

COMMENT

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PRESIDENTRECEIVED C.F.T.C. NATIONAL FUTURES ASSOCIATION
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Chairman Rainer and Commissioners, I appreciate this opportunity to appear before you and speak to the important regulatory initiatives that the Commission is proposing. I have been in the financial services industry for fifty years and have been the President of NFA for the last 18 years and was the President of the Chicago Board of Trade before that. Over the course of my career I have seen tremendous change in the futures industry but little or no change to its basic regulatory structure. The Commission's current proposal presents an historic opportunity to change all of that. The new regulatory framework is needed, it is long overdue, and I enthusiastically support it.

My colleagues on this panel are long-time leaders in the futures industry with valuable insights on how the futures industry should be regulated. However, my perspective is a little bit different from theirs. In fact, of all of the witnesses you will hear from today, I am the only one that is in the same business you are. I am a regulator. These days, that's not always something you would like to admit in public, but the fact is that regulation is all we do at NFA, and as a regulator, we share the same basic goals as the Commission.

We also share some of the same basic problems. Just because the CFTC and NFA are regulators, it doesn't mean that we are immune from the competitive pressures that affect the rest of the industry. All of the revolutionary changes occurring in this industry stem from the simple fact that both exchanges and intermediaries have to find more efficient ways to deliver their services to their customers. If they do, they will thrive. If they don't, they will perish. What's true for exchanges and intermediaries is true for regulators as well.

At their core, regulators are service providers. Our customers include the customers and end users who trade on exchanges; Congress, which represents those customers and end users; and the businesses which are subject to the regulations. Like any other service provider, regulators must provide services that their customers actually need. That's another way of saying that regulations have to advance important public policy objectives. We also have to provide those services at a competitive cost. That's another way of saying that regulations can't impose undue burdens. If we as regulators fail to provide the right services at the right price now, the regulated industry will not be able to compete, business will flow overseas or to OTC markets, and we will have little or nothing left to regulate.

It seems to me that providing the right services at the right cost is the heart of the Commission's proposal, and that's why I strongly support it. The proposal promotes competition and provides the right regulatory services by recognizing that different types of markets have different types of needs. Markets trading commodities

with an inexhaustible supply have different regulatory needs than markets trading commodities susceptible to manipulation. Sophisticated, institutional customers have different regulatory needs than retail customers. By noting these critical distinctions, the Commission would get rid of the one-size-fits-all approach and deliver the regulatory services its customers really need.

But that is just half of the equation. The proposal will also make it possible to deliver regulatory services at the best possible price. It does that by making the Commission an oversight agency, rather than a micro-manager of the industry. In my view, it is entirely appropriate for the Commission to set the standards that registrants are required to meet. But regulation becomes micro-management when the Commission tells registrants not just what to do but how to do it. That's the trap we fall into with detailed, proscriptive rules which become outmoded as technology changes the way the industry does business. Using core principles, supplemented with interpretive guidance on acceptable business practices, is a far better approach. It's much more likely to adapt to a changing business environment and much less likely to impose undue burdens. In short, the use of core principles properly implemented should help reduce regulatory costs and ensure our regulatory services are at the right price.

Having said that I strongly support the Commission's initiatives, I think a number of improvements should be made. Although the proposal makes extensive use of core principles for exchanges, it is far more limited with respect to intermediaries. There are some areas – ethics training, for example – where the Commission is true to

its general approach by eliminating existing regulations and replacing them with core principles supplemented by interpretive guidance. There are other areas, however – recordkeeping, risk disclosure and trading standards on RFEs, for example – where the proposal backs away from the “core principle” approach and merely amends existing regulations. We firmly believe that the Commission’s overall approach is the correct one and should be applied to FCMs, IBs, CPOs and CTAs as well as trading facilities.

The proposal also fails to make full use of self-regulation in developing interpretive guidance on some of the core principles. Whenever we talk about best practices – or “acceptable practices” as the current proposal calls them – we have to consider the basic question of “best practices from whose perspective.” To be effective, these practices have to be considered from the perspective of the customer – both the users of the markets and the people we regulate. The best way to ensure that involvement is through the self-regulatory process.

Although the Commission’s proposal recognizes a place for NFA in issuing interpretive guidance, it does not make full use of NFA’s resources, and, therefore, does not provide regulatory reform at the most efficient price. For example, the Commission notes that NFA will develop the acceptable practices guidance for disclosures to retail customers trading on DTFs but reserves to itself the role of developing guidance on other issues relating to intermediaries. We would be only too happy to develop the guidance relating to intermediaries, as always, subject to Commission approval, and we encourage the Commission to assign this role to us. We have the

knowledge, ability and desire through our proven method of developing rules through our Committee efforts.

I would also like to briefly address one other aspect of the Commission's release. The proposal provides for streamlined registration of banks and broker-dealers dealing only with sophisticated customers but limits that relief to situations in which the sophisticated customers are trading on DTFs. I don't see why the way we process registration forms should depend on what type of market the sophisticated customers are trading on. The Commission does not draw that distinction when it suggests relief from the Series 3 examination for registered representatives dealing with sophisticated customers, and it shouldn't do so here.

Finally, I hope that the Commission recognizes that regulatory change is an attitude, not just an action. Chairman Rainer, you have done great things for the industry in your short tenure as Chairman, but you will not be here forever. It is imperative that the staff as a whole shares your vision for this new regulatory scheme. While it is one thing to change the rules, the real test comes when those changes are implemented. We have worked closely with the CFTC staff for 18 years, and we have always been impressed by their dedication and their professionalism. But they face the same challenge we face every day at NFA. We cannot become so entangled with the letter of the rules that we lose sight of the spirit of the rules. If either NFA or the CFTC falls into that trap, no structure you develop will provide the sort of flexibility we need in today's world. I know that both of our organizations can and will continue to meet that test.

Finally, I am sure that we all recognize that it would be helpful for congress to codify the basic structure outlined in your proposal, and we will continue to work to achieve that legislation as quickly as possible.

I thank you for the opportunity to present my views, and I look forward to any questions you may have.