**Terry Duffy Remarks**
**"Financial Market Quality by the Numbers"**
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*Intro/Define Market Quality*

As those of us in this room know, it's a critical time for financial markets right now. In the U.S. we're still climbing out of an economic recession. Europe is seeking answers to its fiscal crisis.

And we're starting to see a slight downturn in the Chinese economy, which has driven much of the market activity the last few years. On top of this, trading technology is changing and we're seeing more active, faster markets all the time.

The securities and futures markets have each had their share of issues over the last year. Whether stemming from the flash crash, BATS, Knight Capital, MF Global or Peregrine, the confidence of market users has certainly been rattled.

The issues in these events were vastly different – ranging from mechanical malfunctions, to human errors like serious management transgressions. But the combined impact has shaken market confidence overall. This is our shared problem as an industry.

All market participants expect a marketplace they can rely on for price discovery, risk management and capital formation. As we talk today about market quality, two key characteristics are critical: market efficiency and the confidence of market participants.

*The Role of Risk Management*

I'll talk more about each of these in a few minutes. But first, I want to start by discussing something that is at the center of all of this. Why does all this matter? Why is there a push for enhanced technology and worldwide round-the-clock trading?

It is risk management… and the economic benefits this provides. Every business faces risk. We all recognize this simple fact. For a farmer or a hedge fund, the risks would appear to be quite different.

But at their core, those businesses and others face the same thing: the risk of losing income and profits due to either loss of value… or an increase in costs.

Despite some of his comments to the contrary, Warren Buffett, by his own admission, has engaged in large-scale derivatives transactions in order to facilitate certain investment strategies. Mr. Buffett is not the only one who has benefitted from using derivatives.

According to the International Swaps Dealers Association, 92 percent of the world's 500 largest companies have reported making some use of derivatives – including futures and options like those offered at CME Group.

Of these users, more than 90 percent took advantage of derivatives to manage interest rate risk, 85 percent to manage currency risk, and 25 percent to manage commodity price risk. Moreover, academics widely believe that the corporate use of derivatives generally works to increase shareholder wealth.

Certainly, the benefits noted contribute directly and indirectly to economic growth. In this Presidential election year, there's a lot of discussion about the need to grow our economy – about which candidate and which political party has created the most jobs – as well as which one has the better plan to create more. And without question, government has a role to play in job creation.

Now, I know we're in Washington. But if you'll allow me…, I would suggest there's something that has far greater influence over a business's ability to hire workers than who sits in the White House or the halls of Congress.

And that is a business's ability to manage its risk, control costs and invest for the future. When successful in these efforts, the result that is most important is the ability to hire more employees.

But of course there are other results.
By managing risk properly, airlines can fly more flights, farmers can grow more crops, and banks can lend to more businesses and institutions.

Most of the political, economic and weather-related events we hear about in the news have an impact on businesses somewhere.

Take, for example, Hurricane Isaac, which hit the Gulf Coast a few weeks ago. Some oil and gas rigs in the gulf shut down completely before the storm, lowering the supply of those commodities. By reducing supply in the short term, this had an impact on the prices of oil and natural gas.

If you're an energy company or an airline, this affects the price you pay for a commodity critical to your business. Our energy contracts allow the firms that use them to hedge unpredictable events. Therefore they can lock in a price so they can make their costs much more predictable, no matter what the weather does.

And you've probably seen images and data about the drought this year in the Midwest –the most widespread since the dust bowl of the 1930s. Counties in 32 states – more than half the counties in the United States – are designated drought disaster areas.

This has drastically reduced production levels of corn, wheat and soybeans, and has resulted in record prices in those commodities. In the case of wheat, we've seen prices jump as much as 41 percent. This is when the futures market is critical to the preservation, and growth of, the larger economy.

A derivatives exchange like CME plays an important role in helping companies manage the price they pay for grain, and allows them to pass fewer costs on to consumers at the grocery store. At the same time, farmers, ranchers and grain elevators look to CME to serve as a safety net by enabling them to lock in prices. That allows them to increase their gains or limit their losses, and continue planting the next year.

And it doesn't just apply to agricultural commodities. Any company that depends on the use of materials or instruments with fluctuating prices, benefits from managing this risk – and that's exactly what CME allows companies to do.

*Efficiency/Innovating for the Future*

I mentioned earlier the demand for efficiency in our markets. Market users must have confidence that the electronic infrastructure and skilled workers are available to constantly improve the efficiency, speed and reliability of trading.

This is especially true in liquid markets like ours, where more than 3 billion futures and options contracts are traded annually, with an underlying value of more than $1 quadrillion. This staggering volume from just one exchange underscores the vital economic role played by our industry. So it is important to recognize the macro-trends that are impacting us. They include:

- global political and economic uncertainty,
- shifts in financial power to emerging markets,
- a stricter and more complex regulatory environment, and
- ever-faster technology…

These factors are combining to create increasing demands on derivatives markets and the platforms where they trade.

Market participants need to react instantly to news as it breaks and information as it emerges. What happens in other parts of the world – in both developed and emerging economies – is immediately significant in the U.S. and elsewhere.

Let's say an asset management firm in Maryland wants to diversify its clients' portfolios, or find the best price on a financial product in the global market. Through technology, this can be done easily. And the trade can be completed in microseconds.

Certainly, lightning speed is important. Investors require timely execution and immediate access to markets. But I am not really referring to speed when I use the word "efficiency." You can have the fastest markets in the world, but if your markets don't have the proper controls or the necessary liquidity to allow participants to get in or out of a contract, what is speed worth?

When I mention efficiency, I am really talking about integrity – markets that work in all environments… despite all levels of volatility… across borders… and in all regulatory regimes.

Efficient markets must have the necessary controls in place to detect and safeguard against technical issues and human error. As well as controls that allow us to identify compliance issues sooner. That is where CME Group, along with the futures industry, is focused.

The *Wall Street Journal* reported last week that U.S. stock exchanges are looking at proposals to implement what they are referring to as… "kill switches." In the futures industry, we already employ a version of that technology – though we call it Stop Logic Functionality.

Regardless of the title, the application is designed to *automatically* shut off, or pause, trading when market moves reach certain levels – either high or low. By halting trading, participants are able to catch their breath and replenish liquidity. It allows the market to regain equilibrium.

As we look to improving the quality of our financial markets system, we must first look <u>to</u> the best practices in each marketplace.

Despite the headlines, there *are* many positives in our financial markets system. Though there are improvements that can be made… the fact is, our financial markets are among the best in the world. They are resilient, adaptable and highly effective for market users everywhere.

*<u>Ensuring Return of Confidence</u>*

That said, we are at a pivotal moment in our history. So, as we forge ahead to find new solutions to current issues, regulation certainly will play a critical role as well. The challenge for regulators is to promote regulation that provides genuine consumer protections that do not impede sound financial market development.

Over-regulation can hinder the efficiency of any market, making it too costly or complex. That would *dis-incent* businesses from investing or managing risk. As a result, those costs would be passed onto us, the consumers.

Congress, federal regulators, industry regulators, industry groups and CME are all working towards the same goal: to restore confidence in all aspects of the financial marketplace, and strengthen appropriate protections at every point in the system.

We understand that every link in the chain has to be as strong as the next. The businesses and individuals who rely on the futures markets to manage their risk – are relying on all of us to collectively manage their trust.

Just as consumers need confidence in the banks or brokerages where they choose to keep their personal finances, it is important for businesses to have confidence in the markets where they operate.

At CME Group, we are committed to meeting their needs by:

- addressing the current challenges to strengthen <u>customer</u> protections,
- further increasing efficiencies for our users, and
- by building on the history of upholding our marketplace to the highest standards…which is so essential to the fabric of our world economy.

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