Testimony of Chairman Timothy G. Massad before the
U.S. House Committee on Agriculture
Washington, DC
February 12, 2015

Thank you, Chairman Conaway, Ranking Member Peterson, and members of the Committee. It is a privilege to appear before you for the first time as Chairman of the Commodity Futures Trading Commission (CFTC). I am pleased to testify today on behalf of the Commission.

I appreciate the opportunities I have had to meet with many of you, and value your input on the issues facing the Commission. I look forward to working with the Committee going forward.

The CFTC oversees the futures, options, and swaps markets. While most Americans do not participate directly in these markets, they are very important to the daily lives of all Americans, because they shape the prices we all pay for food, energy and many other goods and services. They enable farmers to lock in a price for their crops, utilities to manage their fuel cost, and manufacturers to hedge the price of industrial metals. They enable exporters to hedge foreign exchange risk and businesses of all types to lock in borrowing costs. In short, the derivatives markets enable businesses of all types to manage risk.

For these markets to work well, good regulation is essential. That is why the Commission's job is so important and we must do all we can to prevent fraud and manipulation in these markets. And we must create a regulatory framework that promotes efficiency, competition, and innovation so that these markets can thrive. I am committed to working with this Committee and Congress to make sure these markets continue to be strong, dynamic, and an engine for economic growth.

Today, I would like to review what we have accomplished since last summer when I, as well as two of the other three Commissioners, took office. I would also like to discuss some key priorities going forward.

It has been a busy and productive time for us. We have worked to make sure that commercial end-users can continue to use the derivatives markets effectively and efficiently. We are continuing the work to bring the over-the-counter swaps market out of the shadows and implement the regulatory reforms mandated by Congress. We have also been busy carrying out our traditional responsibilities of surveillance, compliance, and enforcement. And we have been addressing new developments and challenges in our markets, particularly those created by technological development.

I know I speak for all the Commissioners in first thanking our staff for their hard work. The progress we have made is a credit to their commitment and their tireless efforts.

I also want to thank each of my fellow commissioners for their dedication. Each brings good experience and judgment, and I appreciate our candid, robust dialogue on the wide range of issues we face. I commend my fellow commissioners in particular for their efforts to reach out and make sure we are all well informed by a diversity of views, and for their willingness to collaborate and work constructively together. While we will not always agree, I believe we are working together in good faith to do the best job we can in implementing the law and carrying out the Commission's responsibilities.

Over the last several months, the Commission has been actively listening to market participants, getting important feedback on what is working well and what parts of our regulatory framework may need adjusting. We have held two open meetings, and we will hold more open meetings in the future. The CFTC's advisory committees have also provided a good venue for dialogue.

In December, we had a productive meeting of our Agricultural Advisory Committee, of which I am the sponsor. We were honored to have Secretary Vilsack as our special guest. It was an excellent opportunity to gather input directly from farmers, ranchers, and others who rely on these markets day in and day out.

Commissioner Wetjen held a very informative meeting of our Global Markets Advisory Committee (GMAC) in October of last year, a Committee which focuses on matters that affect the integrity and competitiveness of U.S. markets and U.S. firms engaged in global business. He will also be convening another GMAC meeting, as well as a meeting of our Technology Advisory Committee, in the coming months. Commissioner Bowen is sponsoring our new Market Risk Advisory Committee. She has been working to organize it and define its agenda. This committee will help the Commission identify and understand the impact of evolving market structures and movement of risk across clearinghouses, exchanges, intermediaries, market makers, and end-users. And

Commissioner Giancarlo has been working to build up our Energy and Environmental Markets Advisory Committee, which advises the Commission on matters of concern to exchanges, firms, end-users, energy producers, and regulators regarding energy and environmental markets and their regulation by the Commission. He will be holding their first meeting shortly.

Let me turn now to the progress we have made in each of the general areas I noted.

Making Sure the Markets Work for Commercial End-Users

For the derivative markets to contribute to the broader economy, they must work well for commercial end-users — the many manufacturers, farmers, ranchers, and other businesses that rely on these markets to hedge commercial risks. Since last summer, we have made it a priority to address concerns of these participants. We have sought to make sure that our rules do not impose undue burdens or create unintended consequences for these participants, and that we are creating better, more transparent markets for them. Let me review some of the actions we have already taken.

- Margin for Uncleared Swaps. We have made sure that our proposed rule on margin for uncleared swaps exempts commercial end-users from this requirement. We have also worked with the domestic bank regulators, who are also responsible for issuing rules on this subject, to maintain a comparable approach for commercial end-users.

- Local Utility Companies. In September, the Commission amended its rules so that local, publicly-owned utility companies could continue to effectively hedge their risks in the energy swaps market. These companies, which keep the lights on in many homes across the country, must access these markets efficiently in order to provide reliable, cost-effective service to their customers. The Commission unanimously approved a change to the swap dealer registration threshold for transactions with special entities which will make that possible.

- Customer Protection/Margin Collection. In November, the Commission proposed to modify one of our customer-protection related rules to address a concern of many in the agricultural community and many smaller customers regarding the posting of collateral.

These rules had been unanimously adopted in the wake of MF Global's insolvency and were designed to prevent a similar failure from recurring and to protect customers in the event of such a failure. Market participants asked that we modify one aspect of the rules regarding the deadline for futures commission merchants to post "residual interest," which, in turn, can affect when customers must post collateral. The change was that the deadline would not move to earlier than 6:00 pm the day of settlement without an affirmative Commission action and an opportunity for public comment. I hope to finalize this rule change in the very near future.

- Reporting Requirements. We have proposed to exempt end-users and commodity trading advisors from certain recordkeeping requirements related to text messages and phone calls. This proposal is designed to make sure we do not impose undue reporting requirements on commercial end-users. The proposal also clarifies, in response to public feedback, that oral and written communications that lead to the execution of a transaction need not be linked to records identifying that transaction.

- Volumetric Optionality. We have proposed to clarify our interpretation of when an agreement, contract, or transaction that contains embedded volumetric optionality falls within the forward exclusion from being considered a swap. "Embedded volumetric optionality" refers to the contractual right of a counterparty to receive more or less of a commodity at the negotiated contract price. Contracts with this feature are important to, and widely used by, a variety of end-users, including electric and natural gas utilities. The proposed interpretation would clarify when forward contracts with embedded volumetric optionality may be excluded from being considered swaps. In this way, the proposed interpretation is intended to make sure commercial companies can continue to conduct their daily operations efficiently.

- Treasury Affiliates of End-Users. The Commission staff took action to make sure that end-users can use the Congressional exemption given to them regarding clearing and swap trading if they enter into swaps through a treasury affiliate. It is common for a large corporation with significant non-financial operations to have a separate affiliate enter into swaps and financing transactions on behalf of the larger corporation and its subsidiaries.

CFTC staff have taken action to clarify how our rules will be applied to make sure that such companies can utilize the end-user exception.

- Interaffiliate Transactions. We have also worked to harmonize the phasing in of certain rules regarding clearing with the requirements in other jurisdictions. The Commission previously adopted a final rule providing an exemption from required clearing for swaps between certain affiliated entities, subject to specific requirements and conditions. One condition, designed to prevent evasion of the clearing requirement, is that any related swap executed with an unaffiliated counterparty must be cleared in accordance with Commission rules or comparable rules of a foreign jurisdiction. Because other jurisdictions had not yet adopted a mandatory clearing framework, the final rule provided a temporary alternative compliance mechanism. We took action because other jurisdictions need more time. While progress continues to be made with regard to the implementation of mandatory clearing regimes in foreign jurisdictions, many do not yet have a clearing mandate in place. For this reason, the Commission staff recently extended the rule's alternative compliance approach until December 31, 2015.

- Reporting Requirements for Contracts in Illiquid Markets. CFTC staff recently granted relief from the real-time reporting requirements for certain less liquid, long-dated swap contracts that are not subject to mandatory clearing and do not yet trade on a regulated platform. This relief was provided in part because while Dodd-Frank requires real-time reporting for swaps, it also requires that such reporting obligations should not lead to identifying market participants, as that could result in competitive harm. We therefore agreed to permit slightly delayed reporting for these swaps.

- Aluminum Market. Another issue of concern to end-users that we are focused on pertains to the long queues for delivery of aluminum at warehouses in this country licensed by the London Metal Exchange (LME), the relationship of those queues to the pricing and delivery of aluminum, and how those issues impact market integrity and market participants. We do not have direct regulatory authority over those warehouses, and the LME's principal regulator is the Financial Conduct Authority (FCA) in the UK. However, we are looking at these issues closely and speaking with aluminum users, the LME, the HKEx Group, which owns the LME, and the FCA on a regular basis.

- Harmonization with SEC Rules. We continue to work closely with our colleagues at the SEC. For example, in connection with the SEC's efforts to implement the Jumpstart Our Business Startups Act ("JOBS Act"), we took action to harmonize our rules with the new requirements. Specifically, we revised requirements applicable to commodity pool operators that are also registered with the SEC.

In sum, we have been very focused on fine-tuning the rules to make sure they work for commercial end-users, and we will continue to do so.

Continuing Implementation of the New Regulatory Framework for Swaps

Let me turn now to our efforts to implement reforms to the swap market as part of the overall effort on financial regulatory reform. The financial crisis that began over six years ago stands as the worst since the Great Depression: millions of jobs lost and homes foreclosed, countless retirements and educations deferred, and businesses shuttered. It was during the financial crisis that most Americans first heard about derivatives. That was because over-the-counter (OTC) swaps accelerated and intensified the crisis. In the absence of regulatory oversight, a global market had developed that allowed participants to take on excessive risk — risk that they did not always understand, and that was opaque to regulators. The interconnectedness among large institutions meant that trouble at one firm could easily cascade through the system — often across national borders. We faced the possibility of systemic collapse.

The Dodd-Frank Act was a comprehensive response to the market excesses and regulatory gaps that contributed to the crisis. Title VII embodied the four basic commitments that were agreed to by leaders of the G-20 nations to reform the OTC swaps market: require central clearing of standardized swaps through regulated clearinghouses; require regulatory oversight of the largest market participants; require regular reporting so that regulators and the public can have a view of what is happening in the market; and require transparent trading of swaps on regulated platforms.

We have made substantial progress in implementing these reforms. We are focused today on completing that work in a manner that ensures these markets continue to thrive and work well for all participants.

- Clearing of standardized swap transactions

A primary commitment of Dodd-Frank was to require clearing of standardized swaps transactions through clearinghouses. The use of clearinghouses in financial markets is commonplace and has been around for over one hundred years. The idea is simple: if many participants are trading standardized products on a regular basis, the tangled, hidden web created by thousands of private bilateral trades can be replaced with a more transparent and orderly structure, like the hub and spokes of a wheel, with the clearinghouse at the center. The clearinghouse can then monitor the overall risk and positions of each participant.

Clearing through central counterparties is now required in our markets for most interest rate and credit default swaps. Recent data show our progress. The percentage of transactions that are centrally cleared in the markets we oversee has gone from about 15% in December 2007 to about 75% today.

In accordance with Congressional direction, the CFTC acted expeditiously to implement clearing mandates. The United States was among the first of the G-20 nations to do so. Also as directed by Congress, the CFTC specifically exempted from those mandates commercial end-users, including manufacturers or farmers who use the swaps markets to hedge. The CFTC also has exempted agricultural and electrical cooperatives, as well as banks with assets totaling less than $10 billion.

Of course, central clearing is not a panacea. Clearing does not eliminate the risk that a counterparty to a trade will default — instead it provides us with powerful tools to monitor that risk, manage it, and mitigate adverse effects should a default occur. For central clearing to work well, active, ongoing oversight is critical. And given the increasingly important role of clearinghouses in the global financial system, this is a top priority. We must do all we can to ensure that clearinghouses have the financial, operational and managerial resources, and all the necessary systems and safeguards, to operate in a fair, transparent, and efficient manner. We must make sure that contingency plans for clearinghouse recovery and resolution are sufficient. Therefore, we are very focused on all of these issues in our compliance activities and examinations of clearinghouses, as well as in thinking about our regulatory framework.

- Increased oversight of major market participants

Since Congress passed Dodd-Frank, we have increased oversight of major market players through the registration and regulation of major swap participants and swap dealers. More than 100 are now provisionally registered. This list includes many of the largest banks in the world. We have adopted rules requiring these registrants to observe strong risk management practices, and they will be subject to regular examinations to assess risk and compliance with rules designed to mitigate excessive risk.

The new framework requires registered swap dealers and major swap participants to comply with standard business practices, such as documentation and confirmation of transactions, as well as dispute resolution processes. They are also required to make sure their counterparties are eligible to enter into swaps, and to make appropriate disclosures to those counterparties about risks and conflicts of interest.

- Regular reporting for increased market transparency

Congress recognized that having rules that require oversight, clearing and transparent trading is not enough. We must have an accurate, ongoing picture of what is taking place in the market to achieve greater transparency and to address the potential risks. A key commitment in Dodd-Frank is ongoing reporting of swap activity. In 2008, regulators and Congress knew very little about the size and risks in this market. Today, under our rules, all swap transactions, whether cleared or uncleared, must be reported to registered swap data repositories (SDRs), a new type of entity responsible for collecting and maintaining this vital information.

This reporting will enable regulatory authorities to engage in meaningful oversight. Robust surveillance and enforcement, so critical to maintaining market integrity, depends on the availability of accurate market data. And increased transparency helps market participants by increasing competition, facilitating the price discovery process, and enhancing confidence in the integrity of the market. You can now go to public websites and see the price and volume for individual swap transactions. And the CFTC publishes the Weekly Swaps Report that gives the public a snapshot of the swaps market.

While we have made good progress, we have a considerable amount of work still to do to collect and use derivatives market data effectively. There are now four data repositories in the U.S., and more than 20 others internationally, plus thousands of participants who must report data.

We are engaged in three general areas of activity. First, we must have data reporting rules and standards that are specific and clear, and that are harmonized as much as possible across jurisdictions, and we are leading an international effort in this regard. Only in this way will it be possible to track the market and be in a position to address emerging issues. We must also make sure the SDRs collect, maintain, and publicly disseminate data in a manner that supports effective market oversight and transparency. This means a common set of guidelines and coordination among registered SDRs. Standardizing the collection and analysis of swaps market data requires intensely collaborative and technical work by industry and the agency's staff. We have been actively meeting with the SDRs on these issues, getting input from other industry participants and looking at areas where we may clarify our own rules.

Finally, market participants must live up to their reporting obligations. Ultimately, they bear the responsibility to make sure that the data is accurate and reported promptly. We have already brought cases to enforce these rules and will continue to do so as needed.

- Transparent trading of swaps transactions on regulated platforms

With regard to swaps trading, there is also progress as well as work to be done. Congress mandated that certain swaps must be traded on a swap execution facility (SEF) or other regulated exchange. Transparent trading of swaps on swap execution facilities (SEFs) can facilitate a more open, transparent, and competitive marketplace, which will benefit all participants.

Today, there are 22 SEFs temporarily registered, and 2 applications are pending. Each is required to operate in accordance with certain statutory core principles. These core principles provide a framework that includes obligations to establish and enforce rules, as well as policies and procedures that enable transparent and efficient trading. SEFs must make trading information publicly available, put into place system safeguards, and maintain financial, operational and managerial resources necessary to discharge their responsibilities.

Trading on SEFs is still relatively new. It began in October of 2013, and the trading mandate for certain interest rate swaps and credit default swaps took effect about one year ago. Through last year, notional value executed on SEFs was generally in excess of $1.5 trillion weekly. Publicly available data show trading volumes are trending higher. In addition, the number of market participants using SEFs is increasing. One SEF recently confirmed that participation had exceeded 700 firms.

But, there is more to do. Our rules are new, and as we gain experience with their application in the marketplace, we will see what works well and what doesn't, and we will make changes as appropriate. The SEFs themselves are developing best practices and testing different approaches. The new technologies that are being used are likewise changing and being refined. In addition, as other jurisdictions develop their rules on trading, we will look to try to harmonize the rules as much as possible so as to minimize the risk of market fragmentation.

As I said to the SEF industry last fall, our goal should be to create a regulatory framework that not only achieves the Congressional mandate of bringing this market out of the shadows, but which also creates the foundation for the market to thrive. To do so, our rules must ensure transparency, integrity and oversight, while at the same time permit innovation, freedom and competition.

- Finalizing the Remaining Rules

We have also been working on the few Dodd-Frank rules that remain to be finalized. In September, we reproposed our rule on margin for uncleared swaps. While we have made great progress in the proportion of swap transactions which are centrally cleared, we must recognize that uncleared transactions will continue to be an important part of the market. Sometimes, commercial risks cannot be hedged sufficiently through swap contracts that are available for clearing. For example, certain products may lack sufficient liquidity to be centrally risk managed and cleared. This may be true even for products that have been in existence for some time. And there will and always should be innovation in the market, which will lead to new products.

That is why the rule on margin for uncleared swaps is important. Margin will continue to be a significant tool to mitigate the risk of default and, therefore, the potential risk to the financial system as a whole.

Consistent with Congressional intent, our proposal exempts commercial end-users from the margin requirements applicable to swap dealers and major swap participants. Our approach seeks to provide a significant safeguard without imposing unnecessary costs on participants whose activities do not create the same level of systemic risk. We will also make the minor changes necessary in our final rule to ensure conformity with the amendment to the Commodity Exchange Act (CEA) adopted by Congress in December as part of the Terrorism Risk Insurance Act (TRIA).

In formulating our approach, we coordinated closely with the relevant bank regulators, because Congress mandated that margin requirements be set by different regulatory agencies for the respective entities under their jurisdiction. Under the Dodd Frank Act, each swap dealer and major swap participant for which there is a prudential regulator must comply with margin rules established by that prudential regulator. All other swap dealers and major swap participants must comply with margin rules established by the CFTC. I am pleased to say that our rules and those of the bank regulators are substantially similar.

We have also been working with our international counterparts to harmonize our proposed margin rule for uncleared swaps with corresponding rules in other jurisdictions. Europe, Japan and the United States have each proposed rules which are largely consistent, and which reflect a set of standards agreed to by a broader international consensus.

While there were some differences in the proposals, we are working closely with our counterparts in Europe and Japan, as well as the U.S. banking regulators, to try to further harmonize these rules. I am encouraged by the progress we are making and I hope that we can finalize these rules in the near future.

We are also working on two other rules regarding capital and position limits. Congress mandated that we implement position limits to address the risk of excessive speculation. In doing so, we must make sure that the market works for commercial end-users seeking to hedge routine risk through bona fide hedging.

We have received substantial public input on the position limits rule which the staff is reviewing. Most recently, we received valuable input from participants at the December Agriculture Advisory Committee meeting. It is important that we consider these comments carefully as we develop a rule. Commission staff will also be considering next steps on the capital rule as we move forward on finalizing the proposed rule on margin for uncleared swaps.

Cross-Border Issues: The Challenge of Building a Global Regulatory Framework

Another key priority is working with our international counterparts to build a strong global regulatory framework. To achieve the goals set out in the 2009 G-20 commitments and embodied in the Dodd-Frank Act, global regulators must work together to harmonize their rules and supervision to the greatest extent possible. Since I joined the CFTC, I have made it a priority to work with our international counterparts on these issues.

The challenge of harmonizing rules across borders is best understood by remembering the unique historical situation we are in. The swaps market grew to a global scale without any meaningful regulation. So today, we must regulate what is already a global market, and the new framework can only be implemented through the actions of individual jurisdictions, each of which has its own legal traditions, regulatory philosophy, political process, and market concerns. While the G-20 nations agreed to basic reform principles, there will inevitably be differences in specific rules and requirements. The challenge is to achieve as consistent a framework as possible while recognizing that our responsibility as national regulators is first and foremost to faithfully implement and enforce our own nation's laws. We also must remember that in many areas of financial regulation, laws vary among nations. The fact is that, in the case of swaps, we have made great progress in harmonization, and will continue to do so, but it will take time.

Let me note a few of the things that are going on in our effort to work with our international counterparts. First, I have been personally committed to this effort. To that end, since I took office last June, I have made a few trips to Europe and met several times with European and other international officials here in the U.S. Last month, I visited Asia, where I met with government officials in Beijing, Hong Kong, Singapore, and Tokyo as well as with key market participants. These visits provide an opportunity to listen to others' views, identify issues of common concern, and work together to advance our shared goal of bringing the over-the-counter swaps market out of the shadows. I have also met with my counterparts from all over the world at board meetings of the International Organization of Securities Commissions in Europe and South America as well as the OTC Derivatives Regulators Group.

- <u>Clearinghouse Recognition and Regulation</u>

One of the most important cross-border issues before the Commission over the last several months is clearinghouse recognition and regulation. The fact is that a small number of clearinghouses are becoming increasingly important single points of risk in the global financial system. This is an issue that transcends swaps. It is of equal concern to participants in the futures and options markets because the same clearinghouses handle clearing for many products.

We are continuing in dialogue with the Europeans to facilitate their recognition of our clearinghouses as equivalent. We have had productive discussions regarding the rules governing clearinghouses that are located in Europe, but are also registered with the CFTC. There are presently three such clearinghouses.

Our system of dual registration came about originally because we took a very non-territorial view as to where clearing must occur. The U.S. did not mandate that clearing of futures traded on U.S. exchanges must take place in the U.S.; we simply required that it take place through clearinghouses that are registered with us and that meet certain standards. These standards are designed to ensure customer protection and financial stability, and include provisions related to our bankruptcy laws.

Dual registration and cooperative supervision have worked. The model has worked to protect customers, it worked during the crisis, and it is a model on which the market has grown to be global. Fourteen clearinghouses are currently registered with the CFTC to clear either swaps, futures, or both. Five of those are organized outside of the United States, including three in Europe. One such clearinghouse now handles approximately 85% of swaps clearing and has been registered with us since 2001. In addition, the CFTC is now reviewing five registration applications from clearinghouses, including three located outside the United States.

The Europeans have agreed that the framework of dual registration and cooperative supervision should not be dismantled. We are working on the details of substituted compliance for European clearinghouses that are dually registered with the CFTC as well as cooperative supervision, and we are making good progress. We will also seek to coordinate with them on future swaps clearing mandates.

- Oversight of Swap Dealers and Margin for Uncleared Swaps

Another important topic is oversight of swap dealers. A key aspect of this is margin for uncleared swaps, which I noted earlier. We have been active in the development of international standards in this area. The CFTC, along with the U.S. bank regulators, has proposed rules which reflect those standards. Europe and Japan have proposed rules as well. This is an important example of working internationally so that the rules are as similar as possible from the beginning. While there are still some differences in the various proposals, we are working hard to try to minimize those differences. I am hopeful that we can issue final rules in the near future that are largely consistent with the rules of other jurisdictions. As for general harmonization of rules that pertain to oversight of swap dealers much has already been accomplished. We issued substituted compliance determinations in late 2013 with respect to the rules of six other jurisdictions — the European Union, Japan, Australia, Hong Kong, Switzerland, and Canada. We will continue to look at other jurisdictions' rules as those are finalized.

- Reporting

As I noted earlier, there is a lot of cross-border work going on in the area of reporting. The number of data repositories across various jurisdictions — four in the U.S. plus more than 20 others internationally — as well as all of the participants around the world who must report make moving forward in this area more important than ever. We and the European Central Bank currently co-chair a global task force that is seeking to standardize data standards internationally. We are working to achieve consistent technical standards and identifiers for data in trade repositories. While much of this work is highly technical, it is vitally important to international cooperation and transparency.

- Trading Rules and Foreign Boards of Trade

While we have issued our swap trading rules, other jurisdictions generally have not done so. As I indicated earlier, as other jurisdictions develop their rules, we are open to trying to harmonize rules as much as possible consistent with our statutory responsibilities.

Although it pertains to the futures and options markets more than swaps, another key element of our cross-border effort is to recognize foreign exchanges in order to enhance opportunities for the trading of futures globally. We have recently taken some important actions in this area.

The CFTC does not generally regulate the trading of futures by U.S. persons on offshore exchanges. If a foreign futures exchange wishes to provide direct electronic access to people located in the U.S., we have in the past required the exchange to apply for relief from our registration requirements. We have formalized that process and now foreign exchanges, which we refer to as foreign boards of trade or FBOTs, can be officially registered with us.

I am pleased to report that, under this new process, last month the CFTC approved FBOT registration applications for the Tokyo Commodities Exchange (TOCOM), Bursa Malaysia, and Singapore Exchange (SGX). These approvals recognize the increasing interconnectedness of the global derivatives markets and the importance of Asia in that development. More generally, the FBOT registration approval also demonstrates our commitment to a coordinated regulatory approach that relies on foreign supervisory authorities and ongoing cooperation. We look forward to granting additional approvals in the coming months.

- Benchmarks

Another cross-border issue that we have been focused on is the potential regulation of financial benchmarks and indices by the European Union (EU). In our markets, thousands of contracts reference these benchmarks and indices, such as LIBOR, S&P 500 and Brent Crude. The integrity of benchmarks and indices is vital to our financial system. That is why we have focused on this issue in our enforcement efforts, as evidenced by our orders against banks that have tried to manipulate interest rate benchmarks like LIBOR and foreign exchange benchmarks. We have also worked cooperatively with foreign regulators in these enforcement actions, which I will return to in a moment.

We believe there should be standards for benchmarks designed to ensure good administration and transparency and minimize the risk of manipulation. That being said, the EU has proposed legislation that would have adverse market consequences. In particular, benchmarks created by administrators located in countries outside the EU could not be used by European supervised entities, such as banks and asset managers, unless the European Commission determines that any non-EU administrator is authorized and equivalently supervised in the non-EU country. As you know, the United States does not have such a government-sponsored supervisory regime for benchmarks. Accordingly, in light of the EU's equivalence standards, the new proposed benchmark regulation could prohibit EU institutions from hedging using thousands of products traded on US futures exchanges and swap execution facilities.

I have expressed these concerns to European officials. I have encouraged them to consider the work of the International Organization of Securities Commissions (IOSCO) in this area, which the CFTC helped lead. IOSCO's Principles for Oil Price Reporting Agencies (PRA Principles) and Principles for Financial Benchmarks provide a framework for price reporting agencies and financial benchmark administrators to address methodology, governance, conflicts of interest, and disclosure. Many price reporting agencies and financial benchmark administrators have already begun voluntarily complying with these standards.

I hope that we can continue to work with our international counterparts to ensure benchmark integrity in a way that recognizes that most benchmarks are not administered by, or regulated by, a government agency.

Continuing to Fulfill our Traditional Responsibilities

In addition to our new responsibilities to oversee the swaps market, we are equally focused on the markets that have been traditionally our responsibility, the futures and options markets. And on a day to day basis, a lot of what we do is to focus on surveillance and enforcement to prevent fraud and manipulation or other market abuses. Our compliance, examinations and registration work also makes sure that customers are protected, participants comply with their obligations and the markets operate with integrity and transparency. Let me highlight some key elements of these efforts.

- Enforcement and Compliance

A robust compliance and enforcement program is crucial to maintaining the integrity of our markets, as well as public confidence. As a nominee, I committed to maintaining our focus in this area. And we have.

In particular, our priority has been to make sure that the markets we oversee operate fairly for all market participants regardless of size or sophistication. Fraud, manipulation, and abuse should have no place in our financial markets.

We took action against some of the largest banks in the world for attempted manipulation of foreign exchange rate benchmarks. Our investigation revealed that they attempted to manipulate one of the largest markets in the world. We ordered the banks to pay almost $1.5 billion in penalties and to agree to implement reforms designed to prevent the recurrence of this behavior.

This is an important case that was the product of close cooperation with foreign regulators. Benchmarks such as these are extremely important to our futures and swaps markets and to the financial system generally. And the system only works if market participants have confidence that benchmarks are not being manipulated. Our action in these cases exemplifies the CFTC's commitment to the robust enforcement necessary to safeguard the integrity of our markets.

So does our successful litigation against Parnon Energy and Arcadia, two energy companies that systematically manipulated crude oil markets to realize illicit profits. Through the outstanding work of CFTC enforcement staff, the CFTC sends the message that the protection of customers and the integrity of the markets are paramount.

We are also actively pursuing actions against those who try to perpetrate frauds against seniors and other retail investors. The use of our anti-manipulation enforcement authority to address fraud in the precious metals space is one example. These schemes, which often target seniors concerned that they may outlive their retirement assets, purport to offer consumers the ability to buy precious metals like gold using pre-arranged financing. These transactions are typically not conducted on an exchange. They are typically structured so that, taking account of fees and interest, the precious metals would have to double in value year after year in order for the investor to make any money. Even worse, in many cases, the transactions are entirely fraudulent: no precious metals are ever bought. In 2014, the Commission tried and won a case against Hunter-Wise, a Florida company that was a trailblazer in the use of this scheme. In addition to Hunter Wise, we have also taken action to shut down a host of boiler room operations used to identify and recruit potential victims. Our work is ongoing. Just last month, we announced a settlement resulting in restitution and civil monetary penalty of more than $9.6 million against Gold Coast Bullion, Inc. and its principal.

Dodd-Frank provided the Commission with a number of new statutory tools to combat manipulation and practices that can distort the markets, and we are using them. We have new authority, for example, to attack "spoofing," where a party enters a bid or offer without the intent to consummate a transaction; unscrupulous speculators do this to create the false impression of liquidity in a particular product or to move the market price. We brought a civil action using this new authority against a firm and its principal for spoofing in 2013, one of the first such cases, and last October, the U.S. Attorney for Illinois indicted the principal for spoofing, based on a referral from us.

We have also directed self-regulatory organizations to strengthen their efforts to combat spoofing. The CFTC recently recommended, for example, that CME develop strategies to identify instances of spoofing and, as appropriate, pursue actions against perpetrators. The CFTC also recommended that CME maintain sufficient enforcement staff to promptly prosecute possible rule violations. The company should take measures to ensure internal deliberations do not delay disciplinary action.

In all of our efforts, we will also seek to hold not just firms, but also individuals, accountable. We are mindful that there is no stronger deterrent against future misconduct than the possibility of criminal sanctions, including prison. We do not have the authority to bring criminal actions, so in cases involving willful violations of the CEA, we work closely with the Department of Justice and other criminal authorities. The perpetrators who threaten the financial well-being of innocent participants in our markets need to understand that the loss of their own liberty is at stake.

We are equally focused on using our authority to ensure compliance with our rules, such as our reporting rules. Earlier this year, for example, we imposed penalties against a major bank for failing to abide by our reporting requirements.

Although our effectiveness is best measured by the quality, breadth and effect of the actions pursued, quantitative metrics give a picture of the activity. Overall, the CFTC filed 67 new enforcement actions during fiscal year 2014. We opened more than 240 new investigations. The agency obtained $3.27 billion in sanctions, including $1.8 billion in civil monetary penalties and more than $1.4 billion in restitution and disgorgement. This amount of civil monetary penalties is more than 8 times our current annual budget.

As a complement to these efforts, we have also taken steps to encourage individuals to help us detect fraud and other misconduct. The agency's whistleblower program, created by the Dodd-Frank Act is one example. The program provides payments — up to 30 percent of any sanction obtained — to eligible whistleblowers. This is a relatively new program so we are still growing it. Already though, we are receiving relevant tips, complaints, and referrals. We believe the program will be an important tool going forward in identifying, investigating, and prosecuting violations of the law.

We are also working to help consumers be smarter investors and detect fraudulent schemes on their own. At the end of last year, we launched the CFTC *SmartCheck* campaign. This campaign is designed to help investors identify and recognize the most common schemes and the top signs of a fraudulent investment. The campaign includes tools, such as an interactive website, to help investors stay ahead of the fraud perpetrators. For example, investors can use the website to check the background of financial professionals and confirm whether any potential advisors have had past violations.

Going forward, market participants should understand that we will use all the tools at our disposal to ensure compliance with the law.

- Responding to Market Developments

Another example of the importance of the CFTC's role is what happened last month when the Swiss government removed the cap on the exchange rate between the Swiss franc and the Euro. The resulting 23% increase in the value of the Swiss franc roiled the foreign exchange markets. The CFTC closely monitored the markets and several firms in particular that were facing significant losses.

For cleared products affected by this development, CFTC staff immediately started conducting stress tests of open positions, and staff contacted registered clearinghouses as well as clearing members with large exposures. Despite the extreme price moves, all clearing members met their obligations to clearinghouses.

For uncleared products, after the CFTC learned that one firm, FXCM, had a significant capital deficiency, CFTC staff were on site at the firm and also worked closely with staff from the National Futures Association (NFA). Although it is not the agency's responsibility to help a troubled firm secure capital, the CFTC was in touch with FXCM continuously through the night and the next day concerning what actions the firm might take to stabilize its situation and meet CFTC capital requirements. The CFTC monitored the firm's efforts to obtain capital to insure that any capital proposed would meet CFTC requirements and cover customer obligations. The CFTC and the NFA also made sure the firm did not make any disbursements to the detriment of customers during this time. The CFTC also prepared for the necessary legal actions to protect customers to the fullest extent possible in the event the firm was unable to secure additional capital. The firm was able to obtain a capital infusion that satisfied CFTC requirements and thereby stay in business.

Addressing New Challenges and Risks

Finally, I wish to discuss our work in addressing some new challenges and risks in our markets.

- Cybersecurity, Information Security, and Business Continuity

Cybersecurity is perhaps the single most important new risk to market integrity and financial stability. The need to protect our financial markets against cyber attacks is clear. These attacks threaten privacy, information security, and business continuity, all vital elements of a well-working market. We are focusing on this issue in our examinations of clearinghouses and exchanges in particular to make sure they are doing all they can to address this risk. We are also focusing on business continuity and disaster recovery plans, as a well-executed disaster recovery plan will aid in the recovery from a cybersecurity event.

The risk is apparent. The examples from within and outside the financial sector are all too frequent and familiar: the latest include JP Morgan, Sony, Home Depot, and Target. Some of our nation's exchanges have also been targeted or suffered technological problems that caused outages or serious concerns. And again, because of the interconnectedness of financial institutions and market participants, an attack at one institution can have significant repercussions throughout the system. In the Target attack, the intruder gained access to the Target systems by stealing credentials from a vendor used by Target. The perpetrator was able to locate information about Target's customers and steal their credit card information. A similar type of attack — known as phishing — is reported to have been used in the recent breach at Sony. This type of attack launched at an exchange or clearinghouse has the potential to have a significant impact on the operation of the venue and those entities that use its services.

We at the CFTC have responded in a number of ways:

- First, our Core Principles have been modernized in recent years to address cyber and information security concerns. We have adopted regulations to implement the system safeguards core principles for exchanges, clearinghouses, and SEFs, and we are looking at ways to further strengthen and enhance the requirements for information security.

- We require exchanges, clearinghouses, and SEFs to maintain system safeguards and a risk management program, to notify the Commission promptly of incidents, and to have recovery procedures in place. Systemically important clearinghouses, for example, must have plans that enable them to recover and resume daily processing, clearing and settlement activities no later than two hours following a disruption. They must also maintain geographic dispersal of personnel resources to aid in recovery efforts following a disruption.

- We conduct system safeguards examinations, using industry best practices, to determine compliance with these requirements, and we monitor remediation efforts if any issues are identified during the examination process.

There is much more we would like to do in this area. However, our capacity to carry out more frequent examinations and to address cybersecurity more broadly is significantly constrained by our current budget. Some of our major financial institutions are reportedly spending more on cybersecurity each year than our agency's entire budget.

- <u>High Frequency and Automated Trading</u>

Markets are dynamic, and the agency must keep pace to oversee the markets effectively. Technology in particular is an important driver, and we have witnessed over the last several years a dramatic increase in automated trading. Keeping up with these developments has meant investing in the appropriate resources, a challenge given the agency's budget constraints. It has also meant reviewing our rules based on changes in market technology. For example, in April 2012, the Commission adopted rules that require certain registrants to automatically screen orders for compliance with risk limits if they are automatically executed. The Commission also adopted rules to ensure that trading programs, such as algorithms, are regularly tested.

In addition to its current rules, the Commission is currently considering comments received in response to its Concept Release on Risk Controls and System Safeguards for Automated Trading Environments. The Concept Release addresses the evolution from human-centered to automated trading environments. It seeks input on a range of protections, including additional pre-trade risk controls; post-trade reports; design, testing, and supervision standards for automated trading systems that generate orders for entry into automated markets; market structure initiatives; and other measures designed to reduce risk or improve the functioning of automated markets. We are still working through comments and will make a determination on what additional measures, if any, might be necessary to address automated trading.

- Virtual Currencies

We also continue to respond to market developments such as new products. Virtual currencies, such as bitcoin, are an example. Virtual currencies may raise issues for a number of governmental agencies. The CFTC's jurisdiction with respect to virtual currencies will depend on the facts and circumstances pertaining to any particular activity in question. While the CFTC does not have policies and procedures specific to virtual currencies like bitcoin, the agency's authority extends to futures and swaps contracts in any commodity. The CEA defines the term commodity very broadly so that in addition to traditional agricultural commodities, metals, and energy, the CFTC has oversight of derivatives contracts related to Treasury securities, interest rate indices, stock market indices, currencies, electricity, and heating degree days, to name just a few underlying products.

Innovation is a vital part of our markets, and it is something that our regulatory framework is designed to encourage. At the same time, our regulatory framework is intended to prevent manipulation and fraud, and to make sure our markets operate with transparency and integrity. Derivative contracts based on a virtual currency represent one area within our responsibility. Recently, for example, a SEF and a designated contract market listed contracts based on bitcoins. It is important to emphasize that the existence of a contract does not mean the CFTC endorses use of the commodity on which the contract is based and, as with all new developments, we must remain vigilant to ensure market integrity by closely evaluating new contracts and related market practices, over time. We will also continue to coordinate with other regulatory authorities regarding the issues raised by virtual currencies as appropriate.

Retrospective Regulatory Review

Concurrent with our other work, we are engaged in a retrospective regulatory review. In response to Executive Order 13563, the CFTC developed a two-step program of retrospective review, which was announced in the Federal Register on June 30, 2011. First, as part of its implementation of financial reform under Dodd-Frank, the Commission reviewed many of its regulations to determine the extent to which these regulations needed to be modified to conform to the Dodd-Frank Act. This review resulted in modifications to a number of existing rules, both to implement regulatory changes mandated by the Dodd-Frank Act and more generally to update and modernize those rules. For example, the CFTC made a number of changes to reflect market developments and to codify standard or commonly-accepted industry practices.

We have now begun step two of our review during which we will consider the remainder of CFTC regulations. As part of this process, the Commission will solicit public comment to determine which rules may need to be modified or rescinded. Following this review, we will follow up with rulemaking proposals as necessary.

Resources and Budget

Advancing the goals I have outlined and fully implementing the new regulatory framework depends on having resources that are proportionate to our responsibilities. The CFTC did receive a budget increase for FY 2015 for which we are very grateful. It will be put to good use. But in my view, the CFTC's current budget still falls short. The CFTC does not have the resources to fulfill our new responsibilities as well as all the responsibilities it had — and still has — prior to the passage of Dodd Frank in a way that most Americans would expect. Our staff, for example, is no larger than it was when Dodd-Frank was enacted in 2010.

We are fortunate to have a talented and dedicated professional staff, and we keep Teddy Roosevelt's adage in mind — to do all we can, with what we have, where we are. But the limits of our current budget are evident.

Specifically, in the absence of additional resources, the CFTC will be limited in its ability to:

- Review and approve in a timely manner the many new registration applications we face from over 100 swap dealers and over 20 swap execution facilities, as well as from derivatives clearing organizations, designated contract markets, foreign boards of trade, and other market participants.

- Perform thorough examinations of critical infrastructure such as clearinghouses and exchanges, which are so important to our financial system and to financial stability.

- Engage proactively on emerging risks like cybersecurity. The CFTC needs resources to conduct compliance examinations of cybersecurity programs of regulated entities, help develop best practices, and respond when attacks occur.

- Respond in a timely and thorough manner to requests from registered entities and other market participants for clarification or interpretation of the CEA and CFTC regulations or requests for exemption or no-action relief; rule and product submissions filed by exchanges, clearinghouses, and other registered entities; and submissions for clearing and trading mandates. Delays can have an adverse effect on efficiency, customer protection, and financial stability, as well as liquidity and innovation.

- Maintain and improve information technology systems and resources that are vital to its mission, including in particular our ability to receive, store and analyze vast new quantities of data related to the swaps market. Handling massive amounts of swaps data and effective market oversight both depend on the agency having up-to-date technology resources, and the staff — including analysts and economists, as well as IT and data management professionals. Today's financial markets are driven by sophisticated use of technology, and the CFTC cannot effectively oversee these markets unless we can keep up.

- Engage in the necessary level of market surveillance and oversight to detect excessive risk, fraud, manipulation or other abusive practices, which requires increasingly sophisticated tools and the ability to analyze massive amounts of data given the technological advances in the markets.

- Engage in the necessary level of risk surveillance and oversight to ensure the financial integrity of the clearing and settlement process and to protect customers in the event of a clearinghouse or clearing member default.

- Engage in robust enforcement efforts with respect to fraud, manipulation, abusive or disruptive practices, or other threats to market integrity and customer protection.

Simply stated, without additional resources, our markets cannot be as well supervised; participants and their customers cannot be as well protected; market transparency and efficiency cannot be as fully achieved.

Conclusion

We have made substantial progress in recovering from the worst financial crisis since the Great Depression, but there is much work yet to accomplish.

The United States has the best financial markets in the world. They are the strongest, most dynamic, most innovative, and most competitive — in large part because they have the integrity and transparency that attracts participants. They have been a significant engine of our economic growth and prosperity. The CFTC is committed to doing all we can to strengthen our markets and enhance those qualities.

Thank you again for inviting me today. I look forward to your questions.