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BEFORE THE

U.S. SENATE COMMITTEE ON AGRICULTURE, NUTRITION & FORESTRY

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Good morning Chairwoman Stabenow, Ranking Member Roberts and members of the Committee. I thank you for inviting me to today's hearing on implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. I am pleased to testify on behalf of the Commodity Futures Trading Commission (CFTC). I also thank my fellow Commissioners and CFTC staff for their hard work and commitment on implementing the legislation.

I am pleased to testify alongside Michael Gibson from the Federal Reserve.

Financial Crisis

It has been nearly one year since the President signed the Dodd-Frank Act into law. It is important to remember why the Dodd-Frank Act's derivatives reforms are necessary.

The 2008 financial crisis occurred because the financial system failed the American public. The financial regulatory system failed as well. When AIG and Lehman Brothers faltered, we all paid the price. The effects of the crisis remain, and there continues to be significant uncertainty in the economy.

Though the crisis had many causes, it is clear that the swaps market played a central role. Swaps added leverage to the financial system with more risk being backed up by less capital. They contributed, particularly through credit default swaps, to the bubble in the housing market and helped to accelerate the financial crisis. They contributed to a system where large financial institutions were thought to be not only too big to fail, but too interconnected to fail. Swaps – initially developed to help manage and lower risk – actually concentrated and heightened risk in the economy and to the public.

Derivatives Markets

Each part of our nation's economy relies on a well-functioning derivatives marketplace. The derivatives market – including both the historically regulated futures market and the heretofore unregulated swaps market – is essential so that producers, merchants and other end-users can manage their risks and lock in prices for the future. Derivatives help these entities focus on what they know best – innovation, investment and producing goods and services – while finding others in a marketplace willing to bear the uncertain risks of changes in prices or rates.

With notional values of more than $300 trillion in the United States – that's more than $20 of swaps for every dollar of goods and services produced in the U.S. economy – derivatives markets must work for the benefit of the American public. Members of the public keep their savings with banks and pension funds that use swaps to manage their interest rate risks. The public buys gasoline and groceries from companies that rely upon futures and swaps to hedge their commodity price risks.

That's why oversight must ensure that these markets function with integrity, transparency, openness and competition, free from fraud, manipulation and other abuses. Though the CFTC is not a price-setting agency, recent volatility in prices for basic commodities – agricultural and energy – are very real reminders of the need for common sense rules in the derivatives markets.

The Dodd-Frank Act

To address changes in the derivatives markets as well as the real weaknesses in swaps market oversight exposed by the financial crisis, the CFTC is working to implement the Dodd-Frank Act's derivatives oversight reforms.

Broadening the Scope

Foremost, the Dodd-Frank Act broadened the scope of oversight. The CFTC and the Securities and Exchange Commission (SEC) will, for the first time, have oversight of the swaps and security-based swaps markets.

The Dodd-Frank Act also broadened the CFTC’s oversight to include authority to register foreign boards of trade (FBOTs) providing direct access to U.S. traders. To become registered, FBOTs must be subject to regulatory oversight that is comprehensive and comparable to U.S. oversight. This new authority enhances the Commission's ability to ensure that U.S. traders cannot avoid essential market protections by trading contracts traded on FBOTs that are linked with U.S. contracts.

Promoting Transparency

Importantly, the Dodd-Frank Act brings transparency to the derivatives marketplace. Economists and policymakers for decades have recognized that market transparency benefits the public.

The more transparent a marketplace is, the more liquid it is, the more competitive it is and the lower the costs for hedgers, borrowers and their customers.

The Dodd-Frank Act brings transparency in each of the three phases of a transaction.

First, it brings pre-trade transparency by requiring standardized swaps – those that are cleared, made available for trading and not blocks – to be traded on exchanges or swap execution facilities.

Second, it brings real-time post-trade transparency to the swaps markets. This provides all market participants with important pricing information as they consider their investments and whether to lower their risk through similar transactions.

Third, it brings transparency to swaps over the lifetime of the contracts. If the contract is cleared, the clearinghouse will be required to publicly disclose the pricing of the swap. If the contract is bilateral, swap dealers will be required to share mid-market pricing with their counterparties.

The Dodd-Frank Act also includes robust recordkeeping and reporting requirements for all swaps transactions so that regulators can have a window into the risks posed in the system and can police the markets for fraud, manipulation and other abuses.

Lowering Risk

Other key reforms of the Dodd-Frank Act will lower risk posed by the swaps marketplace to the overall economy by directly regulating dealers for their swaps activities and by moving standardized swaps into central clearing.

Oversight of swap dealers, including capital and margin requirements, business conduct standards and recordkeeping and reporting requirements will reduce the risk posed to the economy by these dealers.

The Dodd-Frank Act's clearing requirement directly lowers interconnectedness in the swaps markets by requiring standardized swaps between financial institutions to be brought to central clearing.

Enforcement

Effective regulation requires an effective enforcement program. The Dodd-Frank Act enhances the Commission's enforcement authorities in the futures markets and expands them to the swaps markets. The Act also provides the Commission with important new anti-fraud and anti-manipulation authority based upon similar authority that the SEC, Federal Energy Regulatory Commission and Federal Trade Commission have for securities and certain energy commodities.

By expanding the CFTC's arsenal of enforcement tools, the Act strengthens the ability of the Commission to effectively deal with threats to market integrity. We will use these tools to be a more effective cop on the beat, to promote market integrity and to protect market participants.

Position Limits

Another critical reform of the Dodd-Frank Act relates to position limits. Position limits have served since the Commodity Exchange Act passed in 1936 as a tool to curb or prevent excessive speculation that may burden interstate commerce.

In the Dodd-Frank Act, Congress mandated that the CFTC set aggregate position limits for certain physical commodity derivatives across the derivatives markets. The Dodd-Frank Act broadened the CFTC's position limits authority to include aggregate position limits on certain swaps and certain linked contracts traded on foreign boards of trade in addition to U.S. futures and options on futures. Congress also narrowed the exemptions traditionally available from position limits by modifying the definition of bona fide hedge transaction.

When the CFTC set position limits in the past, the agency sought to ensure that the markets were made up of a broad group of market participants with a diversity of views. Integrity is enhanced when participation is broad and the market is not overly concentrated.

Rule-Writing Process

The CFTC is working deliberatively, efficiently and transparently to write rules to implement the Dodd-Frank Act. At this point, we have substantially completed the proposal phase of our rule-writing.

The public had an opportunity to comment on the entire mosaic of proposed rules in a supplemental comment period of 30 days, which closed last Friday, June 3.

We will begin considering final rules only after staff can analyze, summarize and consider comments, after the Commissioners are able to discuss the comments and provide feedback to staff, and after the Commission consults with fellow regulators on the rules.

The Commission yesterday scheduled public meetings in July and August to begin considering final rules under Dodd-Frank. We envision having more meetings in September and into the fall to take up final rules.

The Dodd-Frank Act has a deadline of 360 days after enactment for completion of the bulk of our rulemakings – July 16, 2011. The Commission had a public meeting yesterday to address issues related to the transition period between July 16 and the effective dates of CFTC rulemakings. The Dodd-Frank Act and the Commodity Exchange Act (CEA) give the CFTC the flexibility and authority to address the issues relating to the effective dates of Title VII. We are coordinating closely with the SEC on these issues.

The Dodd-Frank Act made many significant changes to the CEA. Section 754 of the Dodd-Frank Act states that Subtitle A of Title VII – the Subtitle that provides for the regulation of swaps – "shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provisions of this subtitle."

Thus, those provisions that require rulemakings will not go into effect until the CFTC finalizes the respective rules. Furthermore, they will only go into effect based on the phased implementation dates included in the final rules. During yesterday's public Commission meeting, the CFTC released a list of the provisions of the swaps subtitle that require rulemakings.

Unless otherwise provided, those provisions of Title VII that do not require rulemaking will take effect on July 16. The Commission voted to issue a proposed order that would provide relief until December 31, 2011, or when the definitional rulemakings become effective, whichever is sooner, from certain provisions that would otherwise apply to swaps or swap dealers on July 16. This includes provisions that do not directly rely on a rule to be promulgated, but do refer to terms that must be further defined by the CFTC and SEC, such as “swap” and “swap dealer.”

The order proposed by the Commission also would provide relief through no later than December 31, 2011, from certain CEA requirements that may result from the repeal, effective on July 16, 2011, of some of sections 2(d), 2(e), 2(g), 2(h) and 5d.

The proposed order will be open for public comment for 14 days after it is published in the Federal Register. We intend to finalize an order regarding relief from the relevant Dodd-Frank provisions before July 16, 2011.

Phasing of Implementation

The Dodd-Frank Act gives the CFTC and SEC certain flexibility to set effective dates and a schedule for compliance with rules implementing Title VII of the Act. The order in which the Commission finalizes the rules does not determine the order of the rules’ effective dates or applicable compliance dates. Phasing the effective dates of the Act’s provisions will give market participants time to develop policies, procedures, systems and infrastructure needed to comply with the new regulatory requirements. It will lower risk and costs of compliance.

In early May 2011, CFTC and SEC staff held a roundtable to hear directly from the public about the timing of implementation dates of Dodd-Frank rulemakings. Prior to the roundtable, on April 29, CFTC staff released a document that set forth concepts that the Commission may consider with regard to the effective dates of final rules for swaps under the Dodd-Frank Act. We also opened a public comment file last month that closed on Friday, June 10, to hear specifically on this issue. The roundtable and 291 public comment letters help inform the Commission as to what requirements can be met sooner and which ones will take a bit more time.

One concept that the CFTC is considering with regard to phasing of effective dates is phasing in effective dates over time rather than all at once. Those rules that could be implemented sooner should be so as to lower risk.

A second is that we are looking at whether there are certain requirements that should be met soon than others. For market infrastructures, such as clearinghouses, trading platforms and data repositories, for example, registration with the Commission and development of new policies, procedures and rulebooks should be completed before compliance with those policies, procedures and rulebooks by market participants could be required. More specifically, clearinghouses, for example, may be required to be registered and provide for client clearing at an effective date in advance of any determinations of clearing mandates.

Conclusion

Only with reform can the public get the benefit of transparent, open and competitive swaps markets. Only with reform can we reduce risk in the swaps market – risk that contributed to the 2008 financial crisis. Only with reform can users of derivatives and the broader public be ensured of market integrity in the futures and swaps markets.

The CFTC must be adequately resourced to police the markets and protect the public. The CFTC is taking on a significantly expanded scope and mission. By way of analogy, it is as if the agency previously had the role to oversee the markets in the state of Louisiana and was just mandated by Congress to extend oversight to Alabama, Kentucky, Mississippi, Missouri, Oklahoma, South Carolina, and Tennessee.

With seven times the population to police, far greater resources are needed for the public to be protected. Without sufficient funding for the agency, our nation cannot be assured of effective enforcement of new rules in the swaps market to promote transparency, lower risk and protect against another crisis. It would hamper our ability to seek out fraud, manipulation and other abuses at a time when commodity prices are rising and volatile.

Until the CFTC completes its rule-writing process and implements and enforces those new rules, the public remains unprotected.

Thank you, and I'd be happy to take questions.