Testimony of Chairman Timothy Massad before the U.S. Senate Committee on Agriculture, Nutrition & Forestry

Washington, DC

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Thank you Chairwoman Stabenow, Ranking Member Cochran, and members of the Committee. I am pleased to testify before you today on behalf of the Commission. I last came before you as a nominee. It is a privilege to be here today as Chairman of the Commodity Futures Trading Commission (CFTC). I appreciate the opportunities I have had to meet with many of you during the confirmation process and since, and value your suggestions on the issues facing the Commission. I look forward to this Committee's continued input going forward.

The CFTC is tasked with oversight of the futures, options, and swaps markets. These are highly complex, global markets that most Americans do not participate in. But these markets are profoundly important to the daily lives of all Americans. They impact the prices we all pay for food, energy and many other goods and services.

The derivatives markets enable businesses of all types to manage risk—whether it is a farmer locking in a price for his crops, the utility managing its fuel cost, or the exporter hedging foreign exchange risk. For these markets to work well, good regulation is essential. That is why the Commission's job is so important. We must do all we can to prevent fraud and manipulation in these markets, to make sure these markets operate with integrity and transparency, and to help them thrive. I am committed to working with this Committee and Congress to make sure our financial markets continue to be innovative, dynamic, and an engine for economic growth.

Today, I would like to review what we have done over the last six months since I, as well as two of the other three Commissioners, took office. It has been a busy and productive time for us. In particular, I will discuss our progress in bringing the over-the-counter swaps market out of the shadows. I will also discuss our work to make sure our rules do not pose undue burdens or unintended consequences for the commercial businesses that rely on these markets. Finally, I will discuss some key priorities.

I want to note that, although much of what I will discuss concerns implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank"), and the new regulatory framework for swaps, we are equally focused on our traditional areas of responsibility, the futures and options markets. On a day to day basis, a lot of what we do is to focus on the registrations, examinations, rule reviews, product monitoring, and surveillance of these markets to make sure they operate with integrity. While these markets cover many diverse commodities, they had their origins in agricultural products which remain very important to our work. In this regard, just yesterday 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.

Our advisory committees are very important. Commissioner Wetjen recently held a very informative meeting of our Global Markets Advisory Committee, which focuses on matters that affect the integrity and competitiveness of U.S. markets and U.S. firms engaged in global business, and makes recommendations for appropriate international standards for regulating futures, swaps, options, and derivatives markets, as well as intermediaries. He will also be convening a meeting of our Technology Advisory Committee in the coming months. 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. And, Commissioner Bowen, who is sponsoring our new Market Risk Advisory Committee, has requested public comment on its agenda and membership. This committee helps the Commission identify and understand the impact of an evolving market structures and movement of risk across clearinghouses, exchanges, intermediaries, market makers, and end-users.

Before I discuss implementation of reforms, I would like to highlight one item: our recent enforcement action regarding attempted manipulation of foreign exchange rate benchmarks by some of the largest banks in the world. 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. As we saw with the investigation and fines in the Libor cases, 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. These actions exemplify the CFTC's commitment—and my commitment—to the robust enforcement necessary to safeguard the integrity of our markets. I will further discuss these efforts later in my testimony.

Implementing the New Regulatory Framework

Let me turn now to our efforts to implement financial reform. The financial crisis that began over six years ago stands as the worst since the Great Depression. We must never forget its cost in terms of jobs lost, homes foreclosed and other damage to our economy and to American families. It was during the financial crisis that most Americans first heard about derivatives. That was because over the counter swaps accelerated and intensified the crisis like gasoline poured on a fire. In the absence of regulatory oversight, a global market had developed and some participants took on excessive risk. A bilateral market structure hid the magnitude of these exposures. Because of the interconnectedness among swaps participants, risk associated with one participant's troubles 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 known as central counterparties (or CCPs), 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.

I want to thank the hardworking, professional staff of the CFTC for their work in each of these four areas. We would not be where we are today without their tireless efforts.

- 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 for most interest rate and credit default swaps. Recent data show our progress. About 70% of the transactions in the markets we regulate, measured by notional amount, are being cleared today, compared to about 15% in December 2007.

The CFTC was the first of the G-20 nations' regulators to implement clearing mandates. In doing so, the CFTC has acted in accordance with the Congressional direction and specifically exempted from those mandates most commercial end-users, non-financial companies such as manufacturers or farmers who are using the markets to hedge.

Of course, central clearing is not a panacea. Clearing does not eliminate the risk that a counterparty to a trade will default—but it provides us with powerful tools to monitor and mitigate that risk, and, through the use of mutualized default resources, significantly mitigates the effect of any such default on market participants. To work well, active, ongoing oversight is critical. We must do all we can to ensure that clearinghouses have the financial resources, risk management systems, settlement procedures, and all the necessary standards and safeguards consistent with the Commodity Exchange Act's (CEA) core principles and applicable international standards to operate in a fair, transparent, and efficient manner.

- 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.

We have worked with the SEC, other US regulators, and our international counterparts to establish this framework.

- 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 going on in the marketplace to achieve greater transparency and to address the potential systemic risk. A key commitment in Dodd-Frank is ongoing reporting of swap activity. In 2008 regulators and Congress were essentially blind to the size and the risks in this market. Under our rules, all swap transactions, whether cleared or uncleared, must now be reported to registered swap data repositories (SDRs), a new type of entity responsible to collect and maintain this vital information.

There are currently four SDRs that are provisionally registered with the CFTC. The collection and public dissemination of swap data by SDRs helps regulators and the public. It provides regulators with information that can facilitate informed oversight and surveillance of the market and implementation of our statutory responsibilities. Dissemination, especially in real-time, also provides the public with information that can contribute to price discovery, competition and market efficiency. You can now go to public websites and see the price and volume of swap transactions. Further, the CFTC publishes the Weekly Swaps Report that gives the public a snapshot of the swaps market.

- Transparent trading of swaps transactions on regulated platforms.

The Dodd-Frank Act also requires transparent trading of swaps. Congress mandated that certain swaps must be traded on a swap execution facility (SEF) or other regulated exchange. The trading requirement was designed to 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 the same 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 began in October of last year. As of February 2014, specified interest rate swaps and credit default swaps must be traded on a SEF or other regulated exchange. Through the summer, notional value executed on SEFs was generally in excess of $1.5 trillion weekly. Publicly available data show trading volumes are continuing to increase. In addition, the number of market participants using SEFs is increasing. One SEF recently confirmed that it had exceeded 700 firms as participants.

In all these areas, however, there is more work to do. Our rules are new. We are still phasing in some requirements. As we gain experience with application of new rules in the marketplace, we will see what works well and what doesn't, and we will fine-tune the rules or make other changes as appropriate. And there is substantial work to be done to harmonize rules across national borders.

I believe the Commission today is focused on moving forward. It is comprised of four commissioners all of whom are dedicated to implementing the Dodd-Frank reforms, and all of whom bring good experience and judgment to the table. We are also focused on process. We have already had two open meetings. We are listening to market participants. 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. I am committed to continuing in that spirit as well. We will not always agree, but I believe we are working together in good faith to assess what is working and what needs fine tuning, and to do the best job we can in implementing the law.

There may still be those who say that the basic principles of these reforms are misguided, and would repeal these reforms and return us to the days where the industry operated with little oversight. To those who hold that view, I think the history of the securities and futures markets is a useful guide.

In the 1930s, we created a framework for securities regulation and trading, which proved tremendously successful. Many of its mandates were revolutionary, and at the time, many felt those requirements would be the death knell of capitalism. When Congress passed the Securities Exchange Act, which required public reporting by listed companies, the President of the New York Stock Exchange said it was "a menace to national recovery." History has proved otherwise. Today, the public reporting and basic trading requirements of our securities laws are about as controversial as seat belts. Indeed, they have been the foundation for the growth of our securities markets.

The history of the futures market is no different. Congress created a framework for the regulation of the industry, which properly balanced the need to embrace innovation with strong oversight. We have the strongest, largest and most dynamic markets in the world—in part because they have the integrity and transparency that attracts participants.

With this in mind, our challenge is to ensure that we create a regulatory framework that not only meets the Congressional mandate of bringing the swaps market out of the shadows, but also allows our financial markets to thrive. The regulatory framework must ensure transparency, integrity and oversight, and, at the same time, permit innovation, freedom and competition.

<u>Priorities Going Forward: Making Financial Reform Work for End-Users</u>

Let me turn now to one of the ways the Commission is meeting that challenge. For the last six months, we have made it a priority to address some of the concerns of commercial end-users—such as manufacturers, farmers, ranchers, and other businesses that rely on these markets to hedge commercial risks. 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.

<u>Local Utility Companies</u>. In September, the Commission amended its rules so that local, publicly-owned utility companies could continue to effectively hedge their risks in the energy swap 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.

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 largely tracks staff-issued no-action relief and 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. These types of contracts 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 has recently taken 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 separate affiliates that enter into swaps and other financing transactions on behalf of the larger corporation and its subsidiaries. We have taken action to clarify how our rules will be applied to make sure that such companies can utilize the end user exemption.

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 to December 31, 2015.

Reporting Requirements for Contracts in Illiquid Markets. We 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 and the FCA on a regular basis. We are examining the actions that LME is taking to address aluminum market conditions as well as what other actions could be taken.

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 recently 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. These are not major changes, but significant to the overall success of the new regulatory framework.

Finalizing the Remaining Rules

The CFTC has 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, working in close cooperation with the banking regulators. While central clearing is a key mandate of the Dodd-Frank Act, uncleared, bilateral swap transactions will continue to be an important part of the derivatives market. This is so for a variety of reasons. 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. So, 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 end-users from the margin requirements applicable to swap dealers and major swap participants. In addition, because Congress mandated that margin requirements be set by different regulatory agencies for the respective entities under their jurisdiction, we worked closely with the relevant bank regulators so that our respective margin rules will be substantially the same. 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.

The capital rule and position limits rule are two others that we are working on. We have proposed rules issued in both cases. 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, and staff is still currently reviewing those comments. We also held a meeting of the Agriculture Advisory Committee yesterday, December 9, and discussed position limits—in particular the parts of the proposal applicable to deliverable supply (as that pertains to agricultural commodities). Accordingly, we reopened the comment period for the CFTC's Position Limit Proposal and Aggregation Proposal with respect to such issues for an additional 45 days to allow public comment on what was discussed at that meeting. I expect this input to be very helpful in enabling us to write rules that can achieve the goals of reducing risk and improving the market without imposing unnecessary burdens or causing unintended consequences.

Commission staff will also be considering next steps on the capital rule as we move forward on the proposed rule on margin for uncleared swaps.

Cross-Border Issues: The Challenge of Regulating a Global Market

As we move forward, implementing the new regulatory framework, a key area is working with our international counterparts to build a strong global regulatory framework. To succeed in accomplishing 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. We know that what happens in London, Hong Kong and Tokyo can impact all of us here at home. We learned first-hand during the crisis how risks embedded in overseas derivatives transactions can flow back into the United States. We also know that differences in rules between jurisdictions can lead to changes in how business is conducted, given this market's mobility. I have been focused on cross-border issues since joining the Commission, including through three trips abroad and many meetings with international counterparts here.

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 significant regulation. We must regulate what is already a global market, but 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 observe our own nation's laws. I think we have made good progress in harmonization, but there is much more to do. It will take time.

The timing of implementation of reforms can be a critical issue. We wrote most of our rules faster than other jurisdictions and made many substituted compliance determinations last December. More will eventually follow. But you can't make substituted compliance determinations or meaningfully coordinate regulation until other jurisdictions have their rules in place. For example, while our clearing mandates for key products have been in place now for some time, many jurisdictions are still finalizing or implementing their clearing mandates. This creates the potential for regulatory arbitrage—individual market participants seeking opportunities to avoid regulation and oversight. With many jurisdictions now finalizing their clearing mandates, we expect more progress in this area. And, we will continue to consider the cross-border implications of clearing mandates for additional products.

One of the most important cross-border issues that has been before the Commission over the last several months is clearinghouse recognition and regulation. This is an issue that transcends swaps. It is of equal concern to participants in the futures and options markets.

As you may know, the Europeans have not yet recognized our central clearinghouses as equivalent. Their law, EMIR, requires not only that our rules governing our clearinghouses meet international standards—which they do—but also that our laws have an effective equivalent system of recognition for clearinghouses located in Europe. A few days after I was sworn in, I attended a meeting overseas at which the European Commission announced its intention to recognize the clearinghouses in five jurisdictions—Australia, Hong Kong, Singapore, Japan and India—but not the United States. They said it was because they believed that "effective equivalent system of recognition" meant that the U.S. should not require registration of clearinghouses outside of the U.S. that wish to do clearing for U.S. customers.

That initial position has led us to discuss the rules governing clearinghouses that are located in Europe, but are also registered with the CFTC. There are presently three such clearinghouses.

This dual registration came about because the U.S. did not mandate that clearing of futures—even 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 our standards. Those standards include provisions related to our bankruptcy laws. They provide protection of customer funds and facilitate quick transfers of customer accounts in the event of a failing firm.

We built our swap clearing mandates on this framework of dual registration in the context of a global market, where clearing for U.S. persons largely takes place overseas. It is noteworthy that, currently, fourteen clearinghouses are registered with the CFTC as derivatives clearing organizations (DCOs) either for swaps, futures, or both. Five of those are organized outside of the United States, including three in Europe, one of which has been registered since 2001.

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. In addition, I believe it is a good approach as a matter of public policy because major clearinghouses are extremely important in the global financial system today. A simple notion of deference—if the clearinghouse sits on foreign soil, then we defer to foreign regulation and supervision—is not sufficient.

We continue to be in dialogue with the Europeans to facilitate their recognition of our clearinghouses. We are making good progress. They have agreed that the framework of dual registration and cooperative supervision should not be dismantled. And we have agreed to consider changes that would further harmonize our rules with European rules governing these clearinghouses. This would in turn facilitate their recognition of our U.S. clearinghouses, as well as our exchanges, which they have also not yet recognized. In the meantime, I am pleased that the European Commission has decided to postpone the imposition of higher capital charges on banks clearing through U.S.-based central counterparties. This was due to take effect on December 15 in the event recognition had not been granted. It was this threat of higher capital charges that was going to fragment the market, not the existence of dual registration, which has actually been the foundation for the growth of the global market.

We are working on the cross-border aspects of other issues, including in some cases by trying to get the rules to be similar from the start. This is the case, for example, in the rules on margin for uncleared swaps. Europe, Japan and the United States have each proposed rules which are substantially similar, and which reflect a set of standards agreed to by a broader international consensus. There are, however, still issues in the details and in the timing of the implementation of the reforms, which are important.

Another cross-border issue that I am 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 LIBOR and the foreign exchange markets. We have also worked cooperatively and effectively with foreign regulators in these enforcement actions. We believe there should be standards for benchmarks that insure good administration and transparency and minimize the risk of manipulation.

The European Union (EU) has recently 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 recently published Principles for Oil Price Reporting Agencies (PRA Principles) provide a framework for price reporting agencies to address methodology, governance, conflicts of interest, and disclosure. Many price reporting agencies have already begun voluntarily complying with these standards. IOSCO is also doing work in the area of financial benchmark standards.

Because of the potential consequences on financial markets, the CFTC stands ready to work with its counterparts in the US financial regulatory sector to address this issue further. I hope that we can continue to work with our international counterparts to insure benchmark integrity in a way that recognizes that most benchmarks are not administered by a government agency.

Market data reporting and trading rules—each addressed in more detail below—are two additional areas where cross-border coordination is essential to achieve a well-working, global regulatory framework.

Market Data

Data is another vitally important area. Transparency was a cornerstone of the Dodd-Frank Act, and the establishment of swap data repositories in the U.S., and trade repositories abroad, is bringing unprecedented transparency to the swaps market. As I noted earlier, it is providing regulators with information that can facilitate informed oversight and surveillance of the market and implementation of our statutory responsibilities. Dissemination, especially in real-time, also provides the public with information that can contribute to price discovery and market efficiency.

Still, there is a considerable amount of work left to do to collect and use this data effectively. It is an enormous task that will take time. While harmonization with respect to data standards is a challenge, we are focused on it and committed to moving forward.

There are 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. Only in this way will it be possible to track the market and be in a position to address emerging issues. The proliferation of data repositories across various jurisdictions makes moving forward in this area more important than ever. We are leading an international harmonization effort to achieve consistent technical standards and identifiers for data in SDRs.

We must also make sure the SDRs collect, maintain, and publicly disseminate data in the 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 swap 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.

In short, the data collection issues will take time, but we are making progress. Going forward, it must continue to be one of our chief priorities.

Trading of Swaps on Regulated Platforms

With regard to swaps trading, there is also progress as well as work to be done. Increased trading on swap execution facilities provides greater price transparency, which can bring better pricing to market participants and better information to the public at large.

SEF trading is barely a year old, and our mandates requiring trading are only 10 months old. With platform-based trading of swaps still in its infancy, individual SEFs are still developing best practices under the new regulatory regime. The new technologies that SEF trading requires are likewise being refined. Establishing the new platforms, developing the new workflows, creating the administrative infrastructure, and testing and refining to make sure things work smoothly take time, effort, and resources.

While SEF volumes continue to grow and SEF trading continues to mature, we recognize that, ultimately, markets develop and thrive when private actors find it beneficial to transact on those markets. Therefore, we are looking at ways to make sure our rules help achieve that result.

I expect that we will look at several issues here involving execution methods and work flows, so that we strike the right balance between rules that achieve transparency, fairness and integrity while still allowing market innovation and competition. We are also looking to make sure we phase in requirements where appropriate so that we avoid unnecessary disruptions in the marketplace.

An example of this is how we have handled package transactions—that is, complex transactions that include both a swap that has been required to be traded on a SEF or designated contract market and some other swap or other product. Since SEF trading began earlier this year, we have been working with market participants to resolve questions about how the trading mandate applies in this circumstance.

At my direction, CFTC staff extended previous no-action relief to permit additional time for market participants to phase-in SEF trading of swaps executed as part of certain package transactions. This effort reflects the Commission's commitment to pragmatically implementing Dodd-Frank, while listening to market participants, and reviewing what rules work and what rules might require fine-tuning.

Such phasing of both rule implementation and compliance deadlines provides time for an orderly transition and gives market participants the necessary time to develop operational procedures and safeguards, and to transition smoothly to the new framework without creating unnecessary disruption or costs. It has been and should continue to be an important part of our approach.

We will also focus on the cross-border implications of trading rules. In this regard, the timing of the implementation of reforms has been critical. The Commission has implemented its trading mandate, but other jurisdictions have not. For example, Europe's trading mandate will not take effect until 2017. We will seek to harmonize our rules with those of other jurisdictions as much as possible. But more importantly, I believe we should focus on making sure our rules not only achieve the goals of transparency, but also help to create the kind of robust markets that the U.S. has long been known for and that attract participants from around the world.

Cybersecurity

We must also focus on cybersecurity, perhaps the single most important new risk to financial stability. Cybersecurity and business continuity generally are increasingly important aspects of our oversight for futures and swaps markets. The need to strengthen the security and resilience of our financial markets against cyber attacks is clear. We will be focused 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 will also focus on business continuity and disaster recovery plans as a well-executed disaster recovery plan will aid in the recovery of 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; Home Depot and Target. Some of our nation's exchanges have also been hit or suffered other technological problems that caused outages or serious concerns. And because of the interconnectedness of financial institutions and markets, a failure in one institution can have significant repercussions throughout the system. As was seen in the Target attack, the intruder gained access to the Target systems by stealing credentials from a vendor used by Target and the intruder was able to locate customer information and use credit card information. This type of attack launched at an exchange or clearinghouse has the potential to have a significant impact on the operational risks of an exchange or clearinghouse and those entities that use their services.

Our Core Principles have been modernized in recent years to address cyber and information security concerns. Our regulations have similarly been updated by adding more detailed standards addressing various aspects of cyber security.

We require clearinghouses, SEFs and designated contract markets (DCMs), and other market infrastructures to implement system safeguards, which must include four elements: first, a program of risk analysis and oversight to identify and minimize sources of cyber and operational risk; second, automated systems that are reliable, secure, and have adequate scalable capacity; third, emergency procedures, backup facilities, and a business continuity-disaster recovery plan; and fourth, regular, objective, independent testing to verify that the system safeguards program is sufficient to fulfill its regulatory responsibilities. Each entity must also have a risk management program that addresses seven key elements, including information security, systems development, quality assurance, and governance. In addition, these entities must notify the Commission promptly of incidents and 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 2 hours following a disruption. These entities must also maintain geographic dispersal of personnel resources to aid in the recovery efforts of a disruption.

We conduct system safeguards examinations to determine compliance with these requirements. Our oversight, however, is limited. Keep in mind that some of our major financial institutions are reportedly spending more on cybersecurity each year than our agency's entire budget. We do not engage in independent testing. Instead, we look at whether there is evidence to support management's assertions that they are in compliance with the requirements. Our examinations focus on the following areas:

- Governance—Is the board paying sufficient attention to cybersecurity and taking appropriate steps? Does the board have the expertise, and does it devote the time, to do so?

Is it setting the right tone as to the importance of these issues? The same questions apply, needless to say, to top management.

- Resources—Are sufficient resources and capabilities being devoted to monitor and control cyber-related risks across all levels of the organization?

- Policies and Procedures—Are adequate plans and policies in place to address information security, physical security, system operations, and other critical areas? And is the regulated entity actually following its plans and policies, and considering how plans and policies may need to be amended from time to time in light of technological, market or other security developments?

- Vigilance and Responsiveness to Identified Weaknesses and Problems —If a weakness or deficiency is identified, does the regulated entity take prompt and thorough action to address it? Does it not only fix the immediate problem, but also examine the root causes of the deficiency?

There is much more we would like to do in this area. However, our capacity to carry out examinations and address cybersecurity more broadly is significantly constrained by our current budget. We cannot conduct examinations as frequently or in as much depth as we should. Our response to this rapidly evolving area cannot be as proactive as we would like; and, the increasing number of cybersecurity incidents suggests a proactive approach is precisely what is needed.

High Frequency and Automated Trading

Markets are dynamic, and the agency must keep pace in order 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.

Derivative contracts based on a virtual currency represent one area within our responsibility. Recently, for example, a SEF registered with us made such a contract available. 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. Our responsibilities at the CFTC in this regard are ongoing. It is important to emphasize that the existence of contract does not mean the CFTC endorses it. As with all new developments, we must remain vigilant to ensure market integrity, and will continue to evaluate these new contracts over time. We will also continue to coordinate with other regulatory authorities regarding the issues raised by virtual currencies as appropriate.

Our Continued Focus on Enforcement and Compliance

Let me return to where I started: the importance of our enforcement and compliance function. Robust enforcement and oversight are crucial to maintaining the integrity of our markets, as well as public confidence.

Our pursuit of those who have manipulated benchmarks such as in our recent foreign exchange cases or our continued efforts with respect to LIBOR , a key global benchmark underlying a wide variety of financial products and transactions, is a prime example of this commitment. So is 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.

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. Last year, we brought a civil action against a firm and its principal for spoofing, one of the first such cases, and in 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 the CME develop strategies to identify instances of spoofing and, as appropriate, pursue actions against perpetrators. The CFTC also recommended that CME must maintain sufficient enforcement staff to promptly prosecute possible rule violations. The company should take measures to ensure internal deliberations do not delay disciplinary action.

We have used our anti-manipulation enforcement authority to address fraud in the precious metals space as well. 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. Contrary to Dodd-Frank's mandate, these transactions are typically not conducted on an exchange. They are 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.

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. For that reason, 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.

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. We are committed to aggressive enforcement and policing of our financial markets.

As a complement to these efforts, we have also taken steps to enable 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 ramping it up. 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. Last month, 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.

We will continue to focus on enforcement at all levels, whether it is traditional Ponzi schemes and precious metal retail fraud schemes against retirees, to the new challenges like spoofing that come with our increasingly electronic markets. And we will work with other regulators and law enforcement across jurisdictions to leverage our resources and safeguard our markets. The orders I discussed at the outset against five of the largest banks in the world for attempting to manipulate the foreign currency benchmark rates represent a good example of cross-border cooperation, as we worked closely with the Financial Conduct Authority in the UK and FINMA in Switzerland as well as our domestic counterparts.

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

Resources and Budget

Advancing the goals I have outlined and fully implementing the new regulatory framework depends on having the resources that are proportionate to our responsibilities. In my view, the CFTC's current budget 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 it faces 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 these same participants and other market registrants on a regular basis for compliance with the law and regulations. This is of particular concern when it comes to monitoring 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 the concerns of the public and the users of derivatives markets. This includes responding to the many requests for rule approvals, rule certifications, requests for new product approvals, and submissions for swap clearing and trading mandates. Delays can have a significant 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 its 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. Simply put, the financial markets today are driven by sophisticated use of technology, and the CFTC cannot effectively oversee these markets unless it 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 robust enforcement efforts with respect to fraud, manipulation, abusive or disruptive practices or other threats to market integrity and customer protection.
- Hire and retain enough economists to perform critical analysis of market developments and provide robust assistance in considering the relative costs and benefits of the Commission's regulatory activities.

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. As we continue implementing the necessary reforms that Dodd-Frank mandated, we must work to make sure the regulatory framework serves the needs of the commercial businesses that rely on these markets.

The United States has the best financial markets in the world. They are the strongest, most dynamic, most innovative, most competitive and transparent. 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.