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# Client Alert

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## FinTech – The CFTC's Silver Bullet?

On March 15, Acting US Commodity Futures Trading Commission (CFTC) Chairman J. Christopher Giancarlo excited the futures and options markets when he spoke at length about embracing technology as a key to economic growth. Giancarlo, a longtime supporter of FinTech innovation, reiterated remarks he made as CFTC Commissioner in September 2016 to the American Enterprise Institute, and as keynote speaker of the Swap Execution Facility Conference (SEFCON) VII in January. In September, Giancarlo said the following:

> I want to talk about the ongoing transformation of the world's trading markets from analog to digital, from human to algorithmic trading and from stand-alone centers to seamless trading webs. I will describe how market regulation by the CFTC, particularly, and other agencies, generally, has not kept pace with this transformation and why that curtails its effectiveness in overseeing the safety and soundness of contemporary markets. I will outline a forward-looking agenda for the CFTC and other market regulators that supports America's vital national interest in maintaining the world's deepest, most durable and most vibrant capital and risk transfer markets in the algorithmic, digital world of the 21st century.[i]

In March, as the newly minted Acting Chairman, Giancarlo announced that just after his promotion in January he instructed the CFTC staff to review FinTech innovation possibilities. Giancarlo noted three main issues to review: (1) leveraging FinTech innovation to make the CFTC a more effective regulator; (2) using FinTech innovation to help identify CFTC rules and regulations that need updating for 21st Century digital markets; and (3) identifying the appropriate role for the CFTC to play in promoting US FinTech innovation in Commission regulated markets.[ii]

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The third issue addresses a perceived lag by the CFTC and other US regulators in promoting FinTech when compared to United Kingdom regulators. In the UK, the Financial Conduct Authority (FCA) has already created an innovation hub allowing FinTech firms to test and develop products through its "Regulatory Sandbox." In the US, however, this kind of regulatory innovation for financial services has faced opposition.

Giancarlo's March mandate positions him as an aggressively efficient regulator poised to make major changes to the current CFTC state of play. In his March remarks, Giancarlo promised the Staff's review would be complete and more information would be disclosed in "the next few months," leaving market participants in anticipation of inevitable changes that could affect both the regulatory and enforcement landscapes.

Some have speculated that a Trump Administration and Giancarlo as Chairman would produce an industry-friendly pause in a seemingly relentless regulatory regime. But the appointment of Giancarlo, a longtime critic of the Commission's approach to "backward looking,"[iii] post-crisis regulatory acts, may result in more targeted, technology-focused investigations. Either way, Giancarlo seems intent on leveraging FinTech to maximize the resources of a Commission struggling to prioritize efforts and work within the financial constraints of a budget freeze.[iv]

*FinTech Changes*

The first indication of Giancarlo's evolutionary efforts came in January, when the CFTC approved a Proposal to amend recordkeeping requirements to Regulation 1.31, to "modernize and make technology-neutral the form and manner in which regulatory records must be kept, as well as rationalize the rule text for ease of understanding."[v] The proposed amendments modify definitions to provide more clarity and strike obsolete terms; change the duration, form, and manner of record retention; amend production requirements based on form; add a new section revising ongoing compliance obligations with respect to written regulatory records and procedures; and remove other outdated provisions like references to CD-ROMs. The twenty comments submitted by the March 20 deadline were enthusiastically supportive, with the Securities Industry and Financial Markets Association (SIFMA) going so far as to "urge[] the Commission to adopt the Proposal as quickly as possible,"[vi] and the CME Group calling for the Commission to "provide some immediate relief to the industry," by adopting the amendments.[vii] Other comments, while proposing minor changes, lauded the "technology neutral" and flexible nature of the Proposal and the potential for reduced recordkeeping costs – particularly in the form of the elimination of the requirement to retain a third-party Technical Consultant.[viii]

The Proposal was the first step in a plan to shape the CFTC into a "21st century regulator"[ix] and change the Commission's status as "an analog regulator in an increasingly digital marketplace."[x] This step, coupled with Giancarlo's repeated promises to remake the CFTC as an agency poised to embrace technology, begs the question – what's next?

*Looking Forward*

The CFTC could attempt to harness FinTech in a number of ways. First, it could use FinTech in the form of data mining algorithms to interpret information it receives from market participants, as the speed and efficiency of artificial intelligence promises new regulatory capacity to seek out irregularities in vast amounts of data. Second, FinTech could offer the CFTC transparent, automated, rapid surveillance of commodity holdings. Third, the Commission could gain greater transparency into market participant vulnerabilities and positions if clearinghouses and intermediaries continue to use more sophisticated technology for settlement purposes. Fourth, FinTech offers a multitude of ways to improve the quality and comprehensiveness of data fed to regulators. Fifth, the Commission could attempt to use machine learning technology in the future to minimize attorney review time. Finally, internal tools and automated analyses—available via third party software—could increase automated functions, decreasing the need for additional staff and human analysis.[xi] While the opportunities to increase efficiencies are rapidly increasing with technological advances, practical concerns surrounding IT infrastructure, data security, and human oversight into this process remain implicit in the discussion as a potentially limiting factor, particularly given the CFTC's budget.

More specifically, there are several CFTC regulatory requirements that seem ripe for prompt revision. For example, 17 C.F.R. § 5.16—which mandates "immediate" notice of undercapitalization—cites a requirement of written "facsimile" notice. A law requiring the use of fax machines is woefully outdated. Another, more sweeping example cited by Giancarlo himself, is the CFTC's swaps trading regulatory framework, which he deemed "highly over-engineered" and "biased against technological innovation."[xii] Time delay requirements, limited execution methods, required Order Books, and general delays in disclosures caused by regulations such as the embargo rule are all difficult to manage in a data-driven, FinTech-centric market. Although speculative at this point, it would be reasonable to expect modernization of the swaps trading rules given that Giancarlo discussed these issues in depth in a 89-page criticism from January 2015.

Right now, market participants can only wait and see what effects Giancarlo's FinTech focused approach to Wall Street will have on the industry, and whether that approach paints him as friend or foe. But with his embrace of technology, Giancarlo's pursuit of regulatory modernization will likely be ambitious.



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[i] Remarks of CFTC Commissioner J. Christopher Giancarlo to the American Enterprise Institute, September 21, 2016, *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-17

[ii] Remarks of Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL, March 15, 2017, *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20.

[iii] *Id.* "It's now been a long time since the 2008 financial crisis. Much of the regulatory work in the past half dozen years has been to implement Congress' crisis response – the Dodd-Frank Act. Therefore the regulatory approach, both at the CFTC and across the federal government, was in a sense backward looking."

[iv] Despite a flat budget, the CFTC's great success in collections (besting the SEC in fiscal year 2015) means the agency is unlikely to go quietly into the night.

[v] CFTC Unanimously Approves Proposal to Amend Recordkeeping Requirements, January 12, 2017, *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7512-17

[vi] Securities Industry and Financial Markets Association, Comment Letter on CFTC Proposed Rule – Recordkeeping (RIN 3038-AE36) (March 16, 2017), *available a*t https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61140&SearchText=

[vii] CME Group, Comment Letter on CFTC Proposed Rule – Recordkeeping (RIN 3038-AE36) (March 17, 2017), *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61142&SearchText=
[viii] *See*, e.g., Nasdaq Futures, Inc., Comment Letter on CFTC Proposed Rule – Recordkeeping (RIN 3038-AE36) (March 17, 2017), *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61141&SearchText= *see also* SunTrust Bank, Comment Letter on CFTC Proposed Rule – Recordkeeping (RIN 3038-AE36 (March 20, 2017), *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61143&SearchText=
[ix] Keynote Address of CFTC Commissioner J. Christopher Giancarlo Before SEFCON VII, January 18, 2017, *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-19.
[x] *Id.*
[xi] The SEC is making significant progress in embracing FinTech as a mechanism for efficiency in investigations. For example, in a November 2016 speech, former SEC Chair Mary Jo White described the use of data analytics to identify and investigate misconduct as “transformative” technology. Address of Mary Jo White Before New York University School of Law Program on Corporate Compliance and Enforcement, Nov. 18, 2016, *available at* https://www.sec.gov/news/speech/chair-white-speech-new-york-university-111816.html. The SEC’s examination and enforcement staff are using data analytics to identify risk areas and potential violations and to aid the investigation of many of its cases, particularly those involving insider trading, cyberfraud, asset management, and financial reporting.
[xii] Remarks of Acting Chairman J. Christopher Giancarlo, March 15, 2017.