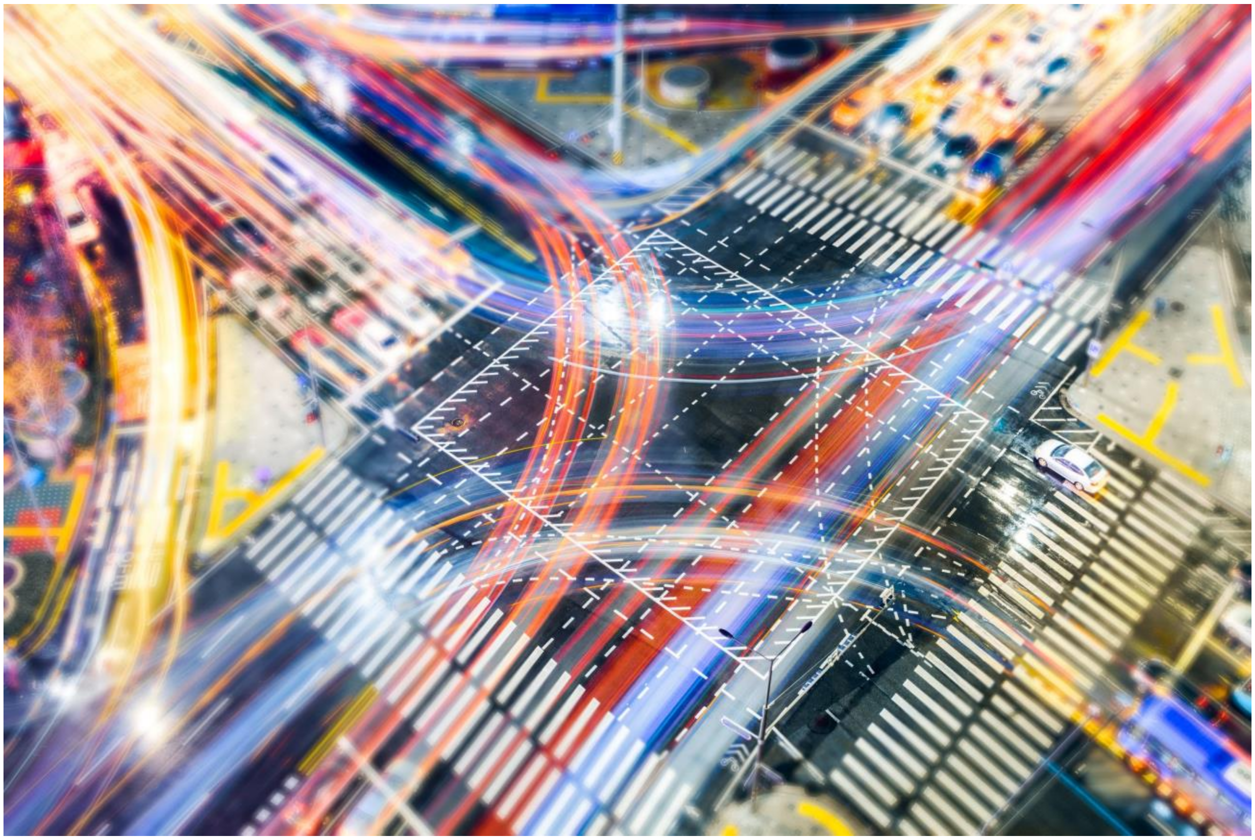


New Rules Of The Road

On November 2nd and 3rd, 2017, regulators, academics and market users gathered in Washington DC to discuss derivatives regulation in an educational roundtable titled "Smart Financial Regulation, Regulating Derivatives Markets." A joint effort by The Institute for Financial Markets and Mercatus Center at George Mason University, the panels focused on three major regulatory themes: the economic impact of regulations, how best to enforce rules, and the future of regulation and how technology will play a role. The content could serve as a valuable contribution to the regulatory reform movement, especially in the wake of new leadership at the Commodity Futures Trading Commission (CFTC).

Below is a report on the ideas shared by 15 speakers on three panels, as well as a keynote speech on regulation, and the narrative that was threaded on how we can move forward with financial regulation in the coming months and years.

This report was written and produced by Jim Kharouf, John Lothian Productions for the IFM.

Introduction

On January 2, 1974, the National Maximum Speed Law was passed by President Richard Nixon, setting the national highway speed limit at 55 miles per hour on all four-lane divided highways. In 1987, Congress permitted states to raise that to 65 mph and in 1995, the National Highway System Designation Act of 1995 allowed states to set their own speed limits, paving the way for some speed limits to rise to 70 to 85 mph. In short, cars, drivers, roads, energy supplies and other variables had changed.

So Congress changed the rules.

In May 2017, the CFTC acting Chairman (now Chairman) J. Christopher Giancarlo announced Project KISS (referring to the old saying, "Keep It Simple, Stupid"), aimed at simplifying and streamlining the massive rule set passed by the agency after the passage of the Dodd-Frank Act in July 2010. With the approval and executive order of President Donald Trump, Giancarlo is looking to change the rules of the financial regulation road, with a goal of taking existing rules and "applying them in ways that are simpler, less burdensome and less of a drag on the American economy."

Source: CFTC: CFTC Requests Public Input on Simplifying Rules

That CFTC initiative marks a new regulatory approach that could fundamentally reshape the regulatory environment for financial markets in the United States, and perhaps elsewhere. Project KISS was welcomed by industry participants and associations, who are looking for new ways to ensure financial market safety and responsible behavior, but also adjust rules that may hamper markets or have unintended consequences. At the Smart Financial Regulation Roundtable event, regulators, market participants, lawyers and other market experts addressed three key items that are the core of the financial regulatory adjustments touted by industry players and the CFTC itself.

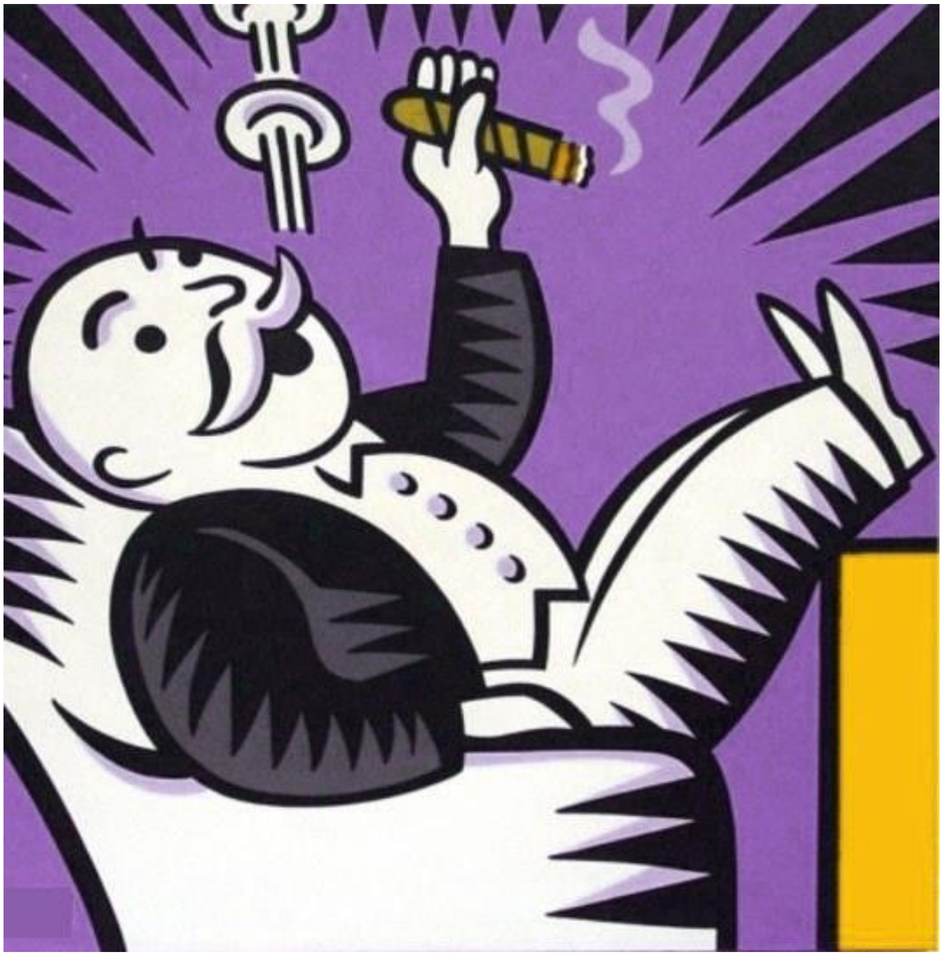
The event's first keynote speaker, CFTC Commissioner Brian Quintenz, said, "The CFTC could have focused on any number of logical reforms designed to strengthen and revitalize our financial markets under the mandates of Dodd-Frank. But in reflecting back on those seven years following Dodd-Frank’s passage, those types of policy objectives weren’t on the CFTC’s list of things to do. The CFTC rushed to finalize and implement many rules, sometimes forsaking the objectives those well-crafted rules would have addressed."

He added that his goal for the CFTC is to focus "on risk by identifying risk appropriately and targeting that risk specifically. Smart regulation, which prioritizes a thoughtful analysis of policy goals, regulatory costs, well-calibrated thresholds, and corresponding impacts on incentives, will best accomplish this."

Source: CFTC: CFTC Commissioner Brian Quintenz's speech at roundtable

The IFM and Mercatus Center took a three-pronged approach to the core question of "What is smart regulation?" Here is how experts view each of them: cost benefit analysis of regulation, enforcement, and technology and regulation.

It's The Principle Of The Matter



Roundtable 1: Applying Economic Principles to Financial Markets Regulation

•Paul Atkins, Chief Executive Officer, Patomak Global Partners

•Sharon Brown-Hruska, Director, Securities and Finance Practice and the White Collar, Investigations and Enforcement Practice, NERA Economic Consulting

•Andy Green,Managing Director of Economic Policy, Center for American Progress

•J.W. Verret, Senior Affiliated Scholar, Mercatus Center at George Mason University and Associate Professor, Antonin Scalia Law School, George Mason University

"The American people deserve a regulatory system that works for them, not against them: a regulatory system that protects and improves their health, safety, environment, and well-being and improves the performance of the economy without imposing unacceptable or unreasonable costs on society; regulatory policies that recognize that the private sector and private markets are the best engine for economic growth; regulatory approaches that respect the role of state, local, and tribal governments;

and regulations that are effective, consistent, sensible, and understandable. We do not have such a regulatory system today." - President Bill Clinton, September 30, 1993, in executive order 12866.

Source: [Federal Register: Executive Order 12866]

Paul Atkins, CEO of Patomak Global Partners, read the executive order to kick off the panel and said this sentiment has been held by virtually every US president in our lifetimes. The question then becomes, how can you best balance cost, or the economic impact of regulation, with the rules for the betterment of the market participants? And that is where the discussion and debate over how best to balance cost and regulation begins.

For some, cost benefit analysis has always been part of the regulatory framework. The CFTC's statutory requirement, in Section 15a of the Commodity Exchange Act, covers the "costs and benefits and antitrust laws." In that section, the agency must consider just that, "the costs and the benefits of the action of the Commission." But many industry participants have been critical of the CFTC's approach and rollout of regulation, arguing the agency ignored that key component when passing rules on the futures and OTC markets.

Source: [Commodity Exchange Act, pages 102-103].

The agency is required to take into account the protection of market participants and the public, efficiency, competitiveness, financial integrity of markets, price discovery, sound risk management practices and a category called other public interest considerations.

"Unfortunately, the absence of a clear statutory quantification requirement has allowed some rules at some financial regulators to become implemented despite cost benefit analysis," Sharon Brown-Hruska said. "The CFTC has often relied on qualitative discussion rather than quantification, which can be readily examined by the public because the agency determined that cost and benefits were too difficult to quantify. Even the qualitative discussion has sometimes been lacking."

For example, the CFTC's Office of the Inspector General said the agency's rule proposal on margin for uncleared swaps relied on "bald assertions or mere assumptions," even though some analysis showed that the rule may actually concentrate risk rather than mitigate it. Brown-Hruska added that the CFTC has shown a willingness, however, to take cost benefit analysis into account.

Source: [CFTC: A Review of the Cost-Benefit Consideration for the Margin Rule]

Recently, there have been some bills introduced in the U.S. House and Senate that aim to address the issue of cost and regulation such as the Insight, Reform, and Accountability Act, which passed the House of Representatives in March 2017. The bill defines a "significant regulatory action," that would "have an annual effect on the economy of $100 million or more" and impact the economy or economic sectors of the economy in a material way.

Source: [H.R.1009 - OIRA Insight, Reform, and Accountability Act]

Another similar bill, the Independent Agency Regulatory Analysis Act of 2017, was introduced in the Senate in June 2017. The bill requires independent agencies to do a cost benefit analysis on new rules with the same $100 million threshold.

Source: [Senate Bill: Independent Agency Regulatory Analysis Act of 2017]

"It is a market that is about financial data, financial relationships. And so we really have an opportunity to bring the CFTC up to the standard of rigorous quantitative cost benefit analyses," said Brown-Hruska, adding that the new legislation involves more public involvement.

"It allows the public to consider the impact of specific assumptions made by regulators. That's something that a qualitative approach lacks."

Andy Green, managing director of economic policy at the Center for American Progress, said there has been progress in incorporating economics into the regulatory process in a transparent way. But he argues that economists can sometimes be well off the mark of what is the true economic impact of financial crises such as the 2008 Financial Crisis, the Enron scandal, Long-term Capital Management and Orange County's bankruptcy.

"The macro aspects are often not captured by micro-analysis," Green countered. "The ability of even the best economists to get it right is limited. Everyone has different assumptions. Go find the top economists in the world, and you have 10 people with 20 different opinions, all about the same thing. So I think we need to be humble about our expectations of what we get in the process."

Analyzing The Analysis

The Securities and Exchange Commission and Commodity Futures Trading Commission came under criticism by panelists for their approaches to rulemaking, primarily for their limited cost benefit analysis in rulemaking procedures. Paul Atkins, who served as a commissioner on the Securities and Exchange Commission from 2002 to 2008, said there are sometimes biases that enter into the procedural approach, and those can be costly and damaging for the agency and for market participants. He said the analysis process is less scientific or procedural than one might think. In his experience, the parties in power at agencies use what he calls "the rule of the golden gut, where my instinct is better than your instinct, and because I have the power, I rule and will push my viewpoint through."

He said 10 or 15 years ago, cost benefit analyses was viewed by the agency as an obstacle to rulemaking. SEC lawyers were often required to come up with their own cost benefit analysis, a process he said was not reliable. In one major example, the US Court of Appeals in the District of Columbia ruled unanimously on July 22, 2011 that the SEC's new so-called "proxy access rule," applied to thousands of mutual funds, was "unutterably mindless." In the case, the court said the rule was adopted in violation of federal procedural law, making the rule invalid. The court concluded that the SEC was arbitrary and capricious in promulgating the rule.

Source: US Court of Appeals: Proxy Access Rule case ruling

"The (SEC) lawyers before the court couldn't even articulate how it would apply in practicality, this general rule to mutual funds in various cases," Atkins said. "This rule shook the agency to its core."

After that case, the SEC put together an economic analysis group at the agency to examine rules more holistically.

"The economic analyses may not be perfect, but at least they are talking about various aspects of the rule and how it would be applied and show how it would work in a workmanlike manner," Atkins said.

He mentioned another case he is working on, regarding the CFTC's Swap Reporting Rules, which has faced problems with industry participants and with the quality of data. Atkins said it was an example of how an agency chairman sometimes pushes policy through, believing it is the right thing to do, but then ignores trusted procedures in developing the rule.

Atkins said the swap reporting rule was pushed through by then CFTC Chairman Gary Gensler, in "pretty much a lawless manner, where he pretty much relied on staff interpretations and no-action letters to get the whole thing through because he couldn't get it completely adopted by his fellow commissioners. That is an example of how somebody is thinking his gut is better than others'."

The CFTC's Division of Market Oversight was ordered on July 10, 2017 by two CFTC commissioners to overhaul those swap reporting rules.

Source: CFTC: Roadmap to Archive High Quality Swaps Data

J.W. Verret, senior affiliated scholar, Mercatus Center at George Mason University and associate professor, Antonin Scalia Law School, George Mason, said that Dodd-Frank Act rules are mandated by Congress, but still must be done with a level of caution and care. Some have argued that a cost benefit analysis is not necessary for that particular rule, an idea Verret disagrees with.

"If the statute is constitutional, it requires a rule, but the agency can make choices in how it implements that rule," Verret said. "So any move from the lowest cost method of implementation to another implementation, that delta requires a cost benefit analysis under the SEC's operative statute."

Taking the opposite point of view, Green said there are limited resources for each of the agencies. He also argued that the day-to-day input from market participants and lobbyists is part of the input into the rulemaking process.

How To Do It Right

Exactly how to improve the rulemaking process is a problem that generates multiple solutions. From Atkins' point of view, one of the keys to creating good regulation is adhering to the simple mantra of "being humble."

"For every action there is an equal and opposite reaction, so that is one aspect of trying to think ahead on the practical implications of a rule," Atkins said.

He mentioned there are still several agencies that do not use cost benefit analysis, including the US Federal Reserve Bank, US Treasury and Financial Stability Oversight Council. Brown-Hruska advocated for an approach that required CFTC staff to use quantitative cost benefit analysis in proposed rules, which could create a virtuous circle of analysis between the agency and the public to help drive for the most accurate cost related data.

"That would force the CFTC to clearly state their assumptions regarding regulations," Brown-Hruska said. "It would allow public commenters to engage directly with the regulators. It's a framework for analyzing a given market."

The problem for some, however, is that much of the rulemaking as part of Dodd-Frank was accepted by the marketplace as reasonable. The issue then becomes how the approach slows the pace of regulation.

"If the problem we want to solve is that agencies act effectively and in the public interest, we have to recognize that the challenge is (that regulators need) to act and act quickly and with certainty," Green said. "And then, let's have a bunch of economists go back and look at what's going on. I want independent economists going out and looking at how all the different agencies are doing."

Green advocated for more data resources and more participants who can look at the data to help provide answers on what is working and what is not. He advocated for more resources for the Office of Financial Research, created in 2010 as part of the Dodd Frank Act to help address issues with financial data and spot potential risks in the markets. The agency, which is facing a proposed 25 percent budget cut by the president and a proposed 38 percent cut in staff by Treasury, could be a valuable partner in the analysis of markets. Brown-Hruska and Atkins countered that the economic teams at the agencies tend to know the subject matter very well and may be best suited to do the analysis.

Verette pointed to his 2015 paper called "Economic Analysis in Securities Enforcement: The Next Frontier at the SEC" in the Cincinnati Law Review, which points to a model for the regulatory approach. He pointed to the Federal Trade Commission, where regulators and economists work on equal footing and in tandem from the very beginning on antitrust litigation. This approach, he said, is critical because enforcement actions by agencies like the SEC work in several ways including: carry deterrence value, set penalties and prioritize cases - all actions that require an economic or cost component.

Source: Cincinnati Law Review: Economic Analysis in Securities Enforcement

"It has worked for decades at the FTC, and it can work at the SEC," Verret said. "Economists need to be more than just an afterthought in the priority setting and part of everything the enforcement agency does."

Verette also advocated for more economic analysis at self-regulatory organizations, or SROs, and implementing a cost benefit analysis on enforcement actions by them. He advocated supplementing this via regulatory budgeting. He said the Office of Management and Budget is considering such an approach now.

Congress Says Do It

The question then becomes, should Congress mandate cost benefit analysis for regulators?

Atkins warned about the pitfalls of Congressional action in regulation, citing the Volcker Rule, which he said had very little public debate before it was inserted into the Dodd-Frank Act.

"Now we're paying for it with less liquidity in the marketplace," Atkins said. "Why? Because the rule as drafted and implemented requires bank regulators to put on their little psychoanalytical hats, and try to figure out what that trader meant when he traded this security a few years ago. So now traders would rather not write a memo about why they traded a security and have gone off to do something else."

In Green's view, better regulation is about incorporating a more inclusive approach.

"If I could pick just one thing, it would be to dramatically increase the amount of data that is available to the public. So then all the good academics out there can do their own crowd-sourced comments and analysis. I think we'd get a much better result."

White Hats And Black Hats

Roundtable 2: Enforcing The Rules Of The Game

(This panel was held under Chatham House Rules, meaning that none of the panelists will be identified in this section of the report)

What is the role of regulatory enforcement or prosecution, as opposed to something else?

The debate has gone on for many years, going back to Roberta Karmel, an SEC commissioner from 1977 to 1980 who authored a book in 1982 called "Regulation By Prosecution: The Securities and Exchange Commission v. Corporate America."

In the book, Karmel argues the SEC was largely ideological in its approach to enforcement and "obsessed with investor protection, according to a review in the Baltimore Law Review by Mark Sargent of the University of Baltimore School of Law. In it, he wrote "Because the Commissioners were largely former staff members, because loyalty to the SEC as an institution clouded individual judgment, and because actions brought by the Enforcement Division were typically resolved by consent injunctions subject to the control of the Division, there was no effective check on the SEC's abuse of its statutory mandate."

Source: Regulation By Prosecution: The Securities and Exchange Commission v. Corporate America, Roberta Karmel

Source: Baltimore School of Law Book Reviews

The book also argued that the SEC was enacting new regulations through enforcement actions which were then settled. One panelist pointed out that the crime of insider trading was set by the SEC in 1961, and it has never been enacted into a statute by Congress. The point here is that setting regulation on a case by case basis makes for bad enforcement policy, said one panelist.

"People who are targeted and are made a new rule is not completely fair to them," the panelist noted.

One panelist said rules should be clear, so actions are not surprising to market participants.

"The enforcement decision should not be about gotcha, or done in ways that are surprising, because then you are actually writing a rule here,'" he said. "And then you haven't gone through the right analysis, cost benefit analysis and all of that. That's a problem."

The key for regulators is to stay within the set rules on each case they are investigating. Once a regulator reaches beyond that, it can be difficult for the agency and for market participants.

"We don't want to be litigating something that is totally new, or totally outside the precedent," one panelist said. "Otherwise, we're not going to be successful in litigating."

Cost Benefits?

Given the current focus on cost benefit analysis, experts said agencies do follow a method of cost benefit analysis in enforcement cases. One step in the process is simply choosing which cases a regulator will pursue.

For most agencies, there is a "gating process." Senior enforcement officials are likely to proceed with an investigation or case because of that filtering process, which helps elevate cases higher within the agency.

The question of whether it would be a good idea to bring in economists to conduct cost benefit analysis was met with some acceptance, and indeed has been tried in practice. The CFTC, under former CFTC Chairman Gary Gensler, created a group of forensic economists and investigators to maximize the enforcement division’s ability to handle complex cases. But adding the component of economic cost benefit analysis to every case, as one panelist put it, "just seems like another layer" of costs. One solution for the CFTC would be to implement guidelines to help determine the setting of fines.

In terms of the fines, there is "extensive cost analysis" done on any case, panelists said. Regulators examine several elements in determining what that number is including: the extent of harm to the markets and egregiousness of the conduct. There is also the size of the fine that "is not just a speeding ticket or the cost of doing business," which would help deter others. Because every case is different, a set fine for cases can take months.

No doubt, the size and potential cost to rule breakers is a component of these cases. In the aftermath of the financial crisis, 16 banks and institutions have paid $320 billion in costs and settlements. There are about 15 federal agencies, attorneys generals from 50 states, district attorneys for Manhattan, and foreign regulatory agencies involved with those cases. In one panelist's viewpoint there should be an economic analysis of the effectiveness of such enforcement.

Turn Yourself In

One approach to enforcement is in the form of self-reporting to an agency. The concept is getting more attention in recent months with the CFTC announcement that firms and individuals who come forward with rule violations may receive lighter treatment. The CFTC announced on September 25, 2017, an updated advisory on "self-reporting and full cooperation." The idea is that offenders who self-report would receive a substantial reduction in the civil monetary penalties. The director of the Enforcement Division, James McDonald, said companies which self report could get a 50 to 75 percent reduction in penalties. And if they didn't do so, firms would face aggressive prosecution.

Source: CFTC: James McDonald, Self-reporting speech

The key elements of this program are:

- Self-report, before the agency has discovered a broken rule
- Remediation, working to clearly spell out expectations so firms can get it right
- Reduction, meaning a "substantial reduction in the penalty" or in rare cases, a free pass.

Source: CFTC: Self-reporting and full cooperation advisory

The CFTC is not alone in pushing this policy. The Department of Justice, for example, launched its self-reporting program in April of 2016. The program was aimed primarily at violations of the Foreign Corrupt Practices Act, or FCPA. The department added 10 additional prosecutors to the unit, upping its staff by more than 50 percent. And it was complemented by the FBI's move to establish three new squads of special agents that are focused on FCPA cases.

The challenge for market participants is what the CFTC or other agencies mean by the term "substantial reductions" in penalties. There have been recent announcements by regulators that stated penalties were reduced because of the self-reporting. But for some watching the program, there is a feeling the CFTC should wave financial penalties for firms that come forward and work with the agency in a transparent manner. That would incentivize other firms to do the same and could be taken on a case-by-case basis.

There is also some confusion about how best to bring these CFTC cases forward and how it affects any other investigation by a self-regulatory organization such as CME Group.

How To Measure Success

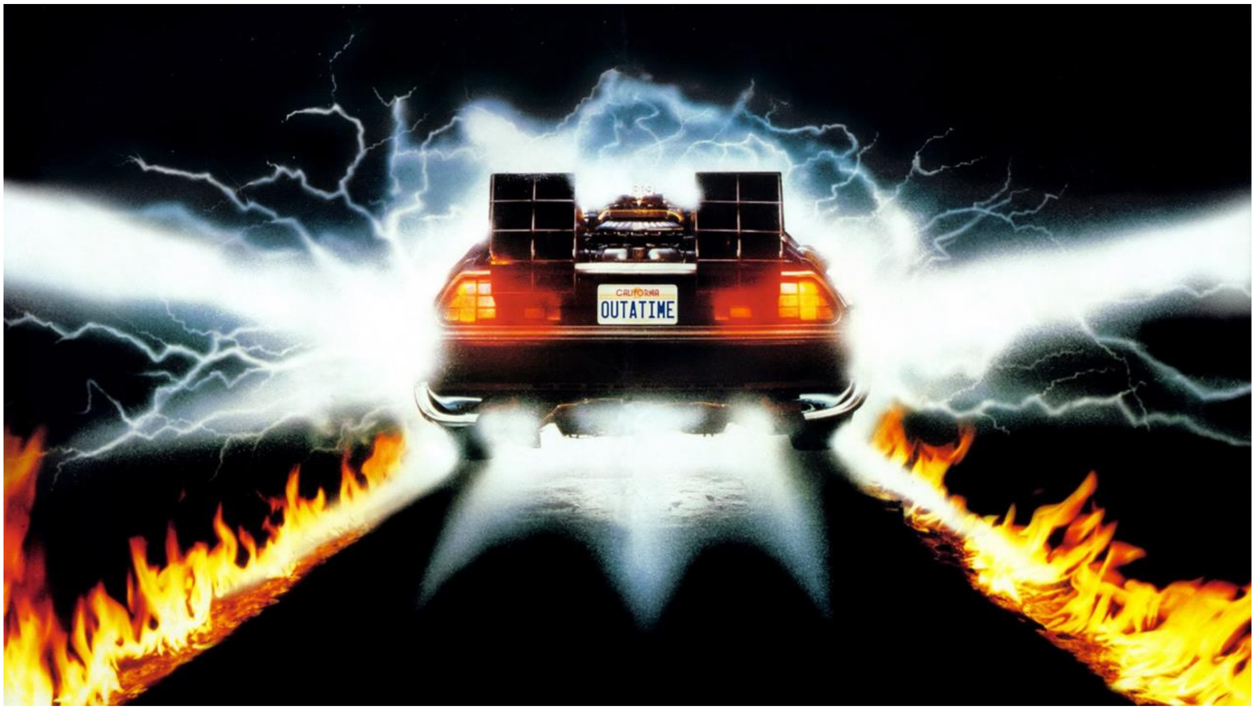
For regulators and industry professionals, judging the success of an agency's enforcement activity is difficult. Panelists generally did not believe total fines is a good metric to follow. Indeed, regulators are in the unenviable position of trying to figure out the balance of catching bad actors and fining or jailing them, while also trying not to hamper the functioning of the markets.

In one panelist's estimation, success would be someone coming forward to their boss and reporting bad behavior or a rule infraction so that firm would come forward to the regulator, and work out a reduced settlement or perhaps one without fines.

For another panelist, success would be to move up the chain to the highest level within a company, find the persons responsible and bring a case against them. Regulators are often criticized for not getting the CEO of a large bank or institution. But regulators say they are striving to hold the right people responsible for their actions, even if the public doesn't quite see that.

The concern is that some enforcement actions, where there are ambiguous issues, may inhibit good behavior. There are so many details to follow, making it more difficult for people do their job as traders, brokers, bankers and so on.

Where We're Going We Don't Need Roads



Roundtable 3: The Future of Financial Regulation

• Daniel Gorfine, LabCFTC Director and Chief Innovation Officer, U.S. Commodity Futures Trading Commission

• Beth Knickerbocker, Chief Innovation Officer, Office of the Comptroller of the Currency

• Roberta Romano, Sterling Professor of Law and Director, Yale Law School Center for the Study of Corporate Law

• Benedict Wagner-Rundell, First Secretary, Economic at Foreign and Commonwealth Office, British Embassy, Washington, DC

• Brian Knight, Senior Research Fellow, Financial Markets Working Group at the Mercatus Center at George Mason University

The pace of change in the financial markets in recent years has been dramatic and is accelerating. With the advent of new technologies such as cloud computing, the potential uses of blockchain and digital ledger technology, machine learning, the prospects of new markets and new asset classes - all set in a very connected global marketplace - regulators face increased challenges to keep up with it all.

The question remains, are the frameworks that have been built and monitor the markets today equipped to handle the markets of tomorrow? The difficulty, of course, is that regulators must regulate in the current market conditions. And how should regulators work with fintech innovators? The answers from two US agencies and one from the UK indicate different approaches to working with firms to not only help them comply with rules but help regulators keep up.

"We're in a market with great dynamic change all the time and there is a lot of uncertainty with all of it," said Roberta Romano, Sterling Professor of Law and Director, Yale Law School Center for the Study of Corporate Law. "There are challenges that we don't know what they might be. Even in the best of times, the regulations you come up with may not even be effective. Or they might be effective now, but as things change, they might become ineffective."

Daniel Gorfine, LabCFTC Director and Chief Innovation Officer, U.S. Commodity Futures Trading Commission, said the challenge for regulators is to stay on top of the changing market landscape so they can adjust as market dynamics and conditions shift. The pace of innovation and adoption is "changing pretty profoundly," he said. He pointed to advancements in the process of payments. Years ago, it would take brick and mortar companies years to scale up their operations regionally and nationally. But today, a mobile payment app can service hundreds of thousands of users and process billions of dollars in transactions in a short period of time. And many of today's new technologies are attempting to disrupt the status quo.

How The UK Led The Way On Fintech Regulation

To see how other countries are trying to adjust to this new market backdrop, it is helpful to take a look at the United Kingdom's Financial Conduct Authority, which was launched in April of 2013, replacing the prior Financial Services Authority. The agency oversees more than 56,000 companies and serves as the prudential regulator for more than 18,000 businesses. It covers everything from banks and credit unions to insurance companies and investment companies. The approach for the new agency came from the angle of competition and the thought that if UK markets operated effectively and efficiently, consumers would benefit. And that would provide confidence in the UK as a global financial hub.

Source: FCA: Overview of the Financial Conduct Authority

Benedict Wagner-Rundell, First Secretary, Economic at Foreign and Commonwealth Office, British Embassy in Washington, DC said the UK's financial services sector is massive and well developed and in some ways encourages competition in sectors where there are few choices for consumers. One example is in consumer banking, where 90 percent of individual checking accounts are held by just five banks. The FCA wanted to encourage innovation in that space so consumers could do better and use more innovative services.

Even before the creation of the FCA, the UK launched Project Innovate in October 2014, aimed at encouraging innovation in three ways:

- Regulatory sandbox - for firms ready to test technologies
- Request direct support - for more tailored regulatory support for firms
- Advice unit - to give feedback to firms developing automated advice and guidance models

In short, Project Innovate is designed to help firms take on regulatory barriers to innovation and help those companies clarify regulatory expectations as well as help the FCA look at its own rules and policies in the best interest of consumers. As of June 2017, Project Innovate has assisted 358 firms, received 720 requests for support, authorized 29 firms with another 11 applications for authorization. Its Regulatory Sandbox is considered the first of its kind, allowing firms to test products and services in a live environment. That department has accepted 31 out of 71 applications through June 2017, nearly double the number of its first round six months earlier.

Source: FCA: Christopher Woolard, Executive Director of Strategy and Competition, Speech

Project Innovate has evolved over time from a simple information sharing format to one that examines a business model and offers advice on what the firm needs to do to offer its services to the public. Now the FCA offers more direct support on what firms need. The Regulatory Sandbox interacts with innovative firms in regulation technology and other service areas. This, Wagner-Rundell said, has helped the FCA by pointing out where it needs to grow and strengthen itself as a regulator or in terms of policy.

Some of the challenges for firms trying to work with the FCA come from old-school barriers such as established institutions which do not want to provide any data that may help a start-up firm test its model. The UK is now requiring more data to be made public with a common API for easier access.

Meanwhile, the CFTC launched LabCFTC, which also is aimed at promoting fintech innovation for its markets. Based in New York, the department aims to accelerate fintech and regtech engagement with the CFTC. It, too, is designed to help those firms and the CFTC itself as an information source for commissioners and CFTC staff.

Source: CFTC: LabCFTC

Gorfine said engagement will help the agency understand what new technologies are coming into the market. Those firms can also help the regulator identify some friction in the system that might enable the agency to adjust policy. LabCFTC is also trying to improve communications via white papers, or primers on new developments. The division recently put out its first primer on digital currencies, which offers guideposts to participants in that space and the CFTC's potential involvement there.

Source: [CFTC: CFTC Primer On Virtual Currencies]

The CFTC will also launch prize competitions in 2018 that might help solve policy challenges in the marketplace.

"Maybe it's making our rulebook machine readable, so when you start looking at the regtech space that could be something that enables innovation in that area," Gorfine said.

The CFTC has some limited ability to work with new technologies but it isn't as flexible as the Bank of England, for example. The central bank is working with firms on a blockchain clearing and settlement proof of concept. But that is something the CFTC cannot currently do with US firms due to procurement and anti-gift rules in place. That said, there may be some areas where regulators can encourage more innovation in a particular sector by offering exemptions to certain products in the marketplace.

The concern among some is that Sandboxes and innovation labs may favor small firms over larger established companies. The FCA counters that by pushing to find technologies that are truly innovative and benefit consumers in terms of cost or efficiency. The Office of the Comptroller of the Currency's innovation program is also not limited to startups, and it often comes from the largest institutions.

Ultimately, regulators are trying to figure out not only how to foster innovation within their sectors, but how to evaluate and measure that. Those metrics are still a work in progress, but regulators have turned a corner in the technology space and will be integral to the development of it in the coming years.

Conclusions:

Like the markets themselves, the regulatory space continues to evolve. The frequent and complex rulemaking in the wake of the Dodd-Frank Act is shifting toward a more collaborative approach with the industry. And that includes more of a focus on cost benefit analysis in rulemaking. Whether Congress or the agencies themselves push forward here, it is clear that courts and market participants would like to see more cost benefit analysis integrated into the rulemaking process. In enforcement, the biggest shift comes from the CFTC's self-reporting program. If the agency and firms can strike the right balance between enforcement and lessons learned by firms, it could be a win-win. Finally, the regulators in the US and UK are looking for ways to work more cohesively with the fintech and regtech sectors. The emergence of technology and its impact on markets could also create value not only for the firms looking to deploy new technologies, but for the regulators as well.

A Teaching Moment: Thomas Lambert Guides The Way On Regulation

Sometimes it is all about the fundamentals. Thomas Lambert rolls out the keys to good regulation in any industry in his new book, "How to Regulate: A Guide for Policymakers" and speaks about the regulator's conundrum and how regulators can and should innovate."

Lambert, Wall Chair in Corporate Law and Governance and Professor of Law, University of Missouri Law School, said the keys to good regulation come down to six tips. They are the following:

1. Optimize - don't let the perfect be the enemy of the good
2. Play doctor - assess, diagnose, catalog remedies, implementation, select approach with the highest benefit
3. Think incrementally - consider cost with the least detrimental regulations
4. Acknowledge knowledge limitations - be humble in predictions
5. Look for bootleggers behind the Baptists - beware of those advocating for rule changes
6. Remember innovation - innovation may obviate the need for regulation.

See the interview with Thomas Lambert.

1 - This report was brought to you by the [Institute for Financial Markets](), a nonpartisan, nonprofit educational foundation. The IFM seeks to increase public awareness and understanding of the importance of financial markets and the financial service industry to the global economy and to improve the technical competence of those in the industry who deal with the public.