SFO
STOCKS, FUTURES AND OPTIONS MAGAZINE
The Official Journal for Personal Investing

Volume 7, No. 6 • June 2008

PUBLISHER'S EDITORIAL

By Russell R. Wasendorf Sr.

It Is About the Model, Sir

Remarks on Regulatory Reform

On behalf of the retail investors and traders that SFO serves, I join my esteemed colleague Leo Melamed in urging the U.S. Treasury Department to refrain from consolidating the most efficient regulators in the financial industry today into a "superagency" as it pursues a "modernized regulatory structure."

True, there must be increased, improved and more sophisticated regulatory coordination domestically and abroad to fulfill the mandate of protecting such diverse market users and publics. Transparencies must be enhanced across all boundaries, no simple exercise. Let us put our reformers and our country's great technology leaders to that task. If transparencies can be created through technological means, the ability will follow to determine where overlap exists among financial institutions and their clients. Identifying this overlap will permit management of the issues and risk associated with it.

In line with Mr. Melamed's eloquent argument, we believe the CFTC has proven that its "modernized, principals-based regulatory philosophy," through its very record, is an adaptable model to achieve the necessary objectives of oversight and customer protection without damaging the strong foundation for innovation, growth and competitiveness achieved since the founding of CFTC by Congress in 1974. What the Blueprint calls for, in essence, is an "objectives-based" Federalism.

We recoil at the idea of clumping, for supervision purposes, savings institutions, securities companies and exchanges that facilitate the transfer of capital, and futures companies and exchanges that facilitate the transfer of risk with public and private financial institutions including insurance providers. Surely such centralized oversight is an illogical replacement for our existing regulatory structure.

Leo Melamed, chairman emeritus, CME Group

STATEMENT PERTAINING TO THE TREASURY DEPARTMENT'S BLUEPRINT ON REGULATORY REFORM

By Leo Melamed, chairman emeritus, CME Group

I commend the Department of Treasury for its comprehensive examination of the American financial services sector. Many of its recommendations are prudent and welcome. However, I join others who strongly object to the recommendation to merge the CFTC and the SEC. While the modernized principles-based regulatory philosophy at the CFTC is an outstanding model for the SEC to adopt, merger of the two agencies would jeopardize many of the necessary differences between futures markets and securities. These differences are fundamental and include the purpose and measure of margin and performance bond, protection of customer funds against broker defaults, price discovery in contrast to price preservation, customer suitability versus know your customer, markets and securities involving margin, mark to the market procedures, and a host of other basic distinctions.

Indeed, recent market upheavals offer solid testimony to the strength of the futures market's model. Throughout the turmoil, the performance of CFTC regulated futures exchanges stand in welcome contrast to the over-the-counter markets. Self regulation under the CFTC's principles-based regulatory regime coupled with a strong central counterparty clearing system that marks open positions to a legitimate market price twice a day works. In fact it anticipates and exemplifies the call for greater transparency in the OTC markets. This commendable record deserves recognition not reform.

—March 31, 2008

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PUBLISHER'S EDITORIAL CONTINUED

This would not, in our opinion, solve the problem with transparency and customer protection.

Securities and Exchange Commission Chairman Christopher Cox stated in March, "Recent events have provided further evidence, if more were needed, that financial services regulation in the United States needs to be better integrated among fewer agencies, with clearer lines of responsibility. Just as systemic risk cannot be neatly parceled along outdated regulatory lines, the overarching objective of investor protection can't be fully achieved if it fails to encompass derivatives, insurance and new instruments that straddle today's regulatory divides. The proposed consolidation of responsibility for investor protection and the regulation of financial products deserves serious consideration as a way to better address the realities of today's markets."

When have you ever known government to effectively streamline processes through consolidation of the bodies it has created? When has government been known to clarify responsibilities to bring blue sky to systemic risk? Have our markets themselves not proven to be a better arbiter of quality and quantity of risk and the very mechanism for successful transfer and management of said risk?

I contend that to "modernize" by creating (quoting from the Blueprint) "an entirely new regulatory structure using an objectives-based approach for optimal regulation"—one which will "consist of a market stability regulator, a prudential regulator and a business conduct regulator"—does indeed throw the baby out with the bathwater.

Examine the structure, yes. Adopt prudent, successful practices existing within each sector/agency? Have regular coordination sessions to review and enhance database connectivity and help flag problems before they are out of hand? Certainly. By all means.

The CFTC has the best model and track record.

CFTC preserves and protects customer funds, and open and free competition among market participants; its techniques have proven appropriate and effective during extremely volatile market conditions throughout its 34-year existence. These pioneering techniques have broader applications. The CFTC continues to assure the economic utility of regulated derivatives markets—futures and options—by encouraging their competitiveness and efficiency. This agency has a 100-percent track record in effectively overseeing these markets, which provide a means for price discovery and offsetting price risk.

Futures customers have never lost a penny of segregated funds held by their firms, a credit to CFTC. Even in the wake of the largest fraud ever perpetuated by a futures firm—Refco Inc. in 2005, when CEO Philip Bennet hid $430 million in bad debts from the company's auditors and investors—the approximately 200,000 customers of Refco Inc. were not the victims. Investors, yes. Customers, no.

CFTC diligence makes sure these funds are protected. It has, by all accounts, duly fulfilled its mission of protecting participants and the public. Now is the time to apply this successful model to the regulation of foreign exchange, over-the-counter trading in a host of markets and global integration that is well underway.

Insurance is a separate market; capital creation is a separate function, and new instruments that "straddle today's regulatory divides" will require use of the most effective model to date, in place in any country—the CFTC.

Through single-stock futures, we have seen what putting a "straddle" instrument concept into the hands of the SEC can do—given the worst characteristics of anything it "resembled" has made the SSF uselessly obsolete before it had a chance to provide the risk transfer blessings it was destined for.

In addressing today's and tomorrow's new products, CFTC has the best model and track record for getting any crossover instrument approved and regulated.

We urge all readers to express their opinion to the U.S. Treasury as it steps into its reformation period through year end, and SFO would love to hear your opinions as well. Send your comments to the co-authors of "Blueprint for a Modernized Financial Regulatory Structure": U.S. Treasury Secretary Henry Paulson, U.S. Undersecretary for Domestic Finance Robert K. Steele and Assistant Undersecretary for Financial Institutions David G. Nason.