate. This observation is not new. Regulators already have developed very extensive networks of bilateral, and in the case of the Boca Declaration and FESCOPOL, multilateral information sharing arrangements. During this Conference, the CFTC signed two such agreements - one with the Monetary Authority of Singapore and one, relating specifically to warehouse information, with the UK Financial Services Authority.

Technology-driven change nevertheless will place increasing pressure on the need to cooperate and the need to develop techniques for meeting the regulatory demands of globalization. Regulators must keep pace as technology increases significantly cross-border trading volume, cross-border market participation, and cross-border exchange combinations. For example, the Chicago Mercantile Exchange recently agreed on cross-access trading and cross margining arrangements with LIFFE; Globex has expanded cross-access arrangements with SIMEX and the ParisBourse; and Eurex and the Chicago Board of Trade have concluded an alliance. Between 1992 and the present, futures trading on markets outside the U.S. more than doubled. In the first quarter of 2000, more than five percent of Eurex volume originated directly from Eurex terminals in the U.S.

The global impact of technology merits a coordinated international response. I recognize and support the substantial work by IOSCO and other forums to bring about more coordination among regulators. Two issues in particular deserve our concerted attention, namely, the disclosure of information to customers and the sharing of information by regulators.

Transparency

As technology permits markets to multiply, we need to assure that users have adequate information to make informed choices. We have several means at our disposal.

- Regulators can encourage markets to use technology to provide more information to investors, including facts concerning trading rules, contract specifications, clearing and settlement procedures, customer funds protections, default provisions and dispute resolution requirements. Many exchanges already have websites-but in some cases, the information provided is not clear or is incomplete.
- National regulators also can assist by publicizing the types of abuses that have been encountered in electronic markets in other countries. IOSCO announced such an initiative during this Conference - the results of Internet Surf Day, a coordinated surveillance effort by futures and securities authorities in 21 countries to uncover Internet fraud.
- To the extent that individuals bent on fraud can use the Internet to reach customers around the globe, it becomes increasingly important for investors to be able to research readily a firm's regulatory status. Regulators should explore further use of electronic technology to provide the public with information on the licensing status of financial services providers and the good standing of markets. Participants in electronic markets should be able to

ascertain without difficulty whether particular markets are regulated and whether intermediaries offering products are properly licensed. Italy's CONSOB lists all firms authorized in Italy on its website.

Regulatory Partnerships

Allied markets connected to multiple jurisdictions by platforms, remote members, or clearing functions, must and will develop harmonized rules and operating procedures. Regulators likewise need alliances.

With respect to electronically linked markets, we must coordinate surveillance activities. The CFTC has worked successfully with the French COB to build an oversight partnership to assure market and customer protection in connection with Globex, and with ASIC and the New Zealand Securities Commission in connection with SYCOM.

At the CFTC, we are seeing more situations requiring us to combine investigative and enforcement efforts with regulators in other countries to reach the perpetrator of a market abuse or to manage a financial problem. The number of cases in which the regulator of the jurisdiction where the harm occurred is different from the regulator of the jurisdiction where the injured party is located will grow. We need to examine our common experiences and determine what steps can be taken to make cross-border enforcement efforts more effective. We could, for example, consider under what circumstances, if any, one regulator should view violations of another national regulator's laws as a basis for refusing or revoking a license.

* * *

The proliferation of electronic futures markets will challenge the U.S. regulatory system at home and from abroad. If we expect to design a regulatory product that crosses borders as effectively as the markets we regulate, we need to consider how best to use technology and regulatory partnerships that deal with these changes in market structure in a satisfactory and responsible manner. We must, and I have confidence that we will, become more comfortable in working with, and relying on, each other.