THE NEXT ERA OF INNOVATION: A CONVERSATION WITH CFTC CHAIRMAN MICHAEL SELIG

Announcer 00:01

Thank you for joining us. Please welcome the panel to the stage.

Michael Piwowar 00:16

Hello, and welcome to the session on a conversation with Commodity Futures Trading Commission Chairman Michael Selig. My name is Mike Piwowar. I'm executive director of the Psaros Center for Financial Markets and Policy and a senior advisor at the Milken Institute. Welcome, Chairman Selig. Let's go ahead and get right to it. Now, before we get into some current topics of interest, I want to talk about the traditional work of the Commodity Futures Trading Commission. The CFTC's mission is to promote the integrity, resilience, and vibrancy of the US derivatives markets through sound regulation. So, Chairman Selig, tell us, how are you fulfilling that mission with respect to futures and swaps markets, and give us some examples.

Michael Selig 01:00

Well, the CFTC is one of those little-known regulators that actually plays a very important role in regulating our financial markets. So the global derivatives markets are actually valued at $1 trillion notional. So it's a very large market, and the US portion of that is very sizable. It's about 30 to 40 percent of that market. So we play an important role in overseeing the global swaps markets, as well as our futures markets here in the United States. And futures contracts are critical for farmers, ranchers, producers to manage and hedge risk. But we're also seeing a wide range of new products, things like financial contracts, interest rate contracts, crypto asset futures, and now the prediction markets.

Michael Piwowar 01:46

Yeah. So you mentioned crypto asset futures. Get to that in a second, but you also oversee the swaps market. So the CFTC was given jurisdiction over Dodd-Frank. Now, Dodd-Frank was passed in 2010, and most people thought that was the end of it. But then the CFTC had to go out and promulgate almost 100 new rules and stuff. Now, are you done with that? You got a good regime you're happy with? Or are you taking a look at that?

Michael Selig 02:12

It's a work in progress. So we saw with Dodd-Frank a really—an autoimmune response to a problem. The swaps markets over the counter had really developed and been a very creative and innovative financial market that came out of the '90s, and it allowed for firms to tailor their risk management. But when firms started to take on additional leverage and utilize these products, the Congress stepped in, and we, of course, had the financial crisis. And a lot of the rules and regulations were, someone joked earlier to me, kind of a belt and suspenders approach. And I believe in the minimum effective dose of regulation. That means we need to lose the suspenders and focus on making sure our markets can flourish here in the United States with the right amount of regulation: no more and no less.

Michael Piwowar 03:01

That's great. So you mentioned digital assets. So that's the new one in your jurisdiction. We're all eagerly awaiting Congress to pass a comprehensive legal and regulatory framework for digital assets. They've passed the GENIUS Act, which covers stablecoins, but they've still got to deal with everything else in the market. And there's the CLARITY Act is working its way through Congress. But in the meantime, you're not just sitting on your hands. You're using existing authorities you already have to do things in the digital asset activity. So give us an update on what you've been doing and what can we expect out of the CFTC in this area in the coming months.

Michael Selig 03:43

We've been working together with the SEC to bring clarity to these markets. And what we saw under the last administration was regulation by enforcement. And this was an effort to drive the industry offshore. We saw the banking regulators debanking lawful firms. We saw the financial regulators cutting off access to the ability to offer these products in the United States, and threatening many with jail time and litigation risk. And so we're turning a page. We're focusing on setting clear rules of the road for crypto. And of course, we're working together with folks on the Hill to get legislation that will future-proof these markets here in the US. But in the interim, there's a lot we can do to clarify. What we've done so far together with the SEC is adopt a joint interpretation that clarifies which types of crypto assets are securities and which are not. And we've also clarified the types of transactions and activities that implicate the securities laws. And this creates an environment where firms can come into the United States, reshore their businesses, engage in financial transactions, and have the certainty and surety that they deserve, as well as the investor protections that are so important in our financial markets.

Michael Piwowar 04:53

Yeah. So you mentioned you're clarifying which are securities and which are not. So the ones that are securities go to the SEC, everything else goes to the CFTC. In the history of both agencies—in the US we have two markets regulators. Most countries and jurisdictions around the world only have one, and the markets regulators are supposed to work together. Having worked at the SEC for a number of years, it hasn't always been the case. But with you and Chairman Atkins over at the SEC, we're in a unique position. Tell folks a little bit about your background. What did you do before you came to the CFTC, and talk about how you're working with Paul Atkins at the SEC so you can provide clarity to everyone as to what jurisdiction they're under.

Michael Selig 05:36

That's right. So before being confirmed as the 16th chairman of the CFTC, I worked at the SEC with Chairman Atkins, and it really is his leadership and his idea to harmonize the CFTC's and SEC's regulatory regimes. And that effort started while I was working on his staff over at the SEC, and we're continuing it now that I'm leading the CFTC. And it's so important, because many of our market participants for so long have had to get double registrations, double compliance, and this isn't helping the American people. It's not creating better regulation, it's just creating duplicative rules and regulation. And so many of these firms can come in and register with a single regulator—that's our vision—and we get the same sort of regulatory and policy control and protections for the American people. We're working together. We've put in place a memorandum of understanding, and this allows not just Chairman Atkins and I to work together, but it helps the staff coordinate and better surveil our markets. So we're sharing information on a regular basis between the different divisions and making sure there are no gaps in regulation, because that's so important, but also just making sure, to my point about the minimum effective dose of regulation, that we're not regulating too much, so we're not strangling firms that really just want to comply. And if you look to foreign regimes, we don't have this bifurcation between the commodities markets and the securities markets, it's typically one regulator that you're dealing with. So having the agencies work together, I think, is the best thing for the American people, and we'll continue to make sure that the staff is fulfilling that vision.

Michael Piwowar 07:13

Yeah. And you mentioned providing clarity for market participants, but also investor protection, right? What was striking about the last administration's approach was that they didn't want to bring anything into the regulatory environment. They left everything out, and so that's why customers of FTX, for example, were dealing with an offshore entity that was not protected by either agency. And what you and Chairman Atkins are doing, it's fantastic. It's not only providing the market participants clarity, but also providing the protections for investors who may not know what they're investing in. Is it a security? Is it a commodity? They don't need to know that, because you guys are working together on this.

Michael Selig 07:48

That's right.

Michael Piwowar 07:48

So that's great. So let's move to another hot topic: prediction markets, one of the hottest financial topics going on right now. In fact, we have a number of sessions going on here at the global conference. So there's a little bit of a jurisdictional battle between the CFTC and some of the state regulators. You have been adamant that all event contracts listed on prediction markets, whether they're related to political events or sporting events or anything like that, are solely the jurisdiction of the CFTC, which have been traditionally regulated by the state. So tell us about that. Tell us about your view and what you expect to see in the future.

Michael Selig 08:32

That's right. So we've ended the turf battle between the SEC and the CFTC, but we now have a fight with many of the states. And when I came into office, I noticed that many of our registrants—so these are CFTC-registered exchanges and brokers and clearing houses—were being sued by various states such as Nevada, California, Texas, and others. And these lawsuits really were impairing their ability to operate within these states with the certainty that our securities and derivatives laws are meant to guarantee. So the states are taking the view that these are gambling products as opposed to derivatives. And we saw this story before at the turn of the century when we had the initial commodities markets emerge in Chicago. Many of these bucket shops were on the sidelines, and these bucket shops were essentially forums where you can come in and gamble on the future price of a commodity. And the Commodity Exchange Act, which is our authorizing statute, developed in the '30s to give us a federal regulatory framework when it comes to commodity derivatives. And so the casinos and bucket shops could offer their own betting markets and wagering, but when you offer a futures contract, an options contract, a swap, or another type of derivative, we regulate that at the federal level, and we allow that to be offered across all 50 states. So when I came into office, I saw many of these states suing our registrants, saying that they're offering legal gambling, and we couldn't allow for that. They're effectively trying to nullify federal law and supplant state laws on top of that. So we've brought lawsuits against Connecticut, Illinois, and various other states to ensure that our jurisdiction is protected.

Michael Piwowar 10:16

Right. So we'll look forward to seeing how these court cases work their way out. And as I mentioned, we have a number of sessions here at the global conference on that. And Congress is going to have to think about this. If you think about digital asset markets five, 10 years ago—is this something they need to deal with? And now, all of a sudden, it's become front and center. It's become a major part of what investors and traders are thinking about. I think prediction markets is starting to pretty much be on that same trend. So glad to see that you're on the front end of that trend. That's great. Let's switch to enforcement. I want to ask you about your approach to enforcement. You mentioned the previous administration had done rulemaking by enforcement. You said you want to focus on fraud and market manipulation. So tell us about what specifically you want to focus on in your enforcement program.

Michael Selig 11:05

Well, we've seen the prior administration regulate by enforcement, really taking a policy view that they didn't like crypto, they didn't like prediction markets, they don't like off-channel communications and certain things in our markets. And so they attempted to regulate by enforcement, set policy through litigation. And our view is that we should set policy using policy tools through rulemaking and through other types of interpretations, as opposed to through litigation. What we are focused on at the agency is policing fraud, manipulation, abuse, insider trading and the like, and that is absolutely critical. The American people deserve free markets, markets with integrity, markets that are resilient, and that are free from fraud, manipulation, and abuse. And so we will continue to devote resources to ensuring that that is the case, but we're going to take resources out of setting policy by suing market participants that may be trying to comply with the law. Maybe they get kind of caught in a foot fault, and that's not the right way to run an enforcement program.

Michael Piwowar 12:07

Yeah. So when you're going to be given jurisdiction over digital assets—let's assume the court cases go in your favor—you're also going to be given jurisdiction over prediction markets. Those have a lot of retail activity. Now, historically, the CFTC—we talked about futures and options in the swaps markets—has been an institutional-only market, and you have highly sophisticated market participants in that. Unlike the SEC, which has a history of doing institutional and retail markets, this will be new for the CFTC. So, how are you handling investor protection concerns, whether it's in the enforcement piece or whether thinking about the regulations that you're working on, are any new authorities needed in this new world?

Michael Selig 12:52

We've got all the authorities we need to police our markets and ensure that they have integrity. We are seeing, of course, different types of illicit activities in our markets that we're always relying on our existing statutory authority to police. We've got broad authority over insider trading, market manipulation, and other abuses, and so we'll continue to ensure that bad actors are kept out of our markets.

Michael Piwowar 13:19

Okay, so let's move on to this idea. Folks really want to get into trade 24/7 or 24/5—24 hours a day, five days a week, or 24 hours, seven days a week. And the CFTC-regulated entities are moving to allow that type of trading. So, from your perspective, what are the implications of 24/5 or 24/7, and what challenges does that present to the CFTC, and how are you meeting those challenges?

Michael Selig 13:46

One size doesn't fit all. So when we're looking at 24/7, we already have 24/7 when it comes to crypto and prediction markets. Other markets, such as agriculture and metals and other financial products, we've got to approach with caution. I do think that we're seeing this real interesting innovation in blockchain technology where you have so many products that are trading on a tokenized basis, 24/7/365. But we have farmers, ranchers, producers, energy firms that are relying on these markets for liquidity and price discovery, and it's very important that these markets have integrity, that they're well-regulated, and we can't expect some of these firms to be monitoring the markets all night when they're relying on these products. Really, it is their day-to-day business to make sure that they're able to hedge risks. So we're, of course, taking input from all these different communities, but we want to make sure that we protect our farmers and ranchers and energy producers because they really are the backbone of this country. And if we push them all into a 24/7 market structure, that may not work for them. And it works for crypto, it works for prediction markets, and that's great, but we're not going to force everyone into that framework.

Michael Piwowar 14:52

So, allowing the option to do it for the markets where it makes sense is your approach to that.

Michael Selig 14:57

Absolutely. It won't be one size fits all, and we'll continue to evaluate case by case and determine where it makes sense to move into 24/7.

Michael Piwowar 15:04

That's great. So we got time for one more question here. I want to ask you about—it wouldn't be a session on financial markets if we didn't bring up artificial intelligence. So, AI applications, as they continue to evolve in financial markets, there's a very real possibility that a market participant filing a registration for a fully autonomous AI bot to serve as a regulated entity. So traditionally, the CFTC regulates the entities that do the trading or the clearing or those types of things. So, how would that work if you have an AI bot that somebody wants to register as a futures commission merchant or as a swap dealer? How are you thinking about this?

Michael Selig 15:49

Well, AI and algorithms aren't new. We've seen this in the high-frequency trading space and the proprietary trading space, where firms are utilizing algorithms. But I think AI is becoming democratized, and we're seeing a lot of interest from retail firms and other participants to utilize these algorithms as well. When we're looking at, for example, an intermediary and whether someone should be registered with us, we're looking for an actual person involved in the equation. And there are questions around whether a bot or an agent itself is a type of intermediary. To the extent that a firm wants to register that algorithm or that agent with us, we would expect to have an intermediary standing behind the agent that's willing to comply with our rules and regulations. So that's certainly something that's possible. For example, a commodity trading advisor that puts up an algorithm—they're doing some sort of automated trading system that they want registered with us. That is a possibility, but we're not looking to find registrants or find persons where they're not persons. My approach to AI is we need to allow for permissionless innovation here in the United States, and we can't force all of these new software systems and technologies into an intermediary-based regulatory structure. It's very important that we not over-regulate and strangle this industry here in the United States. And so we're working to develop clear rules of the road. We've been working together with the White House. Of course, Michael Kratsios has been a leader in this space, as well as David Sacks, to make sure we get the rules and regulations around AI right because we want to set the gold standard and to have the best framework here in the United States.

Michael Piwowar 17:31

Yeah, you mentioned working with the White House. As the chairman of the CFTC, you also sit on something called the Financial Stability Oversight Council, which is a council of all the regulators—SEC, CFTC, the banking regulators—chaired by the Treasury. It was created by Dodd-Frank to look at potential threats to the financial stability of the United States. Not a day goes by when people start to worry about when the AI bots take over in the markets and stuff. Can you give us a little bit of insight in terms of—from the perspective of an FSOC council member—what are folks looking at? Is there concern over systemic risk of AI in derivatives markets? Are you monitoring the situation? Give us a sense of how you're thinking about it.

Michael Selig 18:13

Absolutely. So we're balancing innovation with managing systemic risk. And we've seen over the years fat finger problems and algorithms that go nuts based on a trade, and we can't allow for this democratization of AI to magnify that risk. So if you're thinking about all of the prop firms that are using algos to trade, that's quite a bit. But now we've seen an absolute explosion because anybody can spin up an AI agent using Claude or Open Claude or any of these technologies, and that does amplify the risk. So we're certainly thinking about it. We've looked at—of course, there's the Mythos that's gotten a lot of news. So there's all these new technologies and tools, and I think they offer a great opportunity for the country to generate productivity and magnify our ability to generate returns in the markets. But at the same time, we've got to have some controls because these AI agents are a completely new frontier, and they bring a lot of risk as well. But we're not going to let that undermine the ability to innovate, so we're going to make sure we set some clear rules of the road.

Michael Piwowar 19:31

Oh, that's great. So Chairman Selig, thank you so much. We covered a number of issues in a very short period of time. Thank you so much for taking time out of your busy day.

Michael Selig 19:38

Thanks.

Michael Piwowar 19:42

Thank you.

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