

1997

Keynote Address: Hon. Brooksley Born, Chairperson, Commodity Futures Trading Commission

Brooksley Born

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Recommended Citation

Brooksley Born, *Keynote Address: Hon. Brooksley Born, Chairperson, Commodity Futures Trading Commission*, 66 Fordham L. Rev. 761 (1997).

Available at: <https://ir.lawnet.fordham.edu/flr/vol66/iss3/6>

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KEYNOTE ADDRESS:
HON. BROOKSLEY BORN
Chairperson, Commodity Futures
Trading Commission

PROF. RECHTSCHAFFEN: In discussing the regulation of this vast derivatives industry, Brooksley Born is the voice of the Commodity Futures Trading Commission. She has agreed to serve on our panel as our keynote speaker of this morning's session.

Under Brooksley Born's leadership, the CFTC works together with the industry to preserve our market's integrity. Her presence here demonstrates her commitment to listen to those whom she regulates.

Brooksley Born is a native of San Francisco who received her A.B. degree from Stanford University and her J.D. from the Stanford Law School. She graduated from the Stanford Law School first in her class and she was president of the Stanford Law Review.

Prior to joining the CFTC, Ms. Born was a partner in the Washington, D.C., law firm of Arnold & Porter. Her specialty was institutional and corporate law involving complex litigation, primarily in the federal courts, and futures regulation. In addition, she served as a Professor at Georgetown University School of Law. She also received the Woman Lawyer of the Year Award from the Women's Bar Association of the District of Columbia.

The Honorable Brooksley Born was nominated to be a Commissioner and the seventh Chairperson of the Commodity Futures Trading Commission by President Bill Clinton on May 3, 1996, and was confirmed by the Senate on August 2, 1996. It is my distinct pleasure to welcome the Chairperson of the Commodity Futures Trading Commission, the Honorable Brooksley Born.

HON. BORN: Thank you very much. I am delighted to be here today at this Symposium on Derivatives and Risk Management.

The Commodity Futures Trading Commission was created by Congress in 1974¹ as an independent federal agency with the mandate to regulate U.S. futures and option markets. The Commodity Exchange Act² grants the Commission exclusive jurisdiction over futures and commodity options, whether they are traded on-or-off exchange, and authorizes the Commission to enforce the federal commodities laws with respect to such instruments. Using powers granted to the Commission by Congress in 1992, the Commission has exempted certain over-the-counter transactions primarily between sophisticated traders, from many of the regulations and provisions of the Commodity Ex-

1. Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1398 (codified as amended in scattered sections of 7 U.S.C.).

2. 7 U.S.C. §§ 1-26 (1994).

change Act, including the on-exchange requirement. The Commission has retained fraud and manipulation prohibitions with respect to these markets and watches the over-the-counter market carefully.

Derivatives markets have undergone substantial transformations during the past two decades. The nature of derivatives instruments has changed significantly, and the expansion of electronic technology offers previously unimagined opportunities, including instantaneous, around-the-globe, 24-hour a day trading.

Since its creation, the CFTC has witnessed a rapid evolution of the U.S. futures markets. On the futures exchanges we have seen an explosion of trading in financial products, such as foreign currency, stock index and interest rate futures, leaving the once-dominant trading in agricultural products only a small part of exchange trading today. We have witnessed enormous growth in the use of privately negotiated, customized and often extremely complex off-exchange derivatives contracts, again primarily in the financial sector. We also have seen the establishment of numerous new foreign futures exchanges, creating a truly global marketplace.

We are beginning to see the impact of technological developments on exchange trading of derivative products as well. The designation of a completely electronic Internet-based futures market is a pending question for the first time before the Commission. Just last week, the Chicago Mercantile Exchange ("CME") began trading its new E-mini S&P 500 futures contract, which for the first time on a U.S. exchange combines simultaneous electronic and open-outcry trading on the very same contract. We have entered an era where commodities professionals and their customers can communicate via the Internet.

These changes in our markets present challenges to both the marketplace and the market regulator. To remain competitive, markets must keep pace with technological innovations and the needs of their customers. Market regulators must ensure that their regulatory regimes are streamlined to avoid imposing unnecessary burdens on the regulated industry and stifling market innovation. We must also seek to modernize our rules to take advantage of efficiencies offered by technological developments.

One of the CFTC's top priorities during the past year has been to ensure that the agency is responsive to the challenges facing the U.S. futures markets and their customers, while at the same time preserving the important customer protections and market safeguards. The Commission has accomplished a great deal in its efforts, although we plan to and will do more. Since the beginning of 1997, the Commission has taken several actions to streamline and modernize our regulatory regime.

One of the first actions taken this past spring was in response to concerns expressed by the futures exchanges that the Commission's contract approval process was too slow to allow them to bring new

products to market as quickly as they would like. The Commission implemented new "fast-track" procedures for processing contract designation applications and exchange rule changes. These procedures significantly streamlined the review process for most new exchange contracts and exchange rules, permitting approval within ten days for many types of contracts and most rules, and within forty-five days for many other contracts.

Prior to the adoption of these fast-track procedures, the Commission had already reduced its average contract approval time to about 90 days. Since adoption of the new procedures this spring, 15 new contract designation requests have been filed with the Commission, seven of them under the fast-track procedures. Except for the one contract that was submitted just last week, the Commission has approved all eligible contracts within the fast-track period allowed. Even contracts which are not subject to our fast-track procedures—such as stock index futures, which must be forwarded to the Securities and Exchange Commission for its prior review and comment—have been approved in record time. For example, this past summer the Commission approved the CME's E-mini S&P 500 contract, and the Chicago Board of Trade's ("CBOT") Dow Jones Industrial Average within a few days of receiving the statutorily required SEC comment letters.

The Commission's streamlining efforts have brought significant benefits to futures commission merchants ("FCMs"), which is what we call our commodity brokers; to commodity trading advisors ("CTAs"), which is what we call our investment advisors; and to their customers. For example, in June the Commission approved an interpretation permitting streamlined procedures for allocation of customer orders which are bunched for execution by CTAs.

The CBOT commented that this action was "extremely important to the industry, in that it facilitates the flow of large customer orders directed by CTAs"³ The Futures Industry Association praised the initiative for responding to the need to adapt the regulatory scheme to evolving market conditions. The Managed Funds Association ("MFA") recognized the importance of the customer protections maintained by the Commission, noting that its action provided clarity to all parties and furthered protection of customers by providing for their fair and equitable treatment.

The Commission also provided relief to FCMs with respect to the capital treatment of short option positions to allow more FCMs to carry such positions for customers and to facilitate the efficient use of capital without creating undue financial risk.

3. Letter from Yvonne J. Downs, Senior Vice President and Administrator, Chicago Board of Trade, Office of Investigations and Audits, to Jean A. Webb, Secretary, Commodities Futures Trading Commission (June 9, 1997) (on file with CFTC).

The Commission has also streamlined many of its reporting and disclosure requirements. For example, the Commission amended its reporting requirements to permit filing by large traders of CFTC Form 40, the Statement of Reporting Traders, only when requested specially by the Commission, rather than on a periodic and regular basis. In an important development for CFTC registrants who are also SEC registrants, we adopted rule amendments to harmonize certain of our financial reporting requirements with the requirements of the SEC. The Commission also has approved in principle two-part risk disclosure documents for commodity pool offerings, which potentially would highlight the core information required to be provided to customers and put it into a more useful form.

In our most recent regulatory reform action, taken in early September, the Commission has proposed amendments to its rules governing the risk disclosure obligations of FCMs and introducing brokers ("IBs"). If adopted, the proposed rule should speed the account-opening process for financially sophisticated customers, as identified in the rule, and provide greater flexibility to FCMs and IBs to design their own disclosure of risk by eliminating the current mandatory risk disclosure information and procedures. This proposal responds directly to industry calls to permit different regulatory treatment of sophisticated customers where appropriate.

The Commission also has adopted a number of initiatives designed to take advantage of the increased efficiencies and reduced cost made possible by use of the electronic media. In June, the Commission opened the way for FCMs to use electronic media in communicating with their customers. The Commission's Advisory permits FCMs to deliver monthly statements, account statements, and trade confirmations solely by electronic media to those customers who consent to electronic transmission in lieu of receiving paper documents. Also in June, the Commission authorized CTAs and commodity pool operators ("CPOs") to provide risk disclosure documents to their customers via electronic media, such as the Internet. The Commission's interpretation permits CPOs and CTAs to provide customers with a risk disclosure summary and a hyperlink connection to the entire risk disclosure document.

The Commission also has adopted measures to permit the electronic filing of documents with the Commission. In April, we adopted a rule allowing CTAs and CPOs to file their required disclosure documents with the Commission electronically. We also have undertaken a program to permit FCMs to file required financial reports with the Commission electronically. These electronic media initiatives should increase the timeliness of information flow, reduce the administrative costs of commodity professionals, and allow all members of the industry and their customers to reap the benefits of technological advances. As a side benefit to the Commission, these initiatives will also assist us

in performing more precise computer analyses of firms' financial conditions.

Many of the Commission's actions over the last year were undertaken in direct response to concerns raised by members of the industry. Others were undertaken following internal review and recommendations by the Commission staff. The Commission currently is working on several additional regulatory initiatives, most of which are in direct response to issues raised by members of the industry.

For example, in response to concerns expressed by certain futures exchanges and the FCM community about the need to address the special needs of large customers and institutional market participants, the Commission intends to undertake a review of whether to permit certain non-competitive off-exchange transactions executed subject to the rules of a contract market. The FCM community also has requested that the Commission review whether post-order allocation of bunched orders by CTAs and investment advisors could be allowed with respect to the accounts of sophisticated customers who have explicitly consented to such treatment.

The Commission also intends to review whether to use its exemptive authorities to expand permitted investments of customer funds by an FCM or a U.S. clearing firm to include certain additional categories of liquid and readily marketable investments, as advocated by some FCMs. The CEA currently restricts investment of such funds to obligations of the United States or any state and obligations guaranteed by the United States. The Commission also intends to consider a request by industry representatives that it permit futures-style margining of options for certain sophisticated customers. With respect to each of these proposals, the Commission will seek to accommodate the needs of the industry and its customers with our mission to protect the market and market users.

The Commission's ongoing commitment to streamlining its regulatory requirements and to fulfilling its responsibilities under the CEA in an efficient and cost-effective manner is further evidenced by our recent delegation to the National Futures Association ("NFA") of certain Commission functions. The NFA is a self-regulatory organization of commodity professionals, similar to the National Association of Securities Dealers ("NASD"), which is designated by the Commission under the Commodity Exchange Act to perform certain regulatory functions.

The NFA has recently been actively seeking added functions and responsibilities from the CFTC. During the past year, the Commission delegated additional authority to the NFA in several areas, including:

- registration decisions relating to floor brokers and floor traders with disciplinary histories;

- ethics training of commodity professionals; and,
- various registration and processing functions relating to non-U.S. firms.

The Commission is continuing to evaluate other functions that could be delegated to the NFA, thus relieving the taxpayer of the costs of performing those functions. For example, we will very shortly consider a proposal to authorize the NFA to review disclosure documents required to be filed by CPOs and CTAs.

As you can see from this brief description, the Commission has made some significant steps in the past eight months in streamlining and modernizing our regulations. We are committed to doing more, and I am issuing today a renewed challenge to the Commission staff to fill up my regulatory reform suggestion box. I would also like to reiterate my open invitation to industry participants and all other interested persons to share with us their views on possible regulatory streamlining and reform. I strongly believe that, working together, the Commission and members of our industry can lessen regulatory burdens while at the same time preserving the important protections of customers and market integrity that have made our markets the strongest, most competitive, and most dynamic in the world.

Thank you very much.