MEMORANDUM

To: Crypto Task Force Meeting Log
From: Crypto Task Force Staff
Re: Meeting with Representatives of Crypto Policy Working Group

On April 9, 2025, Crypto Task Force Staff met with representatives from Crypto Policy Working Group.

The topic discussed was approaches to addressing issues related to regulation of crypto assets. Crypto Policy Working Group representatives provided the attached documents, which were discussed during the meeting.

February 13, 2025

Crypto Task Force
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Commissioner Peirce,

We write to formally request a meeting with the Crypto Task Force to discuss how the legal community can support your efforts to bring regulatory clarity to the crypto industry. Our working group represents a broad cross-section of practicing lawyers—law firm partners, in-house counsel, and regulatory specialists—who have been deeply engaged with the industry since its inception. With extensive experience advising businesses, investors, and developers navigating the regulatory landscape, we understand that for this historic opportunity to be fully realized, the industry must work together to identify shared priorities and practical solutions. I am a lecturer on blockchain law at Fordham University and founder of the Fordham Law Blockchain Regulatory Symposium, which brings together leading regulators, academics, judges, lawyers, and business practitioners.

Recognizing this, Ivo Entchev, Olta Andoni, Stephen Rutenberg, and I convened a working group of 90 general counsel, outside counsel, and academics to align on key regulatory priorities for the new administration. These priorities were outlined in an open letter published in CoinDesk and shared with policymakers (attached as Exhibit A)[1]. These individuals, participating in their personal capacity (as listed in Exhibit B), request to attend the meeting, with additional members of the Crypto Policy Working Group invited as space permits.

Since our letter's publication, we have seen encouraging steps from the SEC, including the launch of the Crypto Task Force,[2] the repeal of Staff Accounting Bulletin 121, and an invitation for industry input on achieving regulatory clarity. We welcome these developments and seek to build on this momentum by ensuring that legal practitioners can provide clear, reliable guidance to crypto businesses.

In addition to exploring how our group can help advance the Task Force's goals, our draft meeting agenda (attached as Exhibit C) focuses on how the SEC can leverage existing regulatory tools—rule-making, exemptive relief, enforcement clarity, and no-action letters—to provide practical guidance to the industry.

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[1] https://www.coindesk.com/opinion/2025/01/16/how-to-make-the-united-states-the-crypto-capital-of-the-world

[2] https://www.sec.gov/newsroom/speeches-statements/peirce-journey-begins-020425

We appreciate that the Task Force has received significant interest from industry participants. Our contribution is helping the industry align on key issues, ensuring that regulatory discussions reflect the legal realities businesses and policymakers face daily. We believe our insights can assist the Task Force in refining its agenda in a way that benefits both regulators and market participants.

We appreciate your time and consideration and look forward to the opportunity to discuss these critical issues.

Sincerely,

Professor Donna Redel
Fordham Law School

Exhibit A

Published Open Policy Letter

January 17, 2025

The Honorable Donald J. Trump
Mar-a-Lago
1100 S Ocean Blvd,
Palm Beach, FL 33480

Dear President-Elect Trump

In your keynote address at the Bitcoin conference in Nashville last year, you pledged to make the United States the crypto capital of the world if re-elected for a second term. As you return to the presidential office this Monday, we write to you as practicing members of the crypto law bar to recommend regulatory policies that will help you to achieve that goal.

The United States, which rests on the same foundation of personal liberty as crypto, is naturally positioned to lead the world in its development. Unfortunately, U.S. regulators have until now refused to adapt existing laws to digital assets and the blockchains that underpin them (or even to explain why not), and created an unfavorable business environment that has driven many entrepreneurs and developers abroad.

To unleash American ingenuity and remedy this neglect of the blockchain industry, we propose that you pursue the below forward-looking policies across three areas: supporting U.S. companies; promoting crypto values such as privacy, disintermediation, and decentralization; and cultivating a favorable business environment domestically.

I. Supporting U.S.-Based Businesses

The crypto industry has produced a range of established and emerging use-cases, including digital gold, stablecoins, permissionless payments, decentralized finance, real world assets, decentralized physical infrastructure (DePIN), and many more. Many of them are being responsibly advanced in the United States by businesses such as Coinbase, Circle and Consensys, and by developers contributing to crypto's open-source, decentralized infrastructure. To continue competing against their international rivals, these parties need clear rules of the road and proper regulatory guidance.

A. General Rules of the Road

Token issuance and secondary sales, which lie at the heart of the crypto economy, are subject to confusing and overlapping regulatory authority from the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). Market structure legislation should clearly delineate the scope of jurisdiction among primary regulators and lay out when assets enter and exit that jurisdiction.

Here, Congress should resist giving the U.S. securities laws an overbroad application, as the SEC has done. Tokens powered by open-source software and consensus mechanisms that are otherwise minimally dependent on centralized actors are not securities because there is no legal relationship between token owners and an "issuer," as understood by the securities laws. Similarly, crypto assets such as art NFTs (which are simply digital artwork) and non-investment activities, like staking and lending bitcoin, fall outside the securities laws.

Congress should be bold. That means not feeling bound by prior legislative efforts like FIT21 that were forged in an earlier political environment that have unintended consequences. It also means leveraging the regulatory experience of other nations, such as the European Union with its MiCA framework, while avoiding their pitfalls and charting a unique and dauntless path forward for the United States.

B. Specific Sectors

Besides advocating for general rules, your administration should urge Congress and the relevant agencies to address specific sectors due to their strategic importance to the crypto industry and the nation.

Stablecoins. Stablecoins, with a current market cap in excess of $200 billion, are the lifeblood of the digital asset ecosystem. Increasingly recognized under frameworks like the Stablecoin Standard and by state regulators, they warrant comprehensive legislation for their issuance and management, ensuring that they are transparently backed and do not threaten financial stability. Aside from benefitting consumers, regulatory support of stablecoins furthers national interests. Similar to Eurodollars, stablecoins, which are usually denominated in U.S. dollars, reinforce the dollar's status as the global reserve currency and increase demand for U.S. treasuries, which issuers hold in reserve.

TradFi Integration. The unprecedented success unprecedented success of Bitcoin and Ethereum ETFs demonstrates that crypto has begun integrating with traditional finance. Regulatory policy should ensure a safe and orderly integration by giving consumers access to trusted custody services. This requires amending or rescinding prejudicial SEC accounting guidelines (for instance, SAB 121) and custody rules. But it should not stop there. Pro-innovation policy in this area should also promote the tokenization of securities representing traditional financial assets like stocks, bonds, or real estate as blockchain-based tokens. The resulting benefits, which include improved liquidity, fractional ownership, and faster settlement, would strengthen U.S. capital markets, ensuring they remain the most developed and innovative in the world.

DeFi. Decentralized finance has the potential to modernize the global financial system and to return value to ordinary Americans by removing costly financial intermediaries. You should not allow entrenched interests and alarmism to stop the United States from becoming the world's leader in DeFi. In this regard, regulations aimed at centralized actors, such as exchanges and issuers, must be crafted in ways that avoid inadvertently capturing and paralyzing the still-nascent DeFi ecosystem.

II. Fostering Innovation through a Commitment to Crypto Values

If it is to promote crypto innovation, regulatory policy must show respect for crypto values, including privacy, disintermediation, and decentralization. Two key regulatory principles arise from this commitment. First, regulation should not impose greater burdens on crypto where traditional analogs exist. Second, regulation should evolve where traditional analogs are absent.

A. When To Treat Crypto the Same as Traditional Assets and Tools

The first principle impacts products like self-custody wallets, which enable users to hold and manage their own private keys. Because these tools are analogous to physical wallets used for personal asset management, they should not be treated any differently — namely, as financial intermediaries for purposes of regulatory surveillance and monitoring. You are not required to complete KYC before you can place cash in a physical wallet; the same should be true for storing tokens in your digital wallet.

Similar logic applies to the taxation of block rewards. Americans mining or validating blockchain transactions are creating new property, just like farmers growing crops in their fields. And yet, the IRS currently taxes them on that income. This differential treatment should be abolished.

B. When To Treat Crypto Differently

The second principle demands regulators resist placing crypto actors and activities into legacy frameworks that are incompatible with crypto. Doing so damages the crypto ecosystem, pushes the industry abroad, and erodes the Rule of Law.

Regrettably, this is the path that many U.S. regulators have chosen. The IRS has begun treating crypto front-ends as "brokers" absent statutory authority. The Department of Justice has begun charging non-custodial wallet developers with unlicensed money-transmission violations despite its longstanding policy to the contrary. And the U.S. Treasury has sanctioned the smart contract of privacy mixer Tornado Cash even though it is neither a foreign person nor property, but merely code. (An appellate court overturned the sanction.)

Without diminishing the importance of the governmental interests at play (tax evasion, money laundering, and national security), we submit that the government's approaches in each case are wrong as a matter of innovation policy, and we encourage your administration to reverse them.

Instead of regulating digital asset and blockchain businesses like traditional companies, we urge regulators to collaborate with this new technological paradigm and with our industry. For example, if government surveillance (KYC) in a decentralized environment is actually justified in certain instances, regulators can leverage blockchain-based credentials that are portable across protocols, give users control of their data (a benefit of Web3 architecture), and are aligned with the frictionless blockchain ecosystem. Similarly, they can marshal the programmability of tokens and smart contracts to exclude sanctioned parties from parts of the crypto economy.

III. Attracting Top Talent with a Welcoming Business Environment

To become the leading destination for top crypto talent, the U.S. must cultivate a favorable business environment. Your administration can begin this process on Day One.

End de-banking of crypto companies. Your administration should direct the FDIC and all other agencies involved with Operation Chokepoint 2.0 to immediately cease their unaccountable campaign aimed at de-banking the crypto industry.

Improve SEC rule-making and enforcement. You should instruct your SEC chair to overhaul that agency's approach to crypto. Over the past four years, the SEC has consistently exceeded its authority by pursuing good faith industry leaders such as Coinbase and Consensys, regulating individual developers and users (in its exchange redefinition rulemaking), and launching enforcement actions against wallet providers. It is time for the SEC to correct this pernicious approach and begin engaging constructively with the crypto industry while focusing its efforts on preventing fraud rather than curbing financial speculation, which has benefits for innovation.

Roll back punitive tax rules. Your administration should roll back punitive tax rules that push entrepreneurs and developers abroad while leaving well-meaning taxpayers uncertain about how to calculate their tax bills. Low-hanging fruit improvements include the adoption of current expensing for software development; tax deferral for validation rewards and airdrops; a safe harbor for *de minimis* consumptive transactions (e.g. less than $5,000); a mark-to-market election for crypto investors and a repeal of IRS reporting regulations that treat websites as brokers. Congress should also repeal amendments to Section 6050I, which impose burdensome (and likely unconstitutional) reporting requirements on crypto transactions over $10,000.

Reduce unnecessary red tape. Consistent with the mission of the Department of Government Efficiency (D.O.G.E.), we urge your office to work with Congress and government agencies to reduce the unnecessary red tape restraining crypto and fintech. This includes simplifying or eliminating registration and reporting requirements for digital asset offerings that meet certain conditions, including providing essential investor disclosures. Congress should also consider legislating a unified federal framework for money transmission licensing that would bring clarity and efficiency to the broader fintech ecosystem.

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In pursuing the above forward-looking policies, we encourage your administration to consult with industry leaders and remain sensitive to the transnational scope of the digital asset ecosystem. (We view your formation of a Crypto Council as a positive step in this direction.) We also recommend leveraging devices, such as regulatory sandboxes, that limit the risk of unintended regulatory consequences.

The time is ripe for the United States to begin asserting its global regulatory leadership. By ensuring that it does, your administration will be contributing to the country's future economic

prosperity and endorsing a technology that rests on deeply held American values and freedoms. You should seize the moment.

Sincerely,

Ivo Entchev
Olta Andoni
Stephen Rutenberg
Donna Redel

On behalf of the crypto law bar and as expressly endorsed by the legal practitioners listed in Appendix A hereto.

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APPENDIX A

The following members of the Crypto Law Bar also signed this letter:

Mike Bacina, Joe Carlasare, Eli Cohen, Mike Frisch, Jason Gottlieb, Eric Hess, Katherine Kirkpatrick, Dan McAvoy, John McCarthy, Margaret Rosenfeld, Gabriel Shapiro, Ben Snipes, Noah Spaulding, Andrea Tinianow, Jenny Vatrenko, Collin Woodward, and Rafael Yakobi.

The views represented and reflected upon herein are those of the signatories and not necessarily of their employers

Exhibit B

Proposed Attendees (in their personal capacity)

- Olta Andoni, General Counsel, Enclave Markets (an Avalanche subsidiary)
- Ivo Entchev, General Counsel, Youbi Capital
- Donna Redel, Fordham Law School
- Stephen Rutenberg, Co-Head of the Blockchain and Digital Asset Practice, Polsinelli

Exhibit C

Proposed Agenda

Suggestions for how the SEC can best promote the provision of clear and actionable legal advice about the application of the U.S. securities laws to crypto businesses by using specific tools in its regulatory toolkit, including without limitation:

- Rule-making;
- Exemptive relief;
- Enforcement;
- No-action letters;
- Registration;
- Prospective and retroactive relief; and
- Cross-border sandboxes.

Our submissions will be informed by consultation with roughly 90 members of the crypto law bar comprising general counsel, outside counsel and academics.

April 7, 2025

Crypto Task Force
Securities and Exchange Commission
100 F Street, NE,
Washington, DC 20549

Dear Members of the Crypto Task Force,

In anticipation of our meeting on April 9th, we respectfully submit this summary of our remarks. We hope this will allow us to use our time with the Task Force more productively.

I. Introduction

We represent the Crypto Legal Working Group, a currently ad hoc group of law firm partners, in-house counsel, and regulatory specialists drawn from a broad cross-section of the crypto law bar. A member of our team, Donna Redel, is also the founder of the annual Fordham Law Blockchain Regulatory Symposium, which brings together leading regulators, academics, judges, lawyers, and business practitioners. The aim of the Crypto Legal Working Group is (1) to achieve a more unified industry perspective on the future of regulation, (2) to contribute and provide feedback to regulators regarding policy ideas and (3) to act as a resource and liaison in helping regulators consult with industry.

II. Meeting topics

A. Speaking with one voice on policy

Industry participants tend to be most helpful to policymakers when they communicate their viewpoints clearly and, as much as possible, with one voice. With that in mind, our working group consulted with a broad cross-section of the crypto law bar for the purpose of identifying regulatory policy priorities for the new administration. The resulting policy prescriptions were published in *CoinDesk* as an open letter (attached as Exhibit A hereto)[1] in mid-January and circulated to relevant government officials and staff. Many are now being implemented by the administration. We intend to describe this industry effort at speaking with one voice on crypto policy.

B. Identifying "low hanging fruit"

[1] https://www.coindesk.com/opinion/2025/01/16/how-to-make-the-united-states-the-crypto-capital-of-the-world

We recognize that the Task Force has been flooded with proposals and is looking for ways to act within the limited time it has for completing its work. Commissioner Peirce's public statements indicate that the SEC is focused on three categories: (1) clarifying which digital asset activity falls outside the SEC's jurisdiction, (2) eliminating frictions for digital asset activity within SEC jurisdiction, and (3) working with Congress and others on permanent regulatory framework. To that end, we have reviewed the public submissions to the Task Force and used the same consultative process to distill a short-list of "low hanging fruit" policy proposals (attached as Exhibit B hereto), which we intend to present at our meeting.

C. Principles-based regulation

Finally, we intend to advocate for a principles-based approach to the regulation of blockchain technology. Blockchain networks are analogous to an 'Internet of finance' that increases settlement efficiency, modernizes recordkeeping networks, reduces transaction costs and creates disintermediated markets for currencies and financial assets. When the Internet itself was developed in the 1990s, nobody could foresee the capabilities that we now take for granted. Fortunately, policymakers at the time elected for uniform principles that encouraged investment and innovation over onerous rules that stifled exploration and progress. Where possible, the SEC should be guided by a principles-based approach that respects the "bottom up" character of permissionless protocols and their development in a global marketplace (see Exhibit C hereto).

III. How we can help

Our Working Group can be a resource to the Task Force and its work in three ways. First, we can act as a liaison to industry participants, such as the crypto law bar and entrepreneurs. Second, we can organize or participate in fora devoted to specific topics, such as the elaboration of a principles-based regulatory framework. Third, we can lead specialized projects aimed at producing work-product that implements specific SEC objectives.

Sincerely,

Donna Redel
Ivo Entchev
Olta Andoni
Stephen Rutenberg

Exhibit A

April 7, 2025

The Honorable Donald J. Trump
Mar-a-Lago
1100 S Ocean Blvd,
Palm Beach, FL 33480

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Regrettably, this is the path that many U.S. regulators have chosen. The IRS has begun treating crypto front-ends as "brokers" absent statutory authority. The Department of Justice has begun charging non-custodial wallet developers with unlicensed money-transmission violations despite its longstanding policy to the contrary. And the U.S. Treasury has sanctioned the smart contract of privacy mixer Tornado Cash even though it is neither a foreign person nor property, but merely code. (An appellate court overturned the sanction.)

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III. Attracting Top Talent with a Welcoming Business Environment

To become the leading destination for top crypto talent, the U.S. must cultivate a favorable business environment. Your administration can begin this process on Day One.

End de-banking of crypto companies. Your administration should direct the FDIC and all other agencies involved with Operation Chokepoint 2.0 to immediately cease their unaccountable campaign aimed at de-banking the crypto industry.

Improve SEC rule-making and enforcement. You should instruct your SEC chair to overhaul that agency's approach to crypto. Over the past four years, the SEC has consistently exceeded its authority by pursuing good faith industry leaders such as Coinbase and Consensys, regulating individual developers and users (in its exchange redefinition rulemaking), and launching enforcement actions against wallet providers. It is time for the SEC to correct this pernicious approach and begin engaging constructively with the crypto industry while focusing its efforts on preventing fraud rather than curbing financial speculation, which has benefits for innovation.

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In pursuing the above forward-looking policies, we encourage your administration to consult with industry leaders and remain sensitive to the transnational scope of the digital asset ecosystem. (We view your formation of a Crypto Council as a positive step in this direction.) We also recommend leveraging devices, such as regulatory sandboxes, that limit the risk of unintended regulatory consequences.

The time is ripe for the United States to begin asserting its global regulatory leadership. By ensuring that it does, your administration will be contributing to the country's future economic prosperity and endorsing a technology that rests on deeply held American values and freedoms. You should seize the moment.

Sincerely,

Ivo Entchev
Olta Andoni
Stephen Rutenberg

Donna Redel

On behalf of the crypto law bar and as expressly endorsed by the legal practitioners listed in Appendix A hereto.

APPENDIX A

The following members of the Crypto Law Bar also signed this letter:

David Adlerstein, Mike Bacina, Joe Carlasare, Eli Cohen, Mike Frisch, Jason Gottlieb, Eric Hess, Don Irwin, Katherine Kirkpatrick, Dan McAvoy, John McCarthy, Margaret Rosenfeld, Gabriel Shapiro, Ben Snipes, Noah Spaulding, Andrea Tinianow, Jenny Vatrenko, Collin Woodward, and Rafael Yakobi.

The views represented and reflected upon herein are those of the signatories and not necessarily of their employers.

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Exhibit B

SEC Crypto Task Force Proposals – Short-List

I. Clarifying which digital asset activity falls outside the SEC's jurisdiction

1. Clarify that protocol staking does not involve a securities transaction.
2. Clarify that an entity or actor without custody over digital assets cannot be an exchange or broker.
3. Clarify that airdrops, token grants to developers and incentive-based distributions are not securities transactions.
4. Clarify that cryptographic tokens do not embody investment contracts.
5. Clarify that utility tokens such as in-game tokens are not securities.
6. Clarify that NFT royalties fall outside the securities laws.
7. Clarify that NFTs are not securities.
8. Clarify that stablecoins are not securities (moot).

II. Eliminating frictions for digital asset activity within SEC jurisdiction

1. Exempt via no action letter non-custodial DeFi protocols and non-custodial wallet software providers from registration.
2. Withdraw proposed amendments to Rule 3b-6, expanding definition of "exchange."
3. Retroactive relief and a pathway for existing projects to become compliant.
4. Create safe harbor for exchanges that facilitate secondary sales of unregistered securities in blind bid/ask transactions.
5. Implement (at least provisionally) Commissioner Peirce's Token Safe Harbor proposal.
6. Provide no-action relief that self-custody of digital assets is permitted until a qualified custodian exists.
7. Withdraw proposed Safeguarding Rule, which is unworkable for digital assets and excludes state banks and trusts.
8. Do not pursue exchanges without first establishing that underlying digital assets are securities.
9. Rescind 2019 Framework for "Investment Contract" Analysis of Digital Assets. (potentially moot)
10. Clarify that risk-capital-raising sales of tokens to investors are investment contracts requiring registration or exemption.
11. Clarify that Hinman speech is not SEC guidance.
12. Clarify steps for ensuring platform is not offering or selling digital assets in domestic transactions.

III. Working with Congress and others on permanent regulatory framework

1. Develop a workable token taxonomy, corresponding disclosure requirements and securities status.
2. Create a path for developers to raise capital through token sales and eventually list these tokens on exchanges.

3. Prioritize a clear framework for tokenizing traditional securities, including offering US listed equity in DeFi.
4. Establish principles for the Commission in regulating the digital asset industry.
5. Clarify the concept of an "issuer" for native digital assets.
6. Encourage the development of technical features that ensure compliance with the federal securities laws.
7. Establish SEC/regulatory sandboxes.
8. Establish global regulatory best practices.

Exhibit C

HARVARD
BUSINESS LAW
REVIEW

RULES FOR PRINCIPLES AND PRINCIPLES FOR RULES: TOOLS FOR CRAFTING SOUND FINANCIAL REGULATION

Heath P. Tarbert[†]

I. Introduction[1]

The fundamental objective for any government agency overseeing financial markets and institutions should be sound regulation. And how we regulate is just as important as what we regulate. Every major financial regulator in the world employs, to varying degrees, two primary methods of regulation: principles-based and rules-based. In this article, I discuss the key advantages of each of these forms of regulation. I also offer some considerations for determining when a principles-based, a rules-based, or hybrid approach to regulation is the most appropriate. That is to say, I outline a number of "rules for principles" and "principles for rules" for achieving sound regulation. Finally, I consider some real-world applications of this framework as applied to our modern and increasingly digital markets.

As the Chairman of the Commodity Futures Trading Commission (CFTC or Commission), my focus will be on the CFTC and its agenda.[2] Among my goals is reinvigorating the CFTC's primarily principles-based approach to regulation where appropriate. Such an approach can provide enormous flexibility in rulemaking and enable the CFTC—the world's premier derivatives regulator—to stay ahead of the curve by reacting more quickly to changes in technology and the

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[†] Chairman and Chief Executive, Commodity Futures Trading Commission. The opinions, analyses, and conclusions expressed in this Article are mine and do not necessarily reflect the views of other Commissioners or the Commission itself.

[1] This Article is based on a presentation I gave at the Annual Robert Glauber Lecture, JFK Jr. Forum, Harvard University, Cambridge, Massachusetts on October 24, 2019. I want to thank all the participants for their helpful comments, particularly the Honorable Bob Glauber, former Under Secretary of the Treasury for Domestic Finance and former professor at the Harvard Business School. *See* https://www.cftc.gov/PressRoom/SpeechesTestimony/opatarbert3. I also want to thank Matthew Daigler for his outstanding assistance in the preparation of this Article.

[2] The CFTC regulates U.S. derivatives markets—including futures, the vast majority of swaps, and certain types of options. These markets see over $4 trillion in notional activity in the United States each day. *See* Heath P. Tarbert, *Why the CFTC is the Most Important Regulator You've Never Heard Of*, FOX BUS. (Jul. 29, 2019), https://www.foxbusiness.com/financials/why-the-cftc-is-the-most-important-regulator-youve-never-heard-of.

marketplace.[3] At the same time, I consider the circumstances where a more prescriptive, rules-based approach is preferable. In pursuing this endeavor, I have been able to build on the work and ideas of a number of former CFTC Commissioners and Chairs of diverse backgrounds and political affiliations.[4]

At the outset, I note that in developing this analytic framework and applying it to concrete regulatory initiatives, I have been guided by Aristotle's maxim on methodology: "Our discussion will be adequate if it has as much clearness as the subject-matter admits of, for precision is not to be sought for alike in all discussions. . . ."[5] Evaluating the factors that lead us to a more principles-based or rules-based regulatory approach is dependent on facts and circumstances that are, by their nature, complex and subject to change. We should therefore resist the urge to demand more certainty from this inquiry than it admits.

II. Background

The CFTC has a unique history and tradition of being a principles-based regulator.[6] Loosely stated, this means that the CFTC relies more on clearly stated principles to achieve regulatory objectives than it does on compliance with detailed, prescriptive rules. The CFTC has generally been more of a principles-based regulator than other U.S. regulators, in particular our sister agency, the Securities and Exchange Commission (SEC).[7]

The Commodity Futures Modernization Act of 2000 (CFMA),[8] which was signed into law by President Clinton, solidified the CFTC's status as a principles-based regulator. Based on a

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[3] *See, e.g.*, Sam Woods, Deputy Governor for Prudential Regulation and Chief Exec. Officer, Prudential Regulation Auth., U.K., Stylish Regulation, Speech at the UBS Financial Institutions Conference, Lausanne (May 16, 2019), https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/stylish-regulation-speech-by-sam-woods.pdf?la=en&hash=C63CBBE35E4CFEB15133D1B0D836A347757FD19D (noting the need for regulators "to be sufficiently fleet of foot to respond to . . . shifts [in the financial system] before they create serious problems—in short, regulation should be future-facing and keep fit for purpose").

[4] *See, e.g.*, Bart Chilton, Comm'r, CFTC, Let's Not "Dial M for Merger": CFTC's Principles-Based Regulation—A Success Story, Speech at the Futures Industry Association, Law and Compliance Luncheon (Nov. 13, 2007), https://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-4 (referring to "the CFTC's successful (and sole) exercise of principles-based regulation at the federal level in the United States"); Walter Lukken, Comm'r, CFTC, Smart Regulation for the Global Marketplace, Remarks to the Federation of European Securities Commissions (Jun. 26, 2007), https://www.cftc.gov/PressRoom/SpeechesTestimony/opalukken-25 (noting that the CFTC "has been successfully utilizing a principles-based approach for seven years"); J. Christopher Giancarlo, Comm'r, CFTC, 21st Century Markets Need 21st Century Regulation, Address to the American Enterprise Institute (Sep. 21, 2016), https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-17 ("If regulators are going to be effective overseers of 21st century markets, we must repurpose our rules so that they can keep pace with the digital transformation. It starts with recognizing that most of our legislative authority was written for last century's human markets. We must reconsider and repurpose our analog rules for today's digital markets. At the CFTC, this can only be done with a return to its traditional approach of principles-based regulation.").

[5] Aristotle, Nicomachean Ethics, trans. by W.D. Ross, Batoche Books, Kitchener (1999), Chapter 3. *See* John Braithwaite, *Rules and Principles: A Theory of Legal Certainty*, 27 AUSTL J. OF LEGAL PHIL., 47–82, 48 (2002)

[6] *See, e.g.*, Chilton, *supra* note 4.

[7] *See id.* Jerry W. Markham, *Merging the SEC and CFTC—A Clash of Cultures*, 78 U. CIN. L. REV. 537, 544 (2009).

[8] Commodity Futures Modernization Act of 2000, Pub. L. No. 106–554, app. E, 114 Stat. 2763.

regulatory framework recommended by the CFTC staff,[9] the CFMA added to the Commodity Exchange Act (CEA)[10]—the CFTC's governing statue—core principles for designated contract markets (DCMs) and derivatives clearing organizations (DCOs).[11] In layman's terms, DCMs are exchanges where derivatives are traded, and DCOs are clearinghouses where trades are centrally cleared.[12] While over time the CFTC has adopted a number of regulations to support and elaborate on these core principles, such core principles continue to provide the overarching—principles-based—regulatory framework for CFTC-regulated derivatives exchanges and clearinghouses.[13]

At the time the CFMA was enacted, other major jurisdictions were experimenting with principles-based approaches. For example, in 2000, the United Kingdom passed the Financial Services and Markets Act (FSMA).[14] The FSMA set out key regulatory objectives that were embodied in a set of broadly-stated principles rather than in detailed rules.[15] Both the United States and the United Kingdom came to the same conclusion: a principles-based oversight regime is more effective than a rules-based system for overseeing financial services in this global technological age.[16]

That premise was tested in the aftermath of the global financial crisis. In both the United States and the United Kingdom, policymakers called their respective financial regulatory regimes into question. Britain saw its Financial Services Authority (FSA) dissolved and replaced with a "twin peaks" approach comprising the new Financial Conduct Authority and the Prudential

[9] In 2000, the CFTC staff recommended a flexible framework for the futures market that would replace a one-size-fits-all style of regulation with "core principles." *See* U.S. COMMODITY FUTURES TRADING COMMISSION STAFF TASK FORCE, A NEW REGULATORY FRAMEWORK (2000), https://www.cftc.gov/sites/default/files/files/opa/oparegulatoryframework.pdf. The CFTC issued final rules adopting this approach later in the same year. *See* A New Regulatory Framework for Clearing Organizations, 65 Fed. Reg. 78,020 (Dec. 13, 2000); A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations, 65 Fed. Reg. 77962 (Dec. 13, 2000) (to be codified at 17 C.F.R. Part 1 et al.).

[10] 7 U.S.C. § 1.

[11] While the CFMA codified the CFTC's new regulatory framework without significant changes, it varied in details from the final rules adopted by the CFTC in 2000 (*see supra* note 9), which had not yet become effective. The CFTC engaged in a further notice and comment rulemaking to implement the new statutory scheme established by the CFMA. *See* A New Regulatory Framework for Trading Facilities, Intermediaries, and Clearing Organizations, 66 Fed. Reg. 42,256 (Aug. 10, 2001).

[12] A clearinghouse is an intermediary between buyers and sellers. As the intermediary, or counterparty, to every trade, the clearinghouse acts as the buyer for every seller and the seller for every buyer for every trade. By acting as the counterparty for every trade, the clearinghouse helps mitigate counterparty risk by maintaining a matched book and risk-neutral position. *See, e.g.*, Annette L. Nazareth & Jeffrey T. Dinwoodie, *Clearinghouse Regulatory Basics for Swap Market Participants*, GLOBALCAPITAL (Mar. 14, 2014), https://www.davispolk.com/files/03.14.14.Clearinghouse.Regulatory.Basics.for_.Swap_.Market.Participants.pdf.

[13] *See* 7 U.S.C. § 7(d) (Core Principles for Contract Markets); 17 C.F.R. Part 38 (Designated Contract Markets); 7 U.S.C. § 7a-1(c)(2) (Core Principles for Derivatives Clearing Organizations); and 17 C.F.R. Pt 39 (Derivatives Clearing Organizations).

[14] Financial Services and Markets Act 2000, c. 8 (Eng.).

[15] *See* Julia Black et al., *Making a Success of Principles-Based Regulation*, 1 LAW & FIN. MKT. REV. 191 (2007).

[16] *See* Walter Lukken, Comm'r, CFTC, It's a Matter of Principles, Keynote Address at University of Houston's Global Energy Management Institute (Jan. 25, 2007), https://www.cftc.gov/PressRoom/SpeechesTestimony/opalukken-23; Kern Alexander, *Principles v. Rules in Financial Regulation: Re-assessing the Balance in the Credit Crisis Symposium at Cambridge University, 10–11 April 2008,* 10 EUR. BUS. ORG. L. REV. 169, 170–71 (2009).

Regulatory Authority. Policies associated with the former FSA—including an emphasis on principles—fell out of fashion. Yet more than a decade later, it remains far from clear that it was in fact a principles-based approach that caused vulnerabilities in financial markets. Some have contended that the detailed, Basel capital rules mispriced and incentivized risk-taking.[17] At the same time, there is the unmistakable fact that for a principles-based approach to work, those principles must be enforced. No principle, however noble, can be effective if it is ultimately left toothless. Some scholars and officials have suggested this is what happened in the 2000s, observing that principles-based regulation too often became synonymous with what they regarded as a "light-touch approach."[18]

The United States also revisited its financial regulatory framework in the wake of the global financial crisis. There was little in the way of national consensus on what had gone wrong. Some blamed federal government housing finance policies, which they believed incentivized ill-conceived risk taking in the mortgage markets.[19] Many argued that lax regulations produced moral hazard at Wall Street institutions.[20] Still others pointed the finger at a host of other purported culprits, including accounting standards, securitization, and the Federal Reserve.[21] Across the pond, British commentators observed that "the USA's rules-based regulatory framework did not cope demonstrably better than the UK's principles inclined system" during the financial crisis.[22]

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[17] *See, e.g.*, Aurelio Gurrea-Martínez and Nydia Remolina, *The Dark Side of Implementing Basel Capital Requirements: Theory, Evidence, and Policy*, 22 J. INT'L ECON. L. 125, 128 (2019).

[18] *See, e.g.,* Jill Treanor, *US warns against light touch bank rules that 'ended tragically' for UK*, GUARDIAN (Jun. 7, 2011), https://www.theguardian.com/business/2011/jun/07/us-warns-light-touch-regulations-banks (quoting Timothy Geithner, U.S. Treasury Secretary, as saying: "The United Kingdom's experiment in a strategy of 'light-touch' regulation to attract business to London from New York and Frankfurt ended tragically"); *see also* Andrew Bailey, *The Future of Financial Conduct Regulation*, FIN. CONDUCT AUTH. (Apr. 23, 2019), https://www.fca.org.uk/news/speeches/future-financial-conduct-regulation ("Prior to the financial crisis, the light touch era reflected a view that a greater emphasis on the private interests of firms, their owners and managers would benefit all and thus the public interest. I tend to call this the 'rising tide lifts all boats' view of our world. But it didn't turn out that way—there were very clear losers, and the scale of that problem has emerged over a long period of time.").

[19] *See, e.g.,* PETER J. WALLISON, DISSENT FROM THE MAJORITY REPORT OF THE FINANCIAL CRISIS INQUIRY COMMISSION, Am. Enterprise Inst. for Pub. Pol'y Research, (May 15, 2011), https://www.aei.org/wp-content/uploads/2014/07/-dissent-from-the-majority-report_154941211677.pdf; and Peter J. Wallison, *Three Narratives About the Financial Crisis*, 31 CATO J. 535, 535–36 (2011).

[20] *See, e.g.,* James Crotty, *Structural Causes of the Global Financial Crisis: A Critical Assessment of the 'New Financial Architecture',* 33 CAMBRIDGE J. OF ECON. 563, 575 (2009) ("The past quarter century of deregulation and the globalization of financial markets, combined with the rapid pace of financial innovation and the moral hazard caused by frequent government bailouts helped create conditions that led to this devastating financial crisis"); SHEILA BAIR, BULL BY THE HORNS: FIGHTING TO SAVE MAIN STREET FROM WALL STREET AND WALL STREET FROM ITSELF (Simon & Schuster reprint ed. 2013) at 16 (noting that the "deregulatory dogma" had "infected Washington for a decade" and "[r]egulation had fallen out of fashion" and that "both government and the private sector had become deluded by the notion that markets and institutions could regulate themselves").

[21] *See, e.g.,* Steve Forbes, *The Economic Disaster of 2008: Why It Can Happen Again*, FORBES (Oct. 31, 2018), https://www.forbes.com/sites/steveforbes/2018/10/02/the-economic-disaster-of-2008-why-it-can-happen-again/#6deb83061996; Scott Hirst, *Did Securitization Cause the Mortgage Crisis?,* HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Oct. 19, 2011), https://corpgov.law.harvard.edu/2011/10/19/did-securitization-cause-the-mortgage-crisis/; Matthew O'Brien, *How the Fed Let the World Blow Up in 2008*, ATLANTIC (Feb. 26, 2014), https://www.theatlantic.com/business/archive/2014/02/how-the-fed-let-the-world-blow-up-in-2008/284054/.

[22] THE INST. OF CHARTERED ACCOUNTANTS, IN DEFENCE OF PRINCIPLES, (Mar. 2009), https://www.icaew.com/-/media/corporate/files/technical/ethics/policy-briefing-ind-defence-of-principles-based-regulation.ashx?la=en.

Ultimately, Congress enacted the landmark Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act),[23] which was broad in its scope and breadth. Some federal financial regulators were rewarded, some chided, and others completely dismantled. The CFTC fell into the first category. The futures markets regulated by the CFTC not only worked, but worked extremely well during the financial crisis. Unlike the over-the-counter swaps market—which the CFMA had forbade the CFTC from regulating—the futures markets were subject to full price transparency, margining, and centralized clearing. Given the success of the futures markets, it is my view that Congress likely determined that the CFMA was fatally flawed not because of the principles-based approach that it codified into law but rather because the CFMA failed to apply that approach to all derivatives across the board.

Instead of gutting the CFTC's principles-based framework, Congress reinforced it. First, Sections 725 and 735 of the Dodd-Frank Act updated the CFTC's existing "core principles" for derivatives exchanges and clearinghouses. Furthermore, Congress reversed the decision made a decade earlier and explicitly mandated that the CFTC regulate swaps. The Dodd-Frank Act created new concepts such as "swap execution facilities" and "swap data repositories" that in some ways have replicated key features of the exchange-traded futures framework.[24] For both of these new entities, Congress extended many of the CFTC's existing core principles, confirming the key tenets of the longstanding flexible, principles-based approach. Indeed, the Dodd-Frank Act makes clear that a swap execution facility "shall have reasonable discretion in establishing the manner in which [it] complies with the core principles described in this subsection."[25] As a consequence, the principles-based approach serves as the foundation for much of the CFTC's current regulatory framework for sound derivatives regulation.

III. Principles-Based vs. Rules-Based Regulation

In general terms, principles-based regulation reflects a transition away from detailed, prescriptive rules toward high-level, broadly-stated principles that create standards by which regulated firms must operate.[26] Under this approach, firms are responsible for finding the most efficient way of achieving regulatory objectives.[27]

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[23] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[24] Section 5h(f) of the CEA, as added by Section 733 of the Dodd-Frank Act, sets forth core principles for swap execution facilities, 7 U.S.C. § 7b-3(f)(1)(B). Section 21 of the CEA, as added by Section 728 of the Dodd-Frank Act, sets forth core principles for swap data repositories, 7 U.S.C. § 24(a)(f).

[25] Commodity Exchange Act, 5h(f)(1)(B), 7 U.S.C. § 7b-3(f)(1)(B).

[26] For good overviews of principles-based regulation, *see* Julia Black, *The Rise, Fall and Fate of Principles Based Regulation* 1–36, (London Sch. Econ. Legal Studies Working Paper no. 17/2010), https://core.ac.uk/download/pdf/17332.pdf; Dan Awrey, *Regulating Financial Innovation: A More Principles-Based Proposal?*, 5 BROOK. J. CORP. FIN. & COM. L. 273, 282 (2011); Christopher Decker, *Goals-Based and Rules-Based Approaches to Regulation,* UK DEP'T FOR BUS., ENERGY & INDUS. STRATEGY, Research Paper No. 8 (2018), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/714185/regulation-goals-rules-based-approaches.pdf.

[27] *See, e.g.*, Arnold Kling, *Why We Need Principles-Based Regulation*, AM. ENTER. INST. (May 22, 2012), https://www.aei.org/articles/why-we-need-principles-based-regulation. Of course, if the desired objective is not made clear, principles-based regulation will not work. *See* Bob Zwirb & Steven Lofchie, *CFTC Chair Heath Tarbert Compares Benefits of Principles- and Rules-Based Regulatory Approaches*, CADWALADER CABINET (Dec. 10, 2019), https://www.findknowdo.com/news/12/10/2019/cftc-chair-heath-tarbert-compares-benefits-principles-and-rules-based-regulatory.

Principles-based regulation has the following general characteristics:

- Principles are drafted at a high level of generality to maximize flexibility and breadth of application;
- Principles focus on objectives or outcomes, not specific conduct;
- Principles contain terms that are qualitative rather than quantitative; and
- Principles can be fleshed out by rules or other forms of guidance (both formal and informal) as appropriate.

A common example of the difference between rules and principles involves speed limits. A rule might say, "Do not drive faster than 55 mph." A principle might say, "Drive carefully under the circumstances" or "Drive prudently."[28]

Of course, regulators may supplement principles with rules in cases where greater granularity and precision are necessary or desired. Such rules may serve as safe harbors for compliance. In other cases, industry and self-regulatory organizations (SROs) may be permitted to formulate their own acceptable practices or rules and submit them to their regulator for approval. A good example of this is the CFTC's self-certification process for exchanges and clearinghouses that introduce new products or services.[29]

Principles-based regulation is not intended to be "light-touch." In my view, so-called light-touch regulation is not really regulation at all; rather, it serves more of a monitoring function.[30] That may make sense in isolated circumstances but is far from the kind of conduct regulation or prudential supervision required in financial markets. Nor is principles-based regulation a euphemism for deregulation. Instead, principles-based regulation is a different vehicle for achieving the same regulatory objective or outcome as rules-based regulation.[31] It simply does so in a way that is often more efficient and less burdensome than rules-based regulation, leaving space for flexibility and innovation.

A. Advantages of Principles-Based Regulation

One of the key advantages of a principles-based approach is that it helps reduce the need for volumes of regulations that seek to dictate every aspect of the behavior of an individual, firm,

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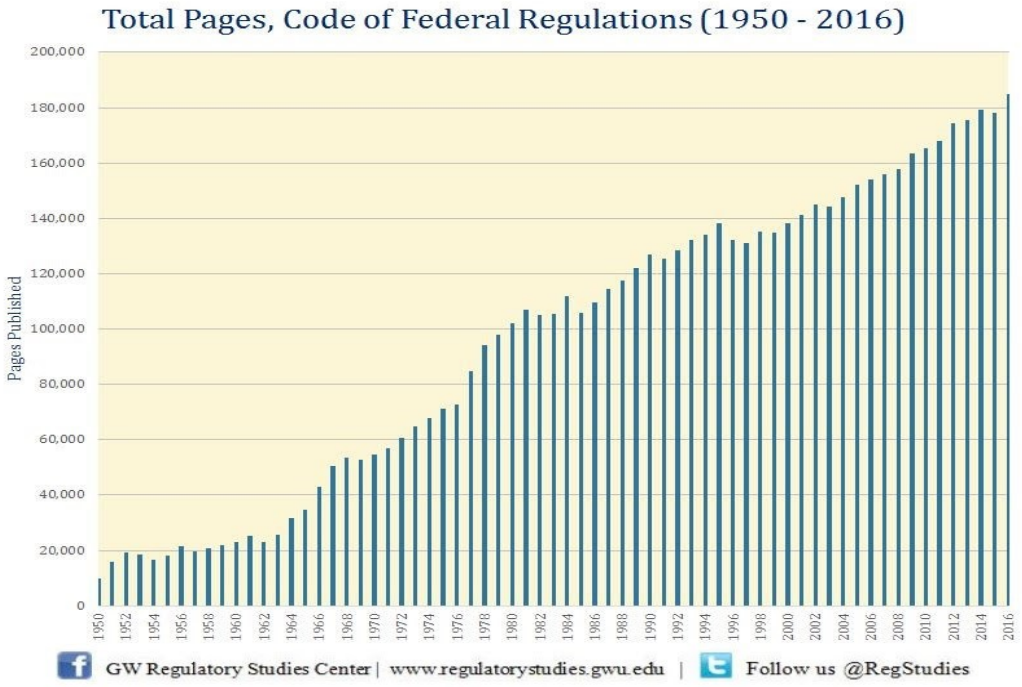
[28] A number of articles cite similar examples. *See, e.g.*, Cristie L. Ford, *New Governance, Compliance, and Principles-Based Securities Regulation*, 45 AM. BUS. L.J. 1, 6 (2008).

[29] *See* CFTC & SEC, A JOINT REPORT OF THE SEC AND THE CFTC ON HARMONIZATION OF REGULATION, at 3 (Oct. 16, 2009), https://www.sec.gov/news/press/2009/cftcjointreport101609.pdf ("Under the CEA's principles-based approach to oversight, applicable to exchanges and clearinghouses as established by the CFMA, in most cases, rule filings are made under self-certification procedures").

[30] To give one example of light-touch regulation, consider the Bank Service Company Act (BSCA). 12 U.S.C. §§ 1861–1867(c). The BSCA governs situations where a bank arranges, by contract or otherwise, for another party to perform its applicable functions. Many of those functions are nonfinancial and more operational in nature, such as information systems or data processing. Arguably, the BSCA was too high-level and barely enforced. Regulators have arguably been slow to issue clarification and guidance regarding the supervision of third-party service providers. This absence of clear guidance—"light-touch" regulation—has led to supervisory failures at certain firms.

[31] *See supra* note 18.

or market. As Winston Churchill so aptly put it, "If you make 10,000 regulations, you destroy all respect for the law."[32] Churchill was arguing against the burdensome regulation of industry by the post-war Labour Government in 1945–51, which hampered market development in Great Britain by creating what he saw as an unfriendly regulatory environment. Today, Titles 12 and 17 of the U.S. Code of Federal Regulations (C.F.R.), which regulate banks as well as SEC and CFTC-regulated financial exchanges and firms, exceed 13,000 pages. One can only wonder what Churchill would make of the entire C.F.R.—nearly 200,000 pages in length—were he to see it today.



The following are some of the more specific advantages of principles-based regulation.

1. Simplicity

A smaller number of principles can reduce regulatory complexity. Complexity can impede compliance as sometimes only the most well-financed and sophisticated firms can expend the resources necessary to comprehend all the nuances of the detailed rules promulgated by regulators. This is a particular challenge for new or smaller entities facing competition from their well-heeled and long-established counterparts that have deep familiarity with establishing effective compliance programs. The fact is that the more detailed, complex rules we adopt, the more difficult it is to comply with them. Regulations should be as simple and concise as possible to achieve their objectives.[33]

[32] WINSTON S. CHURCHILL, IN THE BALANCE 21 (Randolph S. Churchill ed., 1st ed. 1952).

[33] The point of having laws is for people to follow them. But before they can follow them, they first have to be able to grasp how to comply with them. As Judge Learned Hand put it ninety years ago, "The language of the law must not be foreign to the ears of those who are to obey it." The more complex rules or regulations are, the more likely people are to get mired in details. LEARNED HAND, *Is There a Common Will?*, *in* THE SPIRIT OF LIBERTY: PAPERS

2. Flexibility

Principles-based regulation generally promotes a more flexible regulatory approach. Very specific rules can quickly become ossified, frozen in time while our markets continue to change and digitize. By contrast, a principles-based approach can evolve over time as markets and behaviors change. Principles-based regulation provides greater flexibility for both regulators and regulated entities alike to adapt to market developments and changing technology.[34]

3. Addresses Over/Under-Inclusion Problem

Rules are almost inevitably over- or under-inclusive. As Professor Cass Sunstein has noted:

> Conduct that is harmful, and that would be banned in an optimal system, will be allowed under most imaginable rules, because it is hard to design rules that ban all conduct that ought to be prohibited. . . . Rules, in short, are under-inclusive as well as over-inclusive if measured by reference to their background justifications.[35]

Professor Sunstein's point is that, when applied to particular sets of circumstances, rules either fail to capture conduct that a regulator might want to include, or capture conduct that a regulator might not want to include. Principles-based regulation can help avoid this problem by establishing clear and objective standards that regulated entities are required to meet without setting forth rules that may be under- or over-inclusive.

4. Promotes Innovation

By offering flexibility for regulated firms to determine how to comply with core objectives, principles-based regulation can facilitate the development of new business models, products, and internal processes. It also can lower compliance costs, which are particularly felt by new market entrants. Principles-based regulation thus encourages market innovation, which is central to economic growth and prosperity.

5. Discourages Loophole Behavior

Principles-based regulation also discourages "loophole" behavior and "checklist" style approaches to compliance with the law. Because clearly articulated principles are hard to manipulate, creative compliance is more difficult. By contrast, rules may allow actors to comply with the "letter of the law" but not the "spirit of the law." This can lead to evasion of regulatory requirements. As Professor Sunstein has noted, "Because rules have clear edges, they allow people to 'evade' them by engaging in conduct that is technically exempted but that creates the same or analogous harms."[36]

AND ADDRESSES OF LEARNED HAND 56 (Irving Dilliard, 3d ed. 1960) (quoting from address before the American Law Institute in 1929).

[34] *See* Woods, *supra* note 3.

[35] Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953, 995 (1995).

[36] *Id.*

6. Creates Better Supervisory Model

Principles-based regulation can help promote dialogue between regulators and regulated firms. This can create a more collaborative approach to regulation, particularly for firms that mean well, but simply fail to understand what complicated and highly prescriptive rules may require.[37] Dialogue is good not just for regulated entities, but for regulators as well: collaboration makes regulation more insightful and effective because it gives regulators on-the-ground feedback from those working to comply with the regulatory regime.

7. Facilitates International Cooperation

Principles-based regulation helps to promote comparability and convergence among international regulators. While different national regulators rarely agree on specific, granular rules—in part because of differences in markets and statutory mandates—they nonetheless frequently can reach consensus on principles. This creates the possibility for regulators to develop high standards for market behavior that transcend national boundaries.

B. Advantages of Rules-Based Regulation

None of this is to say that a rules-based approach is never desirable. Rules-based regulation has distinct advantages over principles-based regulation in certain circumstances. The following are its main advantages:

1. Greater Clarity

Rules-based regulation can provide greater clarity than principles-based regulation in certain situations. In supplying more details than high-level objectives, rules can provide a clearer standard of behavior for regulated entities. In various cases, this may make a more rules-based approach easier to apply consistently, which some have argued can promote competition because unclear regulation serves as a barrier to entry.[38]

2. Avoids Retrospectivity

Rules-based regulation may also avoid creating situations where regulators act retrospectively—that is, treat past conduct as unlawful when it was not clearly known to be unlawful at the time. This is a potential danger of a principles-based approach to regulation, which can tempt regulators to treat behavior as unlawful without proper notice and opportunity to comment.[39] Such a situation risks offending due process and undermining regulatory credibility.

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[37] *See* Black et al., *supra* note 15, at 195.

[38] *See* Peter J. Wallison, *Fad or Reform: Can Principles-Based Regulation Work in the United States?*, AM. ENTER. INST. (June 2007), http://www.aei.org/wp-content/uploads/2011/10/20070611_21829JuneFSOg.pdf (arguing "[a] rules-based system . . . is transparent and promotes competition by making market entry easier").

[39] Even a rules-based approach may fall short of the mark in this regard. Professor John Braithwaite argues that lawmakers are mistaken in the belief that by writing more rules they can always limit the discretion of regulators. On the contrary, he writes: "The opposite is the truth: the larger the smorgasbord of [specific] standards, the greater the discretion of regulators to pick and choose an enforcement cocktail tailored to meet their own objective. A

3. Provides a Potential Safe Harbor against Private Litigation

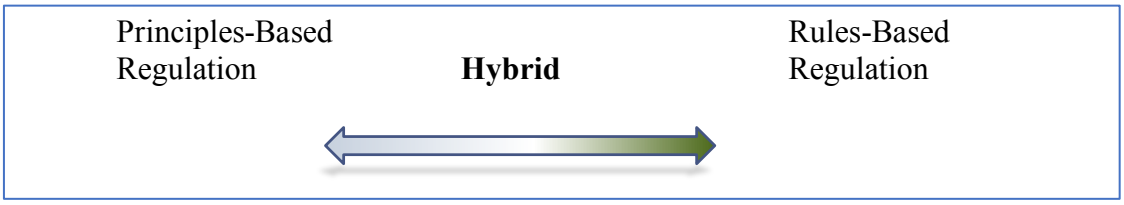
The more litigious a jurisdiction, the more market participants may prefer prescriptive rules.[40] Rules often can provide an effective "safe harbor" from private litigation. Where market participants can clearly demonstrate that they have complied with the law, they have a strong defense in the event they are subject to civil litigation. This is much harder to do when the market participant is subject to more basic principles, the application of which is less clear. At the same time, however, it is more difficult to prove a breach of a principle than it is to prove a rule has not been complied with.

4. Avoids Inappropriate Race to the Top

Rules-based regulation may help avoid a blurring of the distinction between minimum standards and best practices. With the unpredictability and potential hindsight-driven enforcement, market participants subject to a principles-based regime may feel compelled to adhere to best practices, even when they are not actually "best" for their particular circumstances.[41] By having prescriptive rules, market participants are able to comply without having to exercise greater judgment about whether their attempt at compliance fulfills a principles-based goal.

C. Practicality of a Hybrid Approach

In practice, it is rare for there to be pure principles-based regulation or pure rules-based regulation. Pure principles and pure rules are the two points at the ends of the regulatory spectrum.[42] Every principles-based regulatory regime has some rules, and every rules-based regime has some element of principle. For this reason, we frequently see blended or hybrid regulatory systems of principles and rules.



proliferation of more specific laws is a resource to expand discretion, not a limitation upon it." Braithwaite, *supra* note 5.

[40] *See* Wallison, *supra* note 38 ("[A] principles-based system would be precluded by the existence of the private class action litigation system. A principles-based regime depends for its effectiveness on a government regulator that is able to exercise discretion in deciding whether to enforce the rules through litigation or to obtain compliance through less formal means. The characteristic element of a private class action enforcement system, however, is that it operates outside any form of government control or priority-setting except the rules laid down by courts.").

[41] *See* Steven L. Schwarcz, *The 'Principles' Paradox*, 10 EUR. BUS. ORG. L. REV. 175, 183 n.48 (2009) (arguing that "an actor who is, or feels he is, subject to unpredictable liability for varying from a principle is likely, especially if he would be a 'deep pocket' in future potential litigation, to hew to the most conservative interpretation of the principle, effectively acting as if subject to a rule.").

[42] *See, e.g.*, Awrey, *supra* note 26, at 275; James Surowiecki, *Parsing Paulson: Paulson Plan to Regulate Financial Markets*, THE NEW YORKER, (Apr. 28, 2008). https://www.newyorker.com/magazine/2008/04/28/parsing-paulson.

In some cases, the emphasis is on core principles, in other cases on detailed rules.[43] The bottom line is that a principles-based approach rarely can eliminate entirely the need for rules. Rather, as former CFTC Commissioner Walter Lukken has observed: "[A] principles system is a hybrid of desired public outcomes complemented by specific rules aimed at achieving those ends. Each regulatory authority—depending on the maturity of its markets—will need to find the optimal balance between the flexibility of principles and the legal certainty provided by rules."[44] Thus, the choice is not either/or, but more a question of striking the appropriate regulatory balance.[45]

IV. Factors for Applying Principles and Rules

There are four main categories of factors that should be considered in determining the appropriate mix of principles and rules in a regulatory system, namely: (1) regulatory objectives, (2) nature of the market/subject matter, (3) attributes of market participants, and (4) qualities of the regulator. I discuss considerations for each category in turn.

A. Regulatory Objectives

The first category to consider is the regulatory objective—i.e., the desired goal or outcome of the regulatory program. The following factors should inform the decision of whether principles or rules best advance the regulatory objectives.

1. Prudential Supervision

The first factor is whether the objective of regulation is prudential supervision. Prudential requirements (e.g., capital, margin, and risk management) are often very complicated. That is so because businesses are complex—they vary in size, business lines, products, and riskiness. Formulating detailed rules to address prudential requirements across businesses is thus very difficult. That is particularly true with respect to macroprudential supervision, which focuses not on individual institutions but on the safety and soundness of the financial system as a whole, i.e., systemic risk mitigation.[46] Accordingly, a more principles-based approach to prudential regulation

[43] *See, e.g.*, Decker, *supra* note 26, at 44 ("In short, a prudently designed blend of approaches may, in some contexts, bring significant benefits by allowing for the limitations of each approach to be compensated by the benefits of the other approach.").

[44] *See* Lukken, *supra* note 4. In a slightly different context, Cristie Ford writes: "An appropriate balance between rules and principles in securities regulation may look quite different from the appropriate balance in other regulatory arenas. The nature of the industry being regulated, the roles of the various players in it, and the risks associated with that area of conduct will inform the regulatory design process." Cristie L. Ford, *Principles-Based Securities Regulation in the Wake of the Global Financial Crisis*, 55 MCGILL L.J. 257, 268 (2010).

[45] *See* ABA Business Law Section, Comment Letter on Commodity Future Trading Commission's Request for Public Input on Project KISS (Sep. 29, 2017), https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61488&SearchText= ("[R]egulators should not be confined to choosing between solely prescriptive and solely principles-based in all cases. Rather, the appropriate choice in any given circumstance may be a balance between the two approaches that will achieve a particular regulatory objective while also avoiding unnecessary complexity and undue burden on those subject to the rules.").

[46] *See, e.g.*, Paul Tucker, Banking Culture: Regulatory Arbitrage, Values, and Honest Conduct, Address at the Institute for Law and Finance Conference on Bank Culture and Ethics, (Nov. 23, 2015) (transcript available athttp://paultucker.me/wp-content/uploads/2019/12/BANKING-CULTURE.pdf) (noting that "[c]onduct regulation is quite different from stability policy").

may be more appropriate for prudential supervision than trying to develop detailed, prescriptive rules for varying businesses and risk profiles.

2. Need for Quick Action

The need for quick regulatory responses can dictate the decision to apply principles or rules. Regulators have a number of tools for providing immediate relief in appropriate circumstances, such as no-action letters and exemptive relief. However, these solutions are by nature impermanent. By contrast, principles-based regulation can provide a more durable solution when quick action is needed to address market behavior. It is normally easier to promulgate higher-level principles than more voluminous and granular bodies of rules, which require significant time and resources to create. Principles may develop into detailed rules over time, but can provide an immediate antidote to situations demanding a quick response.

3. Involvement of Senior Management

Regulators should also consider whether direct involvement of senior management in regulatory compliance is desired. Principles-based regulation is premised on the idea that, in certain cases, firms and their management are better placed than regulators to determine what processes are most desirable within their businesses to achieve a given regulatory objective.[47] In such cases, principles-based regulation encourages the more direct involvement of C-suite or other senior management rather than relying on lower ranking compliance personnel. This situation can improve the "tone at the top" while achieving buy-in from company leaders. By contrast, a rules-centric regime can push compliance planning lower in an organization because it leaves less space to craft solutions.

4. Multiple Compliance Alternatives

A fourth factor is whether there are multiple ways to achieve the desired regulatory outcome. Often it is the case that firms can comply with a regulatory objective in more than one way. Rather than prescribing detailed rules to mandate one approach over others, regulators can rely on principles-based regulation to give regulated entities flexibility in how best to achieve a desired objective. Such an approach can make financial markets more efficient by allowing firms themselves to choose the most cost-effective way of complying with a specific regulatory objective. However, when there is only one way of complying with a requirement, a rules-based approach is usually preferable.

5. Market Conduct or Disclosure Regulation

An additional factor in considering principles versus rules is whether a chief objective of the regulation is market conduct or disclosure. Unlike prudential requirements, market conduct and disclosure rules are often aimed at protecting retail investors. Unlike institutional investors, retail investors generally do not have the power and the leverage to negotiate terms of their

[47] *See* Black et al., *supra* note 15, at 192 (noting that the "regulators, instead of focusing on prescribing the processes or actions that firms must take, should step back and define the outcomes that they require firms to achieve").

arrangements with market intermediaries, and they may lack the resources to protect their own interests by monitoring intermediaries' performance. Accordingly, a rules-based approach may be appropriate when the regulatory objective is to safeguard retail investors through market conduct rules, disclosure regulation, and related customer-protection efforts.

6. *Malum in se* Behavior

Clarity is a key regulatory objective in many situations, but is especially important in matters involving prohibitions on conduct. Regulators should in particular consider whether the rule targets behavior that is generally *malum in se* ("evil in itself"). In cases where behavior is *malum in se,* a flat prescriptive rule prohibiting the behavior is often preferable to a general principle. An example is fraudulent activity, which is clearly deleterious conduct that serves no legitimate market function. Rules-based clarity is especially important when the regulated person or entity is less sophisticated, as bright-line standards ease compliance burdens and cleanly separate lawful from unlawful behavior.

B. Nature of the Market/Subject Matter

The second category to consider is the nature of the market or subject matter of regulation. The following are a number of factors that should be considered under this category.

1. Possibility of "Gaming"

An initial factor is whether detailed rules can be easily "gamed." Broadly stated principles require firms to focus on how to comply with the *purpose* of the rule rather than using a "check-the-box" approach to conform merely to the letter of the law.[48] Thus, principles-based regulation can lead to a greater degree of compliance by regulated firms where gaming is possible.

Moreover, more specific rules can at times lead to gaps and inconsistencies, which encourage "creative compliance."[49] As regulators adjust to these situations by creating new rules to address the gaps, still further gaps are created that can be exploited—or "gamed"—by regulated entities.[50] Principles-based regulation can address this risk by creating broad standards that are not easily circumvented by efforts designed to comply in form but not function.

2. Need for Frequent Updating

Another factor is whether specific rules governing behavior or processes require frequent updates. Principles-based regulation enhances the responsiveness of regulation to market innovation and other developments. This has the effect of increasing the durability of the principles

[48] *See id*. at 195.
[49] *See* Sunstein, *supra* note 35. *See also* Doreen McBarnet & Christopher Whelan, *The Elusive Spirit of the Law: Formalism and the Struggle for Legal Control*, 54 MODERN L. REV. 848, 849 (1991).
[50] *See* Black, *supra* note15, at 193; McBarnet & Whelan, *supra* note 49, at 873 ("New situations arise and new rules are produced to deal with them. But new rules cannot control creative compliance . . . . [N]ew rules simply mean new games.").

and reducing the need for constant amendment, which can help "future proof" regulatory requirements.

A notable example is where compliance involves the use of economic or mathematic models subject to further refinements and constantly updated and changing data. In such cases, it is extremely difficult—if not impossible—to enshrine one particular model in regulation. This makes a principles-based approach more desirable than rules-based regulation where a rule is subject to frequently changing data inputs.

3. Rapidly Changing Technology

The speed of technological change must also be considered. In rapidly changing markets, a rules-based approach risks falling behind the curve and becoming quickly outdated. It is often difficult for regulators to keep up with changes in the marketplace and technological advancements.[51] Overly prescriptive rules may hamper innovation and impede progress. In markets regulated by the CFTC, too much prescription can have a detrimental effect, not only on intermediaries, but also on the end users who rely on the derivatives markets to hedge their commercial risk.[52] Principles are preferable in rapidly changing environments, as they offer the flexibility to address new and unforeseen situations.

4. Market Maturity

Similar to the prior factor, regulators should consider whether the regulated market and its products are in a nascent phase. New markets are prone to great change, both in terms of structure and product offerings, particularly in the early years. Prescribing detailed rules too soon may retard this development, whereas a principles-based approach may incubate growth while retaining regulatory oversight. Over time, principles can develop into rules as market dynamics warrant.

5. Durability of Specific Rules

Whether specific rules governing behavior or processes are likely to stand the test of time is an additional factor to consider. A rules-based approach is most effective when regulators are able to adopt rules that can endure. As we saw earlier, rapidly changing markets are rarely good candidates for rules-based regulation because detailed rules can quickly become outdated. But when regulators can work with interested parties to craft rules that will endure, regulatory

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[51] *See, e.g.*, Dawn DeBerry Stump, *Regulation: Principles Rather than Prescription*, FOCUS (Oct. 2019), https://focus.world-exchanges.org/articles/regulation-principles-rather-prescription ("I believe the markets regulated by the CFTC have been well served by regulatory principles that are nimble enough to adapt, and that rigid regulations are simply not well suited to a constantly evolving marketplace. Writing prescriptive regulations simply renders the rules outdated almost as soon as they are constructed. Core principles that can be applied flexibly yield better results by encouraging innovation, while also achieving a high standard of integrity through serious compliance expectations.").

[52] As I have previously noted: "In leading the CFTC, I will not lose sight of the underlying purpose of our derivatives markets: to serve the needs of everyday Americans. These instruments touch all corners of the real economy—from farmers and ranchers who need to hedge grain and cattle prices, to manufacturers and exporters who need to manage exchange-rate fluctuations. In regulating these financial instruments, the CFTC serves as a guardian of our free-enterprise system." Tarbert, *supra* note 2.

compliance is more effective. The only thing arguably worse than a bad rule is a constantly changing one.

6. Standard Forms or Disclosures

A final factor is whether the subject matter involves standard forms or disclosures. Regulators frequently establish reporting or registration forms or otherwise impose specific disclosure requirements. In such cases, a rules-based approach is preferable to a principles-based approach. The standardization of forms and disclosure requirements makes it easier for regulators to analyze information and compare institutions, thereby enhancing oversight. A principles-based regime is often a poor choice where standard forms and disclosures are heavily used, as principles do not offer the needed precision.

C. Attributes of Market Participants

The third set of factors to consider relates to the attributes of market participants. The following are a number of factors that should be considered under this category.

1. Sophistication

Whether participants are generally "sophisticated" is a key factor in selecting a principles-based or rules-based approach. The appropriate regulatory approach may depend on whether the participants in the market are retail or institutional.[53] Principles-based regulation is often more appropriate where sophisticated entities or investors are involved, while rules-based regulation has been typically used for safeguarding retail investors. Sophisticated entities or investors are generally better able to protect their own self-interest than retail investors. If not, they generally have the financial wherewithal to hire someone to do so. For this reason, more prescriptive regulations are often targeted at protecting retail investors more than institutional investors—*e.g.*, disclosure requirements, sales practice obligations, and eligible contract participant rules.

2. Information Asymmetry

A second factor is whether information asymmetry exists among market participants. Principles-based regulation works best when there is not information asymmetry among market participants.[54] In that case, rules are not as necessary to address situations in which one party has an embedded advantage—structural or otherwise—over another party. For example, as noted above, institutional markets, where all participants have generally the same information and can look out after their own interests, generally need fewer rules to function efficiently and properly.

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[53] *See, e.g.*, Roel C. Campos, Comm'r, SEC, Principles v. Rules, Speech at the Luxembourg Fund Industry Association and the American Chamber of Commerce (Jun. 14, 2007), https://www.sec.gov/news/speech/2007/spch061407rcc.htm (with respect to the U.S. securities markets, Campos noted that if the United States "didn't have a large retail sector, then we might be in the position to provide basic principles and do less enforcement. That, however, is not the world we live in.").

[54] *See* Awrey, *supra* note 26, at 291.

3. Internal Compliance Systems

Whether participants have existing extensive internal compliance systems is a further factor to consider. The effectiveness of principles-based regulation is often dependent on the level of experience firms have in regulatory compliance matters. The more experienced a company is, the more likely it will be able to implement high-level principles effectively because it will have familiarity with crafting internal compliance systems. By contrast, less experienced firms may benefit from prescriptive rules that lay out, in a more detailed manner, what their compliance obligations are.

4. Presence of a Self-Regulatory Regime

An additional factor is whether participants are subject to supervision by an SRO. SROs are generally closer to market participants than are regulators. As a result, they generally have a better understanding of the businesses and operations of market participants than governmental regulators do. In such cases, it may make sense for a regulator to adopt general principles in an area while directing or encouraging the SRO to impose more specific rules. SRO-based systems are often good examples of hybrid systems, as a regulatory authority promotes broad-based principles that SROs subsequently translate into detailed rules.

D. Qualities of the Regulator

The fourth category to consider is the qualities of the regulator. The following are a number of factors that should be considered under this category.

1. Nature of the Regulatory Relationship

An overarching factor is whether there is a high level of trust and frequent interaction between the regulator and the regulated entity. Principles-based regulation requires close collaboration between regulators and regulated parties with respect to their supervisory relationships. This increases senior management responsibility and engagement in the regulatory process. In addition, when determining how to implement principles, it is helpful to have people in key compliance positions who have worked closely with regulators in the past. This generally leads to better compliance.

2. Information Asymmetry

As markets develop, regulators often lack the knowledge or expertise to regulate them effectively. This can lead to an "asymmetry of information" between regulators and the regulated. Adopting core principles that can guide market development, without imposing cumbersome and detailed rules, may be a preferable approach when the information available to regulators is significantly less than the information available to regulated entities. This is particularly true in markets subject to rapid technological change. In CFTC-regulated futures markets, for example, rules that may work for an open-outcry trading pit may be completely inappropriate for an electronic market.

3. Risk of Private Litigation

Another factor is the absence of private litigation as a tool to reinforce the regulator's regime. A more principles-based approach may not be desirable when companies are subject to a significant risk of private litigation. As noted in Section 3 above, rules may provide an effective "safe harbor" from private litigation. By contrast, a principles-based regime might very well encourage more lawsuits.

4. Overseas Coordination

A final factor is whether the regulator closely coordinates with its overseas counterparts to ensure international standards are satisfied. Principles-based regulation helps to promote comparability and convergence among international regulators. As noted in Section 7 above, while different national regulators rarely agree on specific rules—in part because of differences in markets and statutory mandates—they nonetheless can frequently reach a consensus on high-level principles. For this reason, the CFTC has been a leader in a range of international standard-setting bodies and workstreams.[55] The CFTC's engagement with non-U.S. counterparts in multilateral committees and fora has furthered the development and implementation of a number of key principles and standards.

E. Visualizing the Factors

The table below provides a visual depiction of the four general categories and the factors that support them. The table is intended to be a helpful reference point for regulators confronted with finding the appropriate balance between principles and rules.

	Principles	Rules
Regulatory Objective		
• Prudential Supervision	**X**	
• Need for Quick Action	**X**	
• Involvement of Senior Management	**X**	
• Multiple Compliance Alternatives	**X**	
• Market Conduct or Disclosure Regulation		**X**
• *Malum in se* Behavior		**X**
Nature of the Market/Subject Matter		
• Possibility of "Gaming"	**X**	
• Need for Frequent Updating	**X**	

[55] As the overseer of one of the world's oldest and largest derivatives markets, the CFTC plays a leadership role in the development of common standards for global derivatives markets. The CFTC is a leading participant in work streams and committees in the International Organization of Securities Commissions (IOSCO), as well as other international bodies such as the Financial Stability Board (FSB) and the Committee on Payments and Market Infrastructures (CPMI). The CFTC currently chairs the following international committees: Chair, IOSCO Cyber Task Force; Chair, IOSCO Financial Stability Steering Group; Co-Chair, FSB Working Group on UTI and UPI Governance; and Co-Chair, CPMI-IOSCO Policy Standing Group.

	Principles	Rules
• Rapidly Changing Technology	**X**	
• Market Maturity	**X (if nascent)**	**X (if mature)**
• Durability of Specific Rules		**X**
• Standard Forms or Disclosures		**X**
Attributes of Market Participants		
• Sophistication	**X (if yes)**	**X (if no)**
• Information Asymmetry (among market participants)	**X (if no)**	**X (if yes)**
• Internal Compliance Functions	**X (if experienced)**	**X (if less experienced)**
• Presence of a Self-Regulatory Regime	**X**	
Qualities of the Regulator		
• Nature of the Regulatory Relationship	**X (collaboration)**	**X (non-collaboration)**
• Information Asymmetry (between regulators and regulated)	**X (if yes)**	**X (if no)**
• Risk of Private Litigation	**X (if low)**	**X (if high)**
• Overseas Coordination	**X**	

V. Potential Applications of Principles-Based and Rules-Based Approaches

As noted above, regulators often use a hybrid approach in order to capture benefits offered by both principles-based and rules-based regulation. Using the framework outlined above, I now consider regulatory initiatives that the CFTC may undertake and analyze whether they are better suited to a more principles-based or rules-based approach, or a hybrid of the two.

A. Automated Trading

In 2015, the CFTC proposed rules that were a comprehensive regulatory response to the evolution of automated trading on U.S. exchanges.[56] Historically, U.S. derivatives markets have relied on manual processes for the origination of orders, transmission of information, and trade execution for on-exchange transactions. Today, however, derivatives markets have transitioned from manual processes to highly automated trading and trade matching systems.[57] Trading facilities have reasonable discretion in crafting rules that govern how orders may interact on their systems.[58] This has led to an increase in the complexity of trading systems and markets.

The CFTC's proposed rules, known collectively as Regulation AT, represent a series of risk controls, transparency measures, and other safeguards to enhance the U.S. regulatory regime

[56] Regulation Automated Trading, 80 Fed. Reg. 78,824 (Dec. 17, 2015) [hereinafter Regulation AT]; Regulation Automated Trading, 81 Fed. Reg. 85,334 (Nov. 25, 2016) [hereinafter Regulation AT Supplement].
[57] *See* Regulation AT, *supra* note 56, at 78,825.
[58] *See, e.g.*, *supra* note 24 and accompanying text.

for automated trading.[59] The over-arching objective of the proposed regulation was to guard against events that might lead to market disruptions or manipulation (*e.g.*, a "flash crash").[60]

In its proposal, the CFTC noted a preference expressed by commenters[61] for a principles-based approach rather than prescriptive regulations.[62] Commenters pointed out that prescriptive requirements would become obsolete and stifle innovation because of developments in technology and market practices. They also maintained that prescriptive requirements may not account for the unique characteristics of market participants. In their view, the end result of rules-based regulation would allow for participants to design evasion measures that could undermine the new regulations.[63]

Consistent with the comments received, the CFTC subsequently attempted to take what it believed was a more principles-based approach in this area. In a supplemental proposal, the CFTC sought to provide greater discretion to regulated persons, particularly with respect to the development and testing of algorithmic trading systems.[64] I believe the CFTC was correct in moving to a principles-based approach in this area, but it did not go far enough.

Automated trading is an area of rapid technological development. It requires tailoring rules for implementation in ways that best consider the technical intricacies between firms and exchanges. For this reason, prescriptive rules are likely to become obsolete very quickly. Also, because exchanges have flexibility in how they develop trading rules, there may not be one method of compliance that would adequately address the risks created by automated trading. Finally, I note that each exchange is itself an SRO and is actively involved in monitoring its participants. For these reasons, I have directed the CFTC staff to reconsider the 2015 proposal in order to formulate an even more principles-based approach to regulating automated trading. The goal is to develop risk principles without impeding technological development and market innovation, while still preserving the benefits of regulatory oversight in this area.

B. Position Limits

Position limits is another area where the CFTC has struggled to find the appropriate regulatory balance. Position limits are intended to prevent any person from exerting undue control over a market in a particular futures contract where there is physical delivery. For example, in a commodity with 200,000 open contracts, an order to buy 80,000 contracts could impede the ability of parties to deliver the physical underlying commodity at contract expiration. The main point of

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[59] *See* Regulation AT, *supra* note 56, at 78,824; Regulation AT Supplement, *supra* note 56, at 85,334.
[60] *See, e.g.*, Andrei Kirilenko et al., *The Flash Crash: The Impact of High Frequency Trading on an Electronic Market*, 72 J. OF FIN. 967, 968 (May 5, 2014), https://www.cftc.gov/sites/default/files/idc/groups/public/@economicanalysis/documents/file/oce_flashcrash0314.pdf; Mary J. White, Former Chair, SEC, Enhancing Our Equity Market Structure, Speech at Sandler O'Neill & Partners, L.P. Global Exchange and Brokerage Conference (Jun. 5, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370542004312#.VKP_o6xOlaS.
[61] Comments were responding to a prior CFTC concept release. *See* Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, 78 Fed. Reg. 56,542 (Sept. 12, 2013).
[62] *See* Regulation AT, *supra* note 56, at 78,837–78,838.
[63] *See id.* at 78,338.
[64] *See* Regulation AT Supplement, *supra* note 56, at 85,353, 85,349, n. 119.

position limits is to avoid enabling anyone to manipulate prices to their own benefit while hurting others, most especially through corners or squeezes.[65] Furthermore, these markets are mature, are largely domestic in nature, and have been around for decades.[66]

In contrast with automated trading, position limits is an area where rules-based regulation is more appropriate than principles-based regulation. Specifically, market participants need to know the precise position limits that are established in the various classes of commodities in order to plan their business operations efficiently—*i.e.*, they need clarity and transparency. A rules-based approach in this area also helps avoid potential litigation, where market participants might be subject to uncertain standards of conduct. In addition, establishing precise position limits prevents the CFTC from retrospectively applying its regulations to market participants, providing certainty to the markets.

At the same time, some aspects of a position limits rulemaking will warrant a more principles-based approach. For example, in providing exceptions for bona fide hedging from application of position limits requirements, it is appropriate to take a more principles-based approach. This is particularly true because the nature of hedging varies dramatically depending on the type of company engaged in the activity. For example, an energy company hedging natural gas futures may use very different techniques and methods than a cereal or banking company that is exposed to the price of wheat. Overly prescriptive rules might be over-inclusive, inappropriately subjecting genuine hedgers to position limits.[67]

C. Cross-Border Regulations

Applying the CFTC's rules in the cross-border context is an area where it is appropriate to take a more hybrid approach. For example, the Dodd-Frank Act requires persons engaged in dealing activity in swaps to register with the CFTC as "swap dealers" and be subject to substantive regulatory requirements.[68] Non-U.S. dealers typically engage in swaps with both U.S. and non-

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[65] *See, e.g.*, Heath P. Tarbert, *Making Derivatives Markets Work for American Agriculture*, AM. FARM BUREAU FED'N (Jan. 22, 2020), https://www.fb.org/viewpoints/making-derivatives-markets-work-for-american-agriculture ("If correctly calibrated, these limits could prevent corners or squeezes, which are nefarious tactics to manipulate the market by intentionally driving up or down prices during the last days of a contract. Position limits also could reduce the likelihood of chaotic price swings created by excessive speculation, or when prices reflect the gamesmanship of traders rather than real supply and demand."); Position Limits for Derivatives, 78 Fed. Reg. 75680, 75681 (Dec. 12, 2013) ("With respect to the position limits that the Commission is required to set, CEA section 4a(a)(3) guides the Commission in setting the level of those limits by providing several criteria for the Commission to address, namely: (i) To diminish, eliminate, or prevent excessive speculation as described under this section; (ii) to deter and prevent market manipulation, squeezes, and corners; (iii) to ensure sufficient market liquidity for bona fide hedgers; and (iv) to ensure that the price discovery function of the underlying market is not disrupted").

[66] For example, Henry Hub is a distribution hub on the natural gas pipeline system in Erath, Louisiana for U.S. natural gas futures and has been in operation since the 1950s. *See* Don Briggs, *The Center of the Natural Gas Universe*, DAILY ADVERTISER (Jun. 19, 2017), https://www.theadvertiser.com/story/opinion/columnists/2017/06/19/center-natural-gas-universe/408389001/.

[67] At my direction, the CFTC has recently considered—and approved—a revised position limits proposed rulemaking along these lines. *See* Position Limits for Derivatives, 85 FR 11596 (Feb. 27, 2020).

[68] In brief, a person is required to register with the CFTC as a swap dealer if the swaps connected with its swap dealing activities exceed an aggregate gross notional amount threshold of $8 billion (measured over the prior 12-month period). *See* De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 56,666 (Nov. 13, 2018).

U.S. persons, which raises the question whether the non-U.S. dealers have to count trades with non-U.S. persons toward determining whether they must register with the CFTC as swap dealers.[69] In applying registration requirements to non-U.S. dealers, the CFTC is committed to establishing clear rules to enable non-U.S. dealers to know what dealing swaps they have to count toward determining their registration status.[70] A principles-based approach could lead to uncertainty and confusion, as different firms might take different views regarding which particular swaps need to be counted toward the swap dealer registration threshold.

By contrast, when it comes to applying substantive requirements (*e.g.*, capital, margin, etc.) to non-U.S. swap dealers that are already registered with the CFTC, we have proposed a "deferential" approach to cross-border regulation. I believe the CFTC should rely on other jurisdictions to supervise activities conducted largely in their jurisdiction so long as they have implemented a regulatory regime that achieves comparable outcomes to the CFTC's. This allows non-U.S. entities to register as swap dealers with the CFTC but comply with home country regulation for the most part. It thus avoids duplicative and overlapping regulation.

Over the last decade, the Group of 20 Nations (G20) have moved toward harmonizing the regulation of derivatives.[71] There are many opportunities to build on these accomplishments.[72] For example, the CFTC has made a number of comparability determinations for foreign regulatory regimes in the areas of clearing, trading, and swap dealer requirements.[73] These determinations have largely been made using an outcomes-based approach, where the CFTC looks at the outcomes or objectives guiding a foreign regulatory regime rather than making a detailed rule-by-rule comparison. I have directed the staff to consider whether more substituted compliance determinations are appropriate.

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[69] Title VII of the Dodd-Frank Act added Section 2(i) to the CEA (7 U.S.C. § 2(i)). "Section 2(i) provides that the CEA does not apply to swaps activities outside the United States except in two circumstances: (1) where activities have a "direct and significant connection with activities in, or effect on, commerce of the United States" or (2) where they run afoul of the Commission's rules or regulations that prevent evasion of Title VII. Section 2(i) evidences Congress's clear intent for the U.S. swaps regulatory regime to stop at the water's edge, except where foreign activities either are closely and meaningfully related to U.S. markets or are vehicles to evade our laws and regulations." *See* Heath P. Tarbert, Chairman, CFTC, Statement of Chairman Heath P. Tarbert in Support of the Cross-Border Swaps Proposal (Dec. 18, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement121819.

[70] *See* Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952 (Jan. 8, 2020) (proposed rule). *See also* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45,292 (Jul. 26, 2013).

[71] *See* FINANCIAL STABILITY BOARD, IMPLEMENTATION AND EFFECTS OF THE G20 FINANCIAL REGULATORY REFORMS (2018), https://www.fsb.org/wp-content/uploads/P281118-1.pdf.

[72] *See generally* INT'L SWAPS & DERIVATIVES ASS'N, CROSS-BORDER HARMONIZATION OF DERIVATIVES REGULATORY REGIMES: A RISK-BASED FRAMEWORK FOR SUBSTITUTED COMPLIANCE VIA CROSS-BORDER PRINCIPLES (2017), https://www.isda.org/a/DGiDE/isda-cross-border-harmonization-final2.pdf.

[73] "The CFTC has approved a series of comparability determinations that would permit substituted compliance with non-U.S. regulatory regimes as compared to certain swaps provisions of Title VII of the Dodd-Frank Act and the Commission's regulations." CFTC, COMPARABILITY DETERMINATIONS FOR SUBSTITUTED COMPLIANCE PURPOSES (updated Feb. 4, 2020), https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/DoddFrankCDF5.html.

In addition, the CFTC recently proposed an alternative compliance framework for non-U.S. derivative clearinghouses "that do not pose a substantial risk to the U.S. financial system."[74] Under this framework, those foreign clearinghouses may register with the CFTC but will be deemed compliant with our core principles for derivative clearing organizations through compliance with their home country regulatory regime.[75] This proposal reflects a pragmatic approach to oversight of foreign clearinghouses by using core principles instead of specific regulations.[76]

Overall, the CFTC's approach to cross-border matters is a hybrid of rules-based and principles-based regulation. It is rules-based when regulatory certainty is desirable—*i.e.*, in determining registration status through clear and uniformly applied criteria. At the same time, it is principles-based when coordination with foreign regulators is desirable—*e.g.*, in applying substantive requirements, where overlapping jurisdictions could impose duplicative and conflicting requirements on market participants.

D. Digital Assets

Another area where principles-based regulation is generally appropriate is with respect to developments in financial technology (fintech), including blockchain and digital assets.[77] Emerging technologies and related market developments are prime areas for taking a more principles-based approach to regulation to permit a period of development and observation. It is my view that the United States must lead the world in this technology, and applying overly prescriptive rules could stunt the development of this important market.[78]

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[74] Registration With Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 49,072 (Sep. 18, 2019).

[75] *See id.*

[76] For example, the "Principles for Financial Market Infrastructures" (PFMIs) are the international standards for financial market infrastructures—*i.e.*, payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories. Issued by the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO), the PFMIs are part of a set of key standards that the international community considers essential to strengthening and preserving financial stability. *See* PRINCIPLES FOR FINANCIAL MARKET INFRASTRUCTURES (Apr. 2012), https://www.bis.org/cpmi/publ/d101a.pdf.

[77] *See, e.g.*, J. Christopher Giancarlo, Chairman, CFTC, Derivatives Regulatory Reform: A Principles-based Software Upgrade, Remarks before the Sims Lecture at Vanderbilt Law School (Apr. 13, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo44 ("I believe the CFTC must reaffirm its historic character as a principles-based regulator. The relentless advance of technology and evolution of market structure requires a flexible, principles-based approach to oversight of some of the world's most dynamic commodity and financial derivatives markets."); J. Christopher Giancarlo, Chairman, CFTC, Regulators and the Blockchain: First, Do No Harm, Special Address Before the Depository Trust & Clearing Corporation 2016 Blockchain Symposium (Mar. 29, 2016), https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-13 ("Much like the Internet, U.S. and foreign regulators must coordinate to create a principles-based approach for DLT oversight in order to provide the flexibility, certainty and harmonization necessary for this technology to flourish.").

[78] *See* Press release, CFTC, Chairman Tarbert Discusses U.S. Leadership in Digital Assets on CNBC (Nov. 20 2019), https://www.cftc.gov/PressRoom/PressReleases/8082-19 ("I want the United States to lead, particularly in the blockchain technology that underlies digital assets. . . . [U]ltimately I could see it overtaking the internet or being effectively parallel to the internet in using a variety of different kinds of transactions, not just the financial system, but in other types of transactions as well. . . . I think whoever ends up leading in this technology will end up writing the rules of the road for the rest of the world. My emphasis is on making sure that the United States is a leader.")

However, after we fully understand outcomes and potential risks in this developing area, more tailored and targeted rules may be appropriate. This will be particularly important as retail participation in the digital assets markets increases. Detailed sales practice and disclosure obligation rules may be appropriate for these markets, as well as rules regarding the custodying of customer assets.

While the market develops further, CFTC staff is considering how the core principles applicable to derivatives exchanges and clearing organizations can be augmented given the rapid developments in the fintech space. This may result in the CFTC adding core principles for derivatives exchanges and clearing organizations, or it may necessitate the CFTC providing high-level guidance regarding the application of existing rules and regulations to cutting-edge developments.

VI. Conclusion

Historically, the CFTC has had the distinction of being a principles-based regulator. This has allowed U.S. derivatives markets to evolve to meet the growing demands of our economy. At the same time, it has enabled the CFTC to respond quickly to fast-moving crises and major market developments in a way overly proscriptive regulations would not have permitted. Reinvigorating our historical, principles-based approach, where appropriate, will help our markets remain fair, innovative, and vibrant.

Based on the analytic framework outlined above, I have focused on areas where the CFTC could reinvigorate its principles-based approach to regulation, and have identified areas where a more rules-based approach is preferable. In some cases, this may require the CFTC to adopt detailed, prescriptive rules (*e.g.*, position limits). In other cases, it may require the CFTC to adopt more principles-based regulations that set forth broad objectives and outcomes for regulated parties to strive toward, without necessarily adopting rules that address every particular fact and circumstance (*e.g.*, digital assets). To be sure, we will focus on the right blend of principles and rules to achieve the outcome of sound regulation.

I believe the CFTC should not confront this endeavor alone. These examples, and the analyses upon which they are based, have a broader applicability. It is my hope that the CFTC's use of the framework set out in this article will encourage other financial regulators to reflect on when principles-based regulation may achieve superior results than rules-based regimes, and vice versa. The goal is not to create light-touch regulation or to engage in de-regulation. Rather, the goal is sound regulation. And, at bottom, sound financial regulation is about using the right tools, at the right time, and for the right reasons.[79]

[79] *See supra* note 1.

Public Statements & Remarks

Remarks of Chairman J. Christopher Giancarlo before the Sims Lecture At Vanderbilt Law School, Nashville, Tennessee

Derivatives Regulatory Reform: A Principles-based Software Upgrade

April 13, 2018

Thank you. Good afternoon.

I thank Dean Guthrie and the faculty of Vanderbilt Law School.

I especially thank the Sims family for their continued commitment to the lecture series and to the law school. The Cecil Sims Lectures are important. They are followed closely by legal practitioners and scholars the world over.

When I left these Vanderbilt halls thirty-four years ago, I never dreamed that I would be asked back to give the Sims Lecture. It is a profound privilege and I am humbled by it.

Thank you for inviting me here. This law school continues to earn national prominence based on its principles-based education and breadth of scholarship. I am impressed with its forward looking curriculum, including its new program on law and innovation, preparing lawyers for a digital 21st Century. That is part of what I want to talk to you about today.

Introduction: A Lifetime of Change

First, a word about Cecil Sims. He was born in 1893, two generations removed from the Civil War. He grew up when the past still had a strong hold on the South. Upon graduation as valedictorian from Vanderbilt Law School at age 19, and admission to the bar in 1914, he joined the Army and the First World War. At his death in 1968, he had lived through vast changes in the South and in the world, through the Second World War, Korea, and Vietnam. A year after he died, Neil Armstrong stepped on the moon.

Cecil Sims saw a rapidly changing world in culture, communication, technology and much more. He also the law itself change, evolve, reflect the changing needs of society and the pace of technological evolution.

In 1957, Mr. Sims wrote a visionary article for the American Bar Association Journal. The title was "Lawyers and the Classics: The Spreading Technological Illiteracy." He argued that lawyers need a far-ranging education that included the law and information technology, but also history, classics, philosophy and more.[1]

Why? So a lawyer would assume his or her place as an "architect in public affairs."[2] Let's explore some public policy architecture that Mr. Sims would consider if he were with us today.

What impact do the transformational power of digital technology and the accompanying social evolution have on:

- The adaptability of law and regulation for changing modes of trade and commerce,
- The work of traditionally principles-based agencies like the US Commodity Futures Trading Commission, and
- The relevance of a principles-based approach to legal education that Cecil Sims received and is present today at this law school?

I want to address these questions this afternoon.

The pace of technological change in the course of my own professional career has been stunning. At age twenty-one, I was employed for several months during the first term of Margaret Thatcher's British government as a researcher for Sir Ronald Bell, MP.[3] I wrote research reports outside his office on a manual typewriter. He forbid use of the new memory typewriters, telling me that "word processing will allow governments to snuff out liberty through thousands of pages of legislation that no one will ever read."

Alas, time and technology marched on. When I left Vanderbilt for a Wall Street law firm in 1984, the technology that was changing the practice of law was Federal Express that compressed the legal process into overnight hours. In the thirty-five years since, digital communications technology has pinched the timeframe into milliseconds.

The Digitization of Financial Markets

So much of our world today – from information to journalism, to music to manufacturing to transportation to commerce to agriculture, even legal services – is undergoing a digital transformation.[4]

It should be no surprise then that our financial markets are going through the same digital revolution. In my thirty years practicing law and in business operating derivatives trading platforms, and now four years as a market regulator, I have seen how emerging technologies are impacting trading markets and the entire financial landscape with far ranging implications for capital formation and risk transfer. They include machine learning and artificial intelligence, algorithm-based trading, data analytics, "smart" contracts valuing themselves and calculating payments in real-time, and distributed ledger technologies that may profoundly disrupt traditional market infrastructure. These technologies are reshaping the world around us. It is no surprise that they are having an equally transformative impact on commercial law, with some of the best new scholarship coming out of this law school.[5]

Yet, technology may be having an even more fundamental change – a cultural one. Two months ago, I was called to testify before the Senate Banking Committee alongside SEC Chairman Jay Clayton. The topic was virtual currencies.

As you might expect, I first submitted an extensive forty-page written testimony including attachments and detailed footnotes.[6] I was up to speed on the issue because our agency, the CFTC, had spent much time grappling with the recently self-certified launch of Bitcoin futures by two of our registered futures exchanges.[7]

Yet, in the weekend before the hearing, I reflected on conversations about Bitcoin I had participated in during our New Year's ski vacation with my kids, nieces and nephews - all Millennials and GenZers. I spent time online reading blogs and watching videos about virtual currencies. The more I watched, the more I saw that the energy and momentum behind virtual currencies was not just driven by technological innovation. There was something else going on – something cultural.

I decided to use my opening oral remarks at the Senate hearing to make a point. Let me take you to Capitol Hill. I began with the following statement:

Thank you, Chairman, Ranking Member and distinguished Senators.

I have submitted a written statement for the record that details the CFTC's work and authority over virtual currencies.

With your permission, I'd like to begin briefly with a slightly different perspective.

That is….as a dad.

I am the father of three college age children: a senior, a junior and a freshman.

During their high school years, we tried to interest them in financial markets. My wife and I set up small brokerage accounts with a few hundred dollars they could use to buy stocks. Yet, we haven't been able to peak their interest in the stock market.

I guess they're not much different than lots of kids their age.

Something changed last year, however.

Suddenly, they were all talking about Bitcoin. They are asking me what I thought and should they buy it.

One of their older cousins owns Bitcoin and they were all excited to learn about it. So were their friends.

I imagine that members of this Committee may have some similar experiences in your own families.

It strikes me that we owe it to this new generation:

- **To respect their enthusiasm about virtual currencies with a thoughtful and balanced response, not a dismissive one.**
- **To crack down hard on those who try to abuse their enthusiasm with fraud and manipulation.**
- **To thoroughly educate ourselves – and the public – about this new innovation.**
- **To make good policy choices and put in place sound regulatory frameworks to reduce risk for consumers.**

As I then returned to my formal remarks, something remarkable happened: my Twitter account exploded, gaining thousands of followers in minutes and over 40,000 in the next few days. My remarks were celebrated by virtual currency fans around the globe, who devised clever memes like "#CryptoDad and #FUDBuster[8] and photo shopped my likeness into dozens of online images and videos.

I neither expected nor desired that a few words spoken during a Senate hearing broadcast on C-SPAN would lead to an Andy Warhol "fifteen minutes of fame."

Nor was I – or am I – a virtual currency evangelist.

Technology as Agent of Social Change

The cryptocurrency universe sadly contains a large share of get rich quick schemers, shady entrepreneurs and transactions in illegal goods.[9] It also appears to have a growing contingent of professional, institutional users.[10] Yet, it is also favored by advocates for the poor and unbanked, libertarians, pacifists, Occupy Wall Streeters, earnest tech geeks, economics buffs, long-term investors and many, perhaps naïve, but well-meaning young people.[11]

What I had acknowledged at that Senate hearing is the existence of a community that views technology as an agent of social change. Many of them have come of age during the 2008 financial crisis - the same crisis to which Bitcoin had emerged in response.[12] They have lost faith in the leadership that presided over that mess, in the same way that that fifty years ago the Baby Boomers lost faith in their parents' leadership of wars over civil rights and Vietnam. They have also lost faith in traditional news media that more often lampoons their interest in technology than tries to understand it.

Cecil Sims said we should look for "parallels in history."[13] Here parallels are evident. Just as the Baby Boomer generation strove to change the world through social change – sex, drugs, and rock n' roll. The new generation of Millennials and GenZ sees generational change driven by technological disintermediation of distrusted institutions. They see virtual currency – along with social media - as a means to bypass control by a failed generation of leadership.

How much of our political and social institutions have lost the faith of these new generations? Will they also lose faith in enduring principles of law – the same principles taught here at Vanderbilt. How does market regulation accommodate such profound generational and technological change?

A Principles-Based Approach to Market Regulation

A quick word about the CFTC that I have the privilege to chair. It was founded as an independent agency in 1975. It is composed of 5 commissioners, chosen by the President and confirmed by the Senate. No more than three of the five Commissioners can be of the same political party as the President. It has close to seven hundred career staff. The CFTC regulates markets for derivatives trading, such as exchange traded futures and options on oil, natural gas, wheat, corn, gold, silver, and other commodities. It also oversees some of the world's largest financial markets in listed futures and over-the-counter swaps on rates of interest, credit default, and foreign exchange. For the most part, these are markets for commercial risk transfer and institutional trading.

Historically, the CFTC has been a principles based regulator relying on clearly stated principles and outcome-focused, high-level precepts to achieve desired regulatory outcomes, rather than compliance with detailed and prescriptive rules.[14] The agency began to stray from that approach in some of its implementation of swaps market reforms under the Dodd-Frank Act (Dodd-Frank). [15]

I believe the CFTC must reaffirm its historic character as a principles-based regulator. The relentless advance of technology and evolution of market structure requires a flexible, principles-based approach to oversight of some of the world's most dynamic commodity and financial derivatives markets,

When it comes to the challenge of crypto, it is clear that our governing statutes were not designed for this technology. The CFTC's governing law, the Commodity Exchange Act (CEA) [16], was first passed in 1936 and has been amended several times since then. Unsurprisingly, it contains no reference to virtual currencies. It is like an old computer operating system that struggles to support this new and complex application. In the absence of a legislative update, existing law and regulation must be interpreted on the basis of core principles to keep pace with technological change.

The Regulation Development Lifecycle

Let me now turn to a broader challenge for principles-based regulation: the continuous process of reviewing, updating and optimizing policy applications amidst constant market evolution and technological change. Specifically, I want to talk about ongoing steps to improve the CFTC's initial implementation of swaps market reforms under Dodd-Frank.

We now have more than four years of U.S. experience with the CFTC's initial swaps reform and their varied strengths and shortcomings. Four years provides a statistically significant sample size, if not a long period of history, to evaluate the effects of these reforms and their implementation. Based on that experience, we can now consider ways to better implement Congressional reforms and optimize achievement of the goals of the Pittsburgh Summit.

Why should regulators improve and optimize their rule frameworks? Well, let's consider the evolution of computer software.

The modern software industry is built upon a range of common methodologies and developmental frameworks, such as the software development life cycle, the purpose of which is to preserve the value of software over the time. That value can be enhanced by addressing flaws, enhancing functions, meeting additional requirements, becoming easier to use, more efficient, accommodating newer technology and expanding the user base.

In many ways, regulatory frameworks are like software applications. They are a set of rules and algorithms that direct action to certain desired ends. Often, they guide behavior toward a range of functions, tasks or activities determined to be in the public interest.

Regulatory frameworks also have a development cycle. In the United States context, the cycle begins with Congressional passage of an authorizing statute. Then, it advances through regulatory agency action subject to relevant administrative procedural requirements, including public input and comment.

The maintenance stage is in the hands of regulatory agencies, which gather data and empirical information and can propose rule changes or provide rule relief as appropriate. Their task is also to preserve the value of the core regulatory framework over time. The value can be enhanced by expanding the user base, meeting additional requirements, improving features, clarifying terms of use and increasing efficiency. In the case of some regulatory frameworks, for example CFTC's authorizing statute, the maintenance process is entering its eighty-third year.

Like software users, market participants will always look to participate in well-designed, regulatory frameworks. Trading counterparties seek neither the least nor the most regulated marketplaces, but market places that have the right balance of sensible, objective and well-maintained regulation – in other words: good software. It is in the interest of the United States to achieve such balance.

Financial regulators have a duty to apply the policy prescriptions of their legislators in ways that enhance markets and their underlying vibrancy, diversity and resiliency. That duty also includes the responsibility to continuously review past policy applications to confirm they remain optimized for the purposes intended. It means adopting a forward-looking approach that considers the impact of technological innovation and anticipates changing market dynamics.

Similarly, futures exchanges should continuously review and refresh their futures products. That means a continuous process of reviewing contract design and market conditions and taking affirmative steps to foster trading liquidity, enhance price convergence and deter fraud and manipulation. It is in the interest of the United States that US Dollar-denominated markets for commodity futures remain deep, liquid, well-functioning, diversified and globally competitive. The CFTC has an important role in supporting that vital national interest.[17]

Swaps Reform Version 2.0

The CFTC has been a consistent leader amongst regulators of the world's major swaps and derivatives markets in enacting effective regulation and oversight. It was the first and it remains the most successful implementing body of the core G20 swaps reform here and abroad.

The CFTC remains fully committed to the cause of swaps market reform. That commitment includes a responsibility to pursue improvements to the CFTC version 1.0 swaps regulations that enhance market health and safety while respecting the spirit of global swaps reform and the law embodied in the Dodd-Frank Act. Yet, within that commitment, we must also incorporate lessons from the CFTC's initial reform efforts into a new and improved framework: "Swaps Reform Version 2.0". This is something that I will talk further about in the weeks to come.

Conclusion

In drawing to a close, I want to address the question I asked earlier: how do we accommodate profound technological and generational change?

As CFTC Chairman, I believe the transformational power of technology and the social evolution that accompanies it necessitates the adaptability of law and regulation for changing modes of trade and commerce. I believe that the CFTC, as regulator of the world's largest and most dynamic commodity and financial derivatives markets must continue its historic character as a principles-based regulator. That includes continuously reviewing past policy applications, including the CFTC's initial Dodd-Frank reform implementation, to confirm that it remains optimized for the purposes intended.

This is how a principles-based regulatory approach guides our response to market and technology evolution. It is part of the CFTC's historic DNA. It is part of keeping faith with new generation of market participants. And it is part of keeping market regulation and oversight alive and vital.

And, yes, I believe a principles-based education is the right course for a life in the law, just as it was for Cecil Sims. This has been my experience as a Vanderbilt lawyer through a career spent amidst rapid technological change.

Seventy years ago, in a similar setting, Judge Learned Hand gave the Holmes Lecture at Harvard Law School. As a graduate of Harvard, he thanked the school and its faculty for making his legal career possible. He said, "The memory of those (teachers) has been with me ever since. Again and again they have helped me."

He then paused, looked over the audience, as said "Go ye and do likewise."[18]

Tonight, as a graduate of Vanderbilt Law School, I echo those words. And memories of many extraordinary Vandy professors, who encouraged me to look to the future while drawing on enduring principles from the past.

That is the task for each one of us, as graduates and as professionals. We must never live in fear. Rather, we must be a constant reminder of the best in the law: truth, intellectual rigor and courage to adapt to a changing world on the foundation of a principles-based education.

Cecil Sims understood that. And, each year, the Sims lecture reminds us of his legacy and that of Vanderbilt Law School.

Thank you.

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[1] Cecil Sims, Lawyers and the Classics: The Spreading Technological Illiteracy, 43 A.B.A. J. 31 (Jan. 1957).
[2] Id. at 31.
[3] Sir Ronald McMillan Bell, QC MP (14 April 1914 – 27 February 1982) was a distinguished barrister (Queens Counsel) and Conservative Member of Parliament in the United Kingdom, representing South Buckinghamshire from 1950 to 1974 and Beaconsfield from 1974 to 1982.
[4] *See generally* Erik Brynjolfsson & Andrew McAfee, The Second Machine Age: Work, Progress, and Prosperity in a Time of Brilliant Technologies (2014); Martin Ford, Rise of the Robots: Technology and the Treat of a Jobless Future (2015).
[5] The author commends the scholarly work of Vanderbilt Law School professors, Lisa Schultz Bressman, in the area of Federal administrative and regulatory agency law, and Yesha Yadav, in the area of financial markets and the impact of emerging technology thereon.
[6] See the written testimony of author before the U.S. Senate Banking Committee: Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission, Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs, 115th Cong. 1-42 (Feb. 6, 2018) (statement of J. Christopher Giancarlo, Chairman, U.S. Commodity Futures Trading Comm'n), https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo37.
[7] See Press Release 7654-17, CFTC Statement on Self-Certification of Bitcoin Products by CME, CFT and Cantor Exchange (Dec. 1, 2017), https://www.cftc.gov/PressRoom/PressReleases/pr7654-17.
[8] In the parlance of Twitter, FUD stands for "Fear, Uncertainty, and Doubt."
[9] As the head of an agency with a consumer education mandate, I look to utilize my newfound Twitter following to warn of investment risks through cautionary posts and links to CFTC consumer protection materials.
[10] Institutional market share in cryptocurrency trading already exceeds retail market share, according to recent research by TABB Group. See Monica Summerville, The Wall of Institutional Money Waiting to Flood Cryptocurrency Trading, TABBFORUM.COM (Apr. 6, 2018), https://tabbforum.com/opinions/the-wall-of-institutional-money-waiting-to-flood-cryptocurrency-trading?print_preview=true&single=true.
[11] See Eric Sammons, 10 Types of Crypto fans – Which are You?, DASHFORCENEWS.COM (Sep. 27, 2017), https://www.dashforcenews.com/10-types-of-crypto-fans-which-are-you/.
[12] See Cryptocurrency a Response to Financial Crisis, Says CEO, WALL ST. J., June 14, 2016 (statement of Blythe Masters), https://www.wsj.com/video/cryptocurrency-a-response-to-financial-crisis-says-ceo/D28A8012-413F-447E-AA5A-F1911BA64FC3.html.
[13] Sims, supra note 1, at 33.
[14] See generally Bart Chilton, Commissioner, U.S. Commodity Futures Trading Comm'n, Let's Not "Dial M for Merger": CFTC's Principles-Based Regulation – A Success Story, Speech Before the Futures Industry Association, Law and Compliance Luncheon, The Downtown Association - New York, New York (Nov. 13, 2007), https://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-4.

[15] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 721-774, 124 Stat. 1641, 1641-1807.

[16] Commodity Exchange Act, Pub. L. No. 74-675, 49 Stat. 1491, (1936).

[17] On April 5th through 6th, 2018, the CFTC and the Kansas State University hosted the first-ever economics conference for U.S agricultural futures markets, focused on current macro-economic trends of American agricultural futures markets, including the role of speculators and high-frequency traders, futures contract design, cash price convergence and detecting fraud and manipulation

[18] LEARNED HAND, THE BILL OF RIGHTS: THE OLIVER WENDELL HOLMES LECTURES 77 (1958).

Regulation

Regulation: principles rather than prescription

By: **Dawn DeBerry Stump**, Commissioner, Commodity Futures Trading Commission (CFTC)
Oct 2019

Firstly, I would like to thank the World Federation of Exchanges (WFE) for allowing me to join its 59th Annual Meeting in Singapore earlier this month. I was pleased to take part in one of a series of talks entitled 'The Changing World' - such a fitting topic, recognising that the infrastructure supporting our markets has existed in a constant state of change for decades, evolving to serve a global purpose.

This has been made possible through technological advancements, human ingenuity, and a willingness to embrace creativity. I recently read an interesting article in *The New Yorker* entitled *What 2018 Looked Like Fifty Years Ago* [1]. The article examined the book *Toward the Year 2018* [2], a compilation of predictions published in 1968 (shortly after the WFE was founded) of what the world would look like in 50 years. Some predictions were not particularly remarkable, such as that 'machines will do more of a man's work' [3]. Others were especially clairvoyant: 'The transmission of pictures and texts and the distant manipulation of computers and other machines will be added to the transmission of the human voice on a scale that will eventually approach the universality of telephony' [4]. While the foresight of the book's contributors is incredible, perhaps more astounding is the adaptation of regulatory structures that have permitted these technological advances to become commonly accepted and utilised.

As recently as the year 2000, the Commodity Futures Trading Commission's (CFTC) Technology Advisory Committee considered an agenda that included *Oversight of Electronic Order Routing and*

Execution Systems. While common in today's modern market structure, at the turn of the century electronic trading was the innovation that occupied regulators' attention. Twenty years later, we continue to explore adaptations such as how distributed ledger technology is sensibly applied to the regulated derivatives markets.

So how does a regulator keep up with the rapid pace of change? My own view is largely informed by the unique manner in which the CFTC has historically approached regulation through principles rather than prescription. I believe the markets regulated by the CFTC have been well served by regulatory principles that are nimble enough to adapt, and that rigid regulations are simply not well suited to a constantly evolving marketplace. Writing prescriptive regulations simply renders the rules outdated almost as soon as they are constructed. Core principles that can be applied flexibly yield better results by encouraging innovation, while also achieving a high standard of integrity through serious compliance expectations.

In addition to a principles approach to rule-making, coordination is essential to effectively fulfill our regulatory mission in the ever-changing, increasingly global derivatives markets. We need partners, both in the private sector and among fellow regulators.

We rely upon the infrastructure of exchanges and central counterparties while also demanding a high degree of adherence to standards by these providers in order to ensure that this trust and confidence is respected. We share a common goal of well-functioning markets and while we have different charges, our efforts are naturally complementary. We must maintain an open line of communication. Regulators need to hear from infrastructure providers. It is our best view into the changing marketplace and the dialogue is a critically important element of the information we require.

As for what necessitates a partnership among regulators, never was it more evident than in the midst of the recent financial crisis. Ten years ago, when the leaders of the G20 nations were struggling to respond to the financial crisis, they agreed to develop a coordinated response to change the handling of over-the-counter derivatives. We should build upon, rather than ignore, our progress in fulfilling that vision. If we remain committed to applying comparable regulations globally, there is no need to duplicate supervisory requirements. Such redundancy may actually prove detrimental to the markets we are charged to protect.

At the CFTC our mission is to promote the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation. In order to do so we must recognise the dynamic nature of these markets is constantly impacted by an ever changing world.

The writer is a CFTC commissioner and the views expressed are her own.

[1] Jill Lepore, *What 2018 Looked Like Fifty Years Ago*; the New Yorker, Dec. 31, 2018, https://www.newyorker.com/magazine/2019/01/07/what-2018-looked-like-fifty-years-ago.

[2] Foreign Policy Association, Toward the Year 2018 (Emmanuel G. Mesthene ed., 1968).

[3] *What 2018 Looked Like Fifty Years Ago*, *supra* note 1, *quoting* Charles R. DeCarlo.

[4] *Id.*, *quoting* J.R. Pierce.

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