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Days of Futures Past | Episode 5
Walt Lukken, President & CEO, Futures Industry Association (FIA) and Former Acting Chairman & Commissioner, CFTC

On this week's installment of our *Days of Futures Past* series, we welcome Walt Lukken back into the SmarterMarkets™ studio. Walt is the President & CEO of the Futures Industry Association (FIA) and Former Acting Chairman & Commissioner of the U.S. Commodity Futures Trading Commission (CFTC).

SmarterMarkets™ host David Greely sits down with Walt to turn back the clocks to Lukken's time at the CFTC. Throughout the episode, they cover the economic globalization of the early 2000s and its role in the growth of the exchange-traded derivatives market, the lasting influence of the Commodity Futures Modernization Act (CFMA), Enron's collapse and its impact on energy market regulation, and Lukken's advice for future policymakers.

Walt Lukken (00s):
The Commodity Futures Modernization Act was trying to, in some ways, square the circle from that original act and deal with some of the things, you know, both giving the CFTC some flexibility in how it regulates the futures markets, making it less prescriptive, dealing with some of the jurisdictional issues with the SEC. But also recognizing the over-the-counter derivatives markets and the growth that was happening there. And allowing that market to continue to blossom, to grow complimentary to what was happening to exchange traded derivatives. So all that was addressed as part of the CFMA in 2000, and that just started, that with technology coming into our markets just started a revolution in exchange traded derivatives.

Announcer (46s):
Welcome to SmarterMarkets. A weekly podcast featuring the icons and entrepreneurs of technology, commodities and finance ranting on the inadequacies of our systems and riffing on ideas for how to solve them. Together, we examine the questions: are we facing a crisis of information or a crisis of trust, and will building Smarter Markets be the antidote?
This episode is brought to you in part by Abaxx Exchange, bringing you better benchmarks, better technology and better tools for risk management.

David Greely (01m 28s):
Welcome back. Today's of Futures Past on Smarter Markets. I'm Dave Greely, Chief Economist at Abaxx Technologies. Our guest today is Walt Lukken, President and CEO of the FIA and Former Acting Chairman of the US Commodity Futures Trading Commission. We'll be discussing the history and the legacy of the Commodity Futures Modernization Act of 2000. Hello, Walt. Welcome back to Smarter Markets.

Walt Lukken (01m 52s):
Hey, Dave, how are you?

David Greely (01m 54s):
I'm doing well, I'm doing well, and I'm better for having you here with us again. When you were on the podcast last year, we were talking about your work at the FIA, but today I'd like to go back in time with you more and talk about your experiences as the acting chairman of the CFTC in the 2000s. That period, of course, was one of tremendous growth and change in the exchange traded derivatives markets and their regulation. As someone who is at the center of those changes, as a policy maker, can you take us back to that period and what led to this growth

Walt Lukken (02m 29s):
In the two thousands as you mentioned, if you look at a graph of what happened to exchange traded derivatives from 2000 on the steep slope of growth is pretty amazing and there's a variety of reasons why that occurred, but I think one of them is unlocking the regulatory framework of our markets in a smart way and so I was involved both as acting chairman of the CFTC as you mentioned as a commissioner. But also even before that I worked in the Senate, the Senate Agriculture Committee as a senate staffer in helping to craft

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the Commodity Futures Modernization Act, which was passed in 2000, and really helped to unlock our industry's potential and to allow that growth to happen. You know, really to talk about that bill, you really have to date yourself back to the start of the modern futures industry.

Walt Lukken (03m 22s):
In 1974, we're about to celebrate 50 years of the Commodity Exchange Act, but it did something revolutionary, which is took, you know, a market that was only meant for agricultural products and expanded the definition of commodity to include financial interests, to include equities, to include a variety of different products beyond agriculture and traditional commodities. At the same time, it gave the agency exclusive jurisdiction over those markets, which put it on, a collision course with the SEC with FERC, with others that may have jurisdiction over those cash products, but not over the derivatives products. So the Commodity Futures Modernization Act was trying to, in some ways square the circle from that original act and deal with some of the things, you know, both giving the CFTC some flexibility in how it regulates the futurist markets, making it less prescriptive, dealing with some of the jurisdictional issues with the SEC, but also recognizing the over-the-counter derivative markets and the growth that was happening there and allowing that market to continue to blossom, to grow complimentary to what was happening to exchange traded derivatives. So all that was addressed as part of the CFMA in 2000, and that just started that with technology coming into our markets just started a revolution in exchange traded derivatives.

David Greely (04m 49s):
Absolutely quite the hockey stick in the growth over that period. And you've mentioned the Commodity Futures Modernization Act as being instrumental in this. Can you take us through in a little more detail some of the major features, the major pillars that made that legislation so important?

Walt Lukken (05m 08s):
Well, really sort of three major pillars there. One again, I mentioned was this how the CFTC, the Commodity Futures Trading Commission, could regulate products before that they would have to approve every product that was listed on an exchange, and that could take months, even years for an a new product to get up and running on a futures exchange. So that was problematic. And I think coming into 2000, we wanted to address that, you know, really we had European exchanges that were able to quickly get products up and running in the marketplace and so we had this concept of principles based regulation and principles based regulation means that we would put down for a, an exchange or a clearing house, you know, 14 or 15 principles of how we expected them to act and regulate their markets and within those, those principles where the CFTC could also provide guidance as a way that you would gave in compliance with those principles but it would gave the exchanges more flexibility.

Walt Lukken (06m 17s):
And so if they had something innovative, they wanted to try, maybe outside the norm, principles based regulation would allow them to stretch the envelope and innovate and so we thought that this was a very unique thing that we were going to try with the CFTC. The UK had already tried this with the Big Bang in 1986 but those were really broad missionary purposes of the acts. This was getting more in the specifics of how the ACT would run and so that was, you know, endorsed by the chair of the CFTC at the time, and ultimately implemented as part of the Commodity Futures Modernization Act, that along with self-certification. So instead of the CFTC having to approve products or approve rules of exchanges, they could self-certify. They could come to the CFTC and say, hey, this is meeting all the principles of the act.

Walt Lukken (07m 09s):
We've done our homework. We think it should get up and running, and we're gonna do this quickly so we can compete and that self-certification process came into effect as part of the Commodity Futures Modernization Act as well. You know, the second big bucket was just this jurisdictional divide with the SEC. The SEC and the CFTC had fought over, you know, who should regulate securities or indices on securities. The SEC cared that futures on equities might replace what they were regulating as cash equities and so for years, there was a ban on single stock futures and so the Commodity Futures Modernization Act took off. That band jointly regulated those products between the SEC and CFTC and allowed certain indices to be exclusively in the jurisdiction of, of the CFTC and when they were more narrow, they would be jointly regulated by the two agencies.

Walt Lukken (08m 06s):
So that was a big, big part of the CFMA and then lastly is the over-the-counter markets, the over-the-counter markets were growing, they were getting bigger, but they were not exchange traded. They were happening in bilateral agreements. You know, if you're

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deemed a futures contract in the United States, you have to be traded on an exchange. And so there was some rattling of the CFTC at the time that they were looking to potentially deem over the counter derivatives futures, and as a result, those products would be void, they'd be illegal. And that was caused some systemic risk in the, in the marketplace as a result of that. And so the president's working group of the financial regulators came together and decided to exclude those products outside the CFTC's jurisdiction to avoid that legal uncertainty that was being created by this, this endeavor. Ultimately, that got a lot of attention during the financial crisis because it was seen as a deregulatory effort, but at the time, it was meant to address this legal uncertainty and the potential systemic effect that this, this deeming over-the-counter swaps as futures would've caused in the marketplace.

David Greely (09m 18s):
And I'd love to delve into each of those a little more deeply with you because one of the interesting things right about the United States is that unlike many other countries, we have these different regulatory divisions. We have a securities market regulator in the SEC as well as a derivatives market regulator in the CFTC because commodities began as agricultural products. There's jurisdiction from the agricultural side as well. And since the inception of the CFTC, you know, in 1974, there's been these jurisdictional disputes In the early 80s there was a political compromise, the Shad Johnson Accord which you referred to, but in what ways was that becoming untenable, and in what ways do you think the CFMA needed to come in and clarify those in order to allow for that growth that we saw in the 2000s?

Walt Lukken (10m 11s):
Well, I, I think it's amazing, and I obviously, I'm a his historian of our markets and, and in, but in 1974, when they carved the CFTC out of, out of broad cloth to create the agency, you know, they had, and I think they even went to the SEC and said, do you want to regulate these products and, you know, some of those officials said, well, no, this isn't, you know, we don't want to deal with farm animals and crops and, you know, anything that walks around that's not our, our world and so in order to give them clear lines of jurisdiction, it's pretty remarkable. I mean, when you think about it, they said, okay, we're gonna give you exclusive jurisdiction. Meaning if they claim jurisdiction, no other regulator, the SEC, the states, no other could, could touch it. It was under the exclusive jurisdiction of the CFTC.

Walt Lukken (11m 00s):
And at the same time, they broadly defined commodity to include almost everything you can think of. I mean, if you read the definition, like it, it ends with saying in all rights and legal interest that you can think of, you know, and so it pulled the world into the CFTC's jurisdiction if it, they listed a futurist contract, and it was exclusive. So that meant that products that were under the jurisdiction of FERC potentially could have been pulled into to the CFTC's jurisdiction or SEC mentioned as well USDA even and so over the years, since that time, there have been court cases, there have been ways to try to figure out how do you draw brighter lines around the CFTC's jurisdiction and it's gotten better it's gotten better, but the CFM A really tried to figure this out.

Walt Lukken (11m 49s):
And for years, like I said, you know, security futures. So if you wanted to, if you could, if you want to go to London and buy a future on a European company, you could do that back in 2000. You couldn't do it in the United States and so there was a growing competitive concern that Europe was doing this. They could even list US stocks, but you couldn't do it here on US soil. And so they decided to figure out a way they, they sort of locked the CFTC and the SCC in the room together and said, figure it out and they figured out a joint regulatory structure that would allow that to occur. And also, at the same time indices, broad-based indices, these are legal terms, go exclusively to the CFTC and, and narrow based would be something where there'd be a joint regulatory construct.

Walt Lukken (12m 38s):
That still to this day, becomes an issue because as markets come to become, you know, narrow there are big consequences to, from a, you know, one of these big contracts that are being traded under the CTFCs jurisdiction to become narrow, then they may be outta compliance, these contracts if they become narrow from broad. And so even today, some of these rules are being challenged and thought through. So even though this was done in 2000 to help clarify some things, we still live with the consequences of that. And it still remains an issue at the agency.

David Greely (13m 15s):
And a fascinating point about looking at the history of these markets is the number of markets that are so developed so big, such a part of our life today that were deemed illegal at many points. You know, going back options, contracts, cash settled futures contracts, it's pretty amazing. And obviously the regulatory structure to make that transition needed to be put in place. And as you've said a number of times, it's also, it's not occurring in a vacuum, right. You have regulators in the UK, regulators in other jurisdictions and financial markets can go to a certain extent to where they need to if the regulations are too onerous. And I wanted to ask you, you know, in light

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of the CFTC, you mentioned it moved to principles based regulation and I imagine on the one hand that has a lot of benefits that you mentioned, there's flexibility, there's the ability for markets to adjust more quickly. Sounds like the self-certification kind of came in under a similar envelope, but most of the other agencies in the US were still under that kind of top-down prescriptive type of regulatory approach that that's more traditional. Were there difficulties in implementing this principles based regulation that the C F M A provided to the CFTC?

Walt Lukken (14m 30s):
There were, and it was almost a cultural shift too. I mean, I think most of the regulatory apparatus in the United States, as you mentioned they're lawyers. They're dealing with very specific rules and so to allow all of a sudden a more flexible framework in, and what it was intended to do is to say, here's the principle. Here's a safe harbor of the guidance underneath the principle that we find. Okay. But an exchange or a registered entity could say, I may even go outside of that safe harbor. I may do something different. I think it's still meeting the principle. I still think it, here's why. Here's the proof of why I think it's gonna do what you want me to do, but technically it's gonna allow me to do something a little innovative. And so that concept of allowing the marketplace to innovate in the regulatory sphere was a bit new.

Walt Lukken (15m 22s):
But over the years, I mean, now we're 23 years into principles based regulation, I think we've gotten to a place where it's a blend. It's a blend of both people want certainty of what the rule means and how to be in compliance with it, and the lawyers get comfortable with it, but it gives us at least a, a conceptual framework and to say, you know, we're always thinking about ways to do it better. We're always, you know, whether it's the marketplace itself can go to the market regulator and say, I think I'm in compliance. Or the regulator itself can say, let's stretch this. We, the marketplace has moved and we have to update our guidance to meet the principle. So I think you're, you're right, there was some growing pains at the beginning, but I think even now, I mean, you, you know, Chairman Gensler post financial crisis was at the agency, and he's not a guy that's shy about, you know, going after wrongdoing in, in the marketplace. But even he was a proponent of principles based regulation, and he understood the benefits of it. So I think hopefully that after 23 years, it's a bit more accepted by the industry and what its benefits are and how we can help keep the marketplace in compliance.

David Greely (16m 34s):
And in those early days, though, there, there were a number of challenges to it in that, you know, with the financial crisis in 2008, a lot of the blame for that kind of came at the feet of complex, over-the-counter derivatives based on the housing market, mortgage backed securities and the like and the CFMA was often cited as having deregulated that market and created the conditions that led to the excesses that helped contribute to the financial crisis. How do you see the CFMA and its role in some of the issues that led up to the financial crisis? What, what's your view of the real story there?

Walt Lukken (17m 13s):
Well, I think, you know, it was trying to deal with an immediate issue, which is there were given concerns that the CFTC was moving to regulate over the counter derivatives as futures. It could have caused systemic issues and I think there was broad agreement around that. The president's working group, when it came out with its recommendations to exclude over the counter derivatives from this CFTC's jurisdiction, it also said that it was up to the president's working group to think through a proper regulatory structure for those products. Those products is, you know, were being looked at by prudential regulators over the years. And over that time, there wasn't a potential, there wasn't a specific market regulator overseeing the swaps market, but certainly there were regulators overseeing banks, prudential regulators, overseeing banks that had transparency into those, those markets. And so, you know, that second step that I mentioned of, you know, did the president's working group come back together and say, okay, it's big enough now it's causing a systemic problem, should we be thinking about on a proper regulatory approach.

Walt Lukken (18m 21s):
And unfortunately, they never got around to that. And, and the prudential regulation didn't get a chance to see the totality of the marketplace. I was acting chairman in 2007, so I was in the meetings with Hank Paulson, with Ben Bernanke, with Chris Cox as we were talking about these CDs products the credit default swaps, and all these different structured products that had these toxic derivatives in them and the housing crisis and all that was going on in the background. And at that point, we were at triage point, there wasn't anything we can do, but just try to understand the scope of it. And ultimately, the financial crisis came and we, we had sort of seen this coming over, you know, a six month period of time, the potential for this, you know, I was up in Lehman Brothers over that weekend making sure our markets were being properly regulated and transferred away from Lehman. But it was, it culminated in the, the financial crisis that has been replayed many times on in books and, and on the news media. And I think in hindsight, you know, I wish

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they, they had gone back to, to all that and figured out a regulatory structure. I think coming out of the financial crisis, this idea of bringing things into more lit markets, into clearing, probably if it had, they had done that earlier in the two thousands, maybe avoid, have avoided some of the issues we dealt with during the financial crisis.

David Greely (19m 46s):
It seems like that's always the challenge, right. Is getting the focus and the attention before the crisis, after the crisis. We all seem to, to focus on these things. One other area, or I think a similar, to a lesser extent issue played out in the energy markets, was Enron's implosion kind of occurring in the shadow of the passage of the CFM A. How did the CFMA deal with energy derivatives, and how did the collapse of Enron change the regulatory approach toward the energy markets?

Walt Lukken (20m 15s):
Well, it, it was a bit of a controversial issue. I think the president's working group when it said, you know, Hey, get these over-the-counter derivatives out of the CFTC's jurisdiction, they were really talking about financial derivatives and not energy, you know, physical commodities. That was, I think arguably more in the CFTC's jurisdiction, that they still had a stake in that there were certainly exchange traded derivatives, energy derivatives markets that had an impact on what was happening over the counter. But it was included, Congress decided to include it as part of those over-the-counter derivatives that were excluded. And so those markets as a compromise, I think what the, the Commodity Futures Modernization Act said was that the CFTC had certain abilities to look at those markets to see the trading systems, to track those markets. And so they were sort of halfway regulated, I would say, coming out of the CFMA, but truthfully not enough that would, it would capture the whole regulatory system that Enron ended up exploiting.

Walt Lukken (21m 19s):
So Enron, you know, in 2002 I think was when the Enron situation all went down, you know, they were running a dealer market that really looked like an exchange, but didn't trigger the commodity futures trading commission's jurisdiction and yeah, I think after its implosion, there was a recognition in Congress, and I was, at the time, I was chairman of the agency, and we decided to regulate, you know, those price discovery markets that yes, we need over-the-counter energy products. But if you start to be such a, you know, liquid market and you start to discover prices, if people are quoting your over the counter of products publicly because they're, they're price discovery products, then they need to be regulated as exchanges. And we created this ability to trigger those, those more liquid products into the CFTC's jurisdiction. And I worked at the time closely with Dan Berkovitz, who ultimately became a CFTC commissioner. He was on the hill at the time working for Senator Levin, and we came up with this concept and Congress in a bipartisan way came together and, and fixed the issue. But I think there was a recognition on energy that really we need to, for the same reason, you know, Dodd-Frank pulled a lot of these swaps into more regulated markets, certainly energy, we needed to get more in lit markets, get more into cleared markets, and we, we fixed some of that pre Dodd-Frank when I was chairman of the agency.

David Greely (22m 52s):
Yeah. In addition to this, this trend driven by some of these events of migrating more OTC things onto exchange where it's regulated, there was another big trend in the two thousands, which was the exchanges beginning to demineralize. For our listeners, can you explain how exchanges traditionally operated, and then how did this trend towards demineralization converged with what was happening in the regulatory environment?

Walt Lukken (23m 20s):
Yeah, no, I mean, for hundreds of years, exchanges were, they were clubs, they were membership clubs. That was the New York Stock Exchange, that was the CME, that was all these exchanges and partly is because they wanted to control the environment in which trading happened and so they would allow members to, to join for a certain price to, to be a part of the club and then once you were in the club, they would regulate you as a member and you would have to abide by their rules and make sure that things were fair as part of the club, but also that mutualization meant that you also shared in the profits of the club, right. So you, you were there and, and, and you wanted to make sure that the people you were dealing with were, you know, upstanding individuals in the community. They had a certain amount of credit, you know, associated with them, that they could pay their bills if you were trading with them.

Walt Lukken (24m 11s):
And, and so that's how things were for, for many, many years until about 2002, I think CME may have been the first exchange to go and de mutualize and ultimately list an IPO with the New York Stock Exchange, but that then unlocked in this, you know, equity that the exchanges were looking and so they, as a result, you know, the owners now became investors in this, these exchanges, they still had, you know, members, people who were now members of the exchange just had to abide by their rules, had to abide by their regulations,

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but the profits were no longer associated with membership. It was now owned by the shareholders of those organizations. So they changed a bit of the dynamics, you know, before both the profits and the risk were, you know, aligned. But after 2002 and after all these exchanges went public you broke apart sort of the equity and the risk, and now the risk was being born by the people who are still members, but didn't benefit from the profits.

Walt Lukken (25m 18s):
And the profits were being, you know, benefited by people who may not have any affiliation with the exchange, but didn't have anything to do with the risk. And so what had to happen is, is to make sure that the risk was properly being taken care of, not at the expense of profits, but you, you know, you get attention there and so I think over the years that's been something that's been playing out. These exchanges are big fortune 500 companies with shareholders, and the shareholders are the ones that, as any chief executive officer would do, they pay attention to shareholders, they want to deliver shareholder value and risk has to be somehow hedged back into their oversight and so it's just made it an interesting dynamic moving away from these mutualized exchanges and making sure that the risk aspect of what they do is aligned with the equity aspect of the exchanges but, you know, unlocking that capital for all of those organizations has contributed to that two thousands growth that we saw and helped to unleash some of that investment into those organizations.

David Greely (26m 30s):
Yeah, it's a, it's a fascinating problem because as you said, on the one hand, it unlocked all this investment capital and allowed the, the investment to grow these exchanges and grow these markets. On the other hand, you know, as you've said, when the exchange is owned by the members, there's a lot of value there. You don't want to risk blowing up the exchange. So there's a lot of self-policing that occurs because you have a lot of skin in the game. You know, we've heard echoes of this in other places as well, where, you know, the, the movement from the trading pits to electronic trading where it democratized the exchanges and globalized them and had many wonderful aspects, there was another aspect where, you know, misbehavior in the pit was dealt with in the pit, you know, in a certain way that, so I'm kind of curious as a regulator, when there's been the movement to kind of allow things like self-certification and, and kind of put the onus on the industry at the same time, some forces are making it less natural to have that self-policing aspect. How do you, how do you see the regulatory interaction coming in with that?

Walt Lukken (27m 36s):
No, it's a great question and I think for us, you know, it's making sure incentives are aligned and so I think that's how the regulators have to approach it. They just have to understand that there are these natural tensions now that exist. And so, like you said, it sort of self-policed itself before, and so you knew that if, if something bad was happening on the floor, that the floor would take care of it because there was accountability. There was accountability there, you know, before. So now we have to sort of reconstruct it. We have to reconstruct that accountability, reconstruct, you know, how we block these conflicts of interest. I think, you know, that is something the regulators are, are looking at. I mean, I think they're trying to figure out how can, and even this, this concept of, you know, exchanges now owning FCMS, okay, well, exchanges also regulate FCMS as members of their organization.

Walt Lukken (28m 31s):
So can you be a competitor and also regulate your competitors and again, the horses out of the barn at this point, right, with the mutualization, that doesn't mean though, we can't, you know, identify where the conflicts lie, create structure in order to deal with those conflicts, to manage them, to bring transparency to them. And I think, you know, regulators today, as technology brings all these functions together, just have to be thoughtful about, you know, how do we deconstruct the, what's actually happening under the hood and make sure there's proper firewalls and existence and conflicts of interest management. So that's gonna be the challenge I think, for the next, you know, five to 10 years for regulators.

David Greely (29m 13s):
And I'd like to, you know, shift gears a little bit and look at things a little bit more globally, because of course, the 2000s people who aren't involved in exchanges will look back and say, well, that was a big period of globalization in the economy broadly and I was curious, you know, how did those big global influences and what was happening globally in the futurist markets during this time contribute to the growth and change in the exchange traded derivatives markets and how regulators were approaching them?

Walt Lukken (29m 44s):
Well, even before the CFMA in 2000, there were exchanges as technology was coming into, into play, there were exchanges like the like the predecessor to UREX who wanted to come and list terminals in the United States and capture, you know, liquidity from the United

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States and there was no way that the CFTC under its jurisdiction had the ability to, there wasn't a construct in which to, to deal with that and so I think what we saw in two thousands was really the unlocking of global trading and how do, how do you deal with that you know, today we talk a lot about, you know, equivalence and recognition, and those are concepts that people are, are familiar with, but back then it really was, unless it's on my soil and in this building, you know, I don't know how to regulate these things, but technology unlocked all of that.

Walt Lukken (30m 35s):
And so coming into the 2000s and the CFMA with its principle space regulation helped with that. And ultimately, Congress passed the foreign board of trade concept, which is allowing foreign exchanges to register with the CFTC and give access to u US citizens to those foreign exchanges. But what the CFTC did in the meantime was deal use, its exemptive authority to recognize these foreign exchanges through just its rulemaking, powerful rulemaking abilities, and to, to recognize them, to put conditions on them. If you're gonna talk to US customers, they have to abide by customer protection rules and hold their funds here and do the following. But the CFTC in the two thousands was able to come up with a construct that would work to allow foreign exchanges to access US citizens. And the same was happening for foreign participants wanting to access US exchanges.

Walt Lukken (31m 33s):
I remember I was a commissioner at the time, but I asked Jim Newsom, who was chairman of the CFTC, asked me to go to a meeting of the president's working group. And Alan Greenspan was chairman of the Fed. And before the CFTC was an application by UREX to get access to US customers. And we were going through the process this that I mentioned, of approving them and making sure all these protections were in place and Greenspan is a very pro competition, pro-free trade guy, sort of cornered me And he said, you know, hey, what are you gonna approve that your actually application. We need to get those, you know, that competitive, you know, cuz there's not many futures exchanges. And he wanted to see competition in our markets. And so you know, fast forward, we did approve it and we did, they did launch their, their products. But if you talk to any exchange today from C M E to urx to to life in London, whatever it might be, as significant, a third to two thirds of their volume comes from over their borders from somewhere else that didn't exist before 2000. But today it's such a global marketplace, we are pulling from liquidity all around the globe. And this concept that was really developed and exercised in 2000 is what has gotten us here today.

David Greely (32m 50s):
Once again, it's amazing that it wasn't that way about 20 years ago, Yeah, but you know, when you, you brought up, I guess the, the CFTC is approaching its 50th birthday and it's been, you know, about 23 years since the adoption of the Commodity Futures Modernization Act. So, you know, that was almost half of the CFTC's lifetime ago and it makes me wonder, do you think we're due for another modernization of how we regulate the derivatives markets? And if so, what principles and lessons from your experience in the two thousands should we carry forward to make sure that these markets continue to grow and thrive into the future?

Walt Lukken (33m 28s):
Well, I do think the Commodity Exchange Act, because of the flexibility that has been built in over the years, is well suited to deal with new products, new innovations that are occurring. You know, the one area that's obvious is the, the digital asset space. You know, right now there is a gap in regulation in the United States. The securities, if it's deemed as security and some digital assets are security, that naturally will flow to the, to the SEC. But if it's just a cash commodity, it's just, you know, it's not a security, but it's also not a futures. So it's not a futures on a commodity then it's in a gap. It's, it's not regulated by anybody and the United States. So I do think there are efforts, and they were hearings last week to, to look at how do we close the gap?

Walt Lukken (34m 13s):
You know, how do we define what digital assets are securities and which digital cash assets to go to the CFTC, including the futures derivatives aspects of those cash assets. So both the House Financial Services Committee and the House AG Committee had a joint hearing and my guess is that they're gonna try to close that gap around digital assets and to me that's pretty interesting. And that could be something that, you know, revolutionizes the CFTC space is to give it not just future jurisdiction, but actually cash market jurisdiction over digital assets. I would say the other big issue right now are event contracts. So you're hearing more marketplaces that are just betting on, what we would call binary options, but just, you know, is this economic event gonna happen or not. Is GDP gonna hit this or not. Even if it gets into even the elections, will, you know, will the house flip Republican or Democrat, you know, and people are starting to list these products with an economic aspect behind it.

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Walt Lukken (35m 17s):
So the CFTC you know, in the commodity definition says you have jurisdiction over these things, but not gaming, gaming is, is not part of your jurisdiction. And so these things get pretty close to gaming and so one of the things Congress may have to do is put in a line to say, yes, we want the CFTC to regulate these types of markets that have maybe an economic activity behind them, but this, whether it's political contests or whatever, they may say, we don't want you to be touching that. We don't want markets on assassinations and markets on political events, and there's too much, too much wrongdoing that could happen on those types of things. So to me, that's gonna be an interesting space to watch and how that might be incorporated into the Commodity Exchange Act.

David Greely (36m 08s):
And maybe just my last question to you is, any advice for future policy makers as they deal with how these markets grow and evolve over time to, you know, make sure that the principles and lessons that you learned help us continue to build strong markets into the future?

Walt Lukken (36m 25s):
Well, I think, you know, they have over the years built a lot of flexibility into the act, which gives the regulatory authority the ability to evolve with the markets as they evolve. So if we want to maintain our leadership and financial services in the United States over the years, we want to make sure that the markets are safe, they're properly protected, but we're not stifling innovation through regulation and so my words of caution to policymakers would be, you know, make sure that those aspects of the, the flexible regulatory approach are protected. So, you know, during Dodd-Frank, for example, there's exemptive authority given to the CFTC Section 4C of the act. It was severely restricted, you know, during Dodd-Frank to not allow the agency to, to amend its rules in ways as the market evolved. I'd love to see, personally, this is Walt Lukken speaking.

Walt Lukken (37m 22s):
I'd love to see it, you know, it given back to its original glory you know, of the act because the agency has to evolve and, and Congress shouldn't necessarily be you know, too overzealous and limiting what it can do. They have oversight ability, they have the ability to appropriate to the agencies to limit its ability. They have plenty of tools to tell the CFTC it's outta line, but to get into that kind of prescriptive regulation without allowing it to be flexible and, and make sure that it can implement smart regulations for our markets and allow us to be the leading markets globally, I think is, is dangerous. So I'm hopeful that Congress continues to allow the CFTC to do the job it's doing, allow it to have some flexibility and continue to lead from a regulatory standpoint.

David Greely (38m 15s):
Thanks again to Walt Lukken, President and CEO of the FIA and Former Acting Chairman of the US Commodity Futures Trading Commission. We hope you enjoyed the episode. Join us next week with our two guests from Abaxx Exchange and Clearinghouse in Singapore. Dan McElduff, President and Head of Strategy and Development, and Joe Raia, Chief Commercial Officer. We'll be discussing the launch of Clear Port in 2002 at the NYMEX, which brought the backing of the clearinghouse to the global OTC markets, and today clears transactions from 1800 listed contracts across multiple asset classes. We hope you'll join us.

Announcer (38m 51s):
This episode was brought to you in part by Abaxx Exchange. Market participants need the confidence and ability to secure funding for resource development, production, processing, refining, and transportation of commodities across the globe. With markets for LNG, battery metals, and emissions offsets at the core of the transition to sustainability, Abaxx Exchange is building solutions to manage risk in these rapidly changing global markets. Facilitating futures and options contracts designed to offer market participants clear price signals and hedging capabilities in those markets is essential to our sustainable energy transition. Abaxx Exchange: bringing you better benchmarks, better technology, and better tools for risk management.

Announcer (39m 40s):
That concludes this week's episode of SmarterMarkets by Abaxx. For episode transcripts and additional episode information, including research, editorial, and video content, please visit smartermarkets.media. Please help more people discover the podcast by leaving a review on Apple Podcast, Spotify, YouTube, or your favorite podcast platform. SmarterMarkets is presented for informational and entertainment purposes only. The information presented on SmarterMarkets should not be construed as investment advice. Always consult a licensed investment professional before making investment decisions. The views and opinions expressed on SmarterMarkets are those of the participants and do not necessarily reflect those of the show's hosts or producer. SmarterMarkets, its hosts, guests,

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