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THE STATE OF THE DERIVATIVES MARKET AND PERSPECTIVES FOR CFTC REAUTHORIZATION

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

UNITED STATES SENATE

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CERTAINTY IN GLOBAL MARKETS FOR THE U.S. AGRICULTURE SECTOR

TUESDAY, JUNE 25, 2019

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 9:49 a.m., in room 328A, Russell Senate Office Building, Hon. Pat Roberts, Chairman of the Committee, presiding.

Present or submitting a statement: Senators Roberts, Boozman, Hoeven, Ernst, Braun, Grassley, Thune, Fischer, Stabenow, Brown, Bennet, Casey, Smith and Durbin.

Chairman ROBERTS. I call this hearing of the Senate Agriculture, Nutrition, and Forestry Committee to order. Before delivering my opening statement I ask unanimous consent that written testimony from a large number of coalition groups and trade associations be submitted for the record. Without objection, so ordered.

[The following information can be found on pages 76-104 in the appendix.]

STATEMENT OF HON. PAT ROBERTS, U.S. SENATOR FROM THE STATE OF KANSAS, CHAIRMAN, U.S. COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Chairman ROBERTS. The Senate Agriculture Committee has the responsibility of reauthorizing programs administered by multiple Federal agencies and commissions, notably the numerous programs of the U.S. Department of Agriculture. I would note, yet again, that as the Committee we authorized hundreds of programs worth billions of dollars last year, in the farm bill, and in doing so fulfilled its role by providing certainty and predictability to many stakeholders. I say thanks to the Committee, but more especially to our distinguished Ranking Member.

This Committee also has distinct jurisdiction over the Commodity Futures Trading Commission and its role in implementing the law governing worldwide derivative markets as authorized in the Commodity Exchange Act. While the CFTC has continued to receive funding as it works to ensure that U.S. derivative markets function properly and in an open, safe, and transparent manner, it has done so without authorization since October 2013. That is almost six years ago.

I think it is fair to say a lot has changed since the last time CFTC was reauthorized, alongside the 2008 Farm Bill. We have seen a rollout and adoption of a number of regulations as required under the Dodd-Frank Act.

I am pausing if anybody wants to cough at that particular moment.

They have created greater transparency in the over-the-counter derivative markets while still ensuring non-financial end users are provided flexibility in the way they utilize derivatives to hedge their commercial risk.

Recently we have seen legislative efforts in the European Union, which will have the unfortunate effect of undoing the agreed-upon mutual recognition of foreign-based clearinghouses, likely creating uncertainty, to say the least, for some of our most important global financial stakeholders.

We have seen incredible advances in technology, including the emergence of blockchain technology. In addition to supporting the emergence of Bitcoin and other cryptocurrencies, it has the potential to revolutionize the way companies do business, including speeding up the time it takes to verify and execute international commodity trades.

We have worked together in a bipartisan manner to confirm nominees and to ensure that the Commission is fully functioning. I think that is a star in the Committee's crown.

As we move forward with reauthorization, it is important that Congress provide CFTC with certainty. We should do our job and not just for some of the Committee agencies and stakeholders but for all of those impacted by the laws within our purview.

Within this process it is important we listen to stakeholders to better understand what is or is not currently working. We must explore what provisions may need a legislative update to reflect current and future market dynamics and what the CFTC already has the authority to accomplish through rulemakings.

This hearing is designed to provide us with that opportunity. Our panel of distinguished witnesses today covers a broad spectrum of industry stakeholders and perspective. We will hear from the derivatives industry's self-regulatory organization with an update on safety and soundness of U.S. derivative markets and insight on legislative recommendations for further strengthening consumer protections.

We will hear from a leading global trade association representing exchanges, clearing firms, swap dealers, asset managers, and other financial stakeholders about current market trends. We will hear testimony from one of our Nation's leading agriculture cooperatives about the vital role that derivatives play for stakeholders hedging their commercial risks in the production and marketing of our Nation's ag commodities. A tough job at this current time.

Last we will hear from a consumer advocacy organization, formed after the 2008 financial crisis, about any additional reforms it believes may be necessary.

I thank you all again for joining us. I look forward to our conversation today about the state of global derivatives markets and CFTC reauthorization, and now I will turn to my distinguished colleague, Ranking Member Stabenow, for her opening remarks.

STATEMENT OF HON. DEBBIE STABENOW, U.S. SENATOR FROM THE STATE OF MICHIGAN

Senator STABENOW. Thank you, Mr. Chairman, and welcome to our witnesses today for this very important discussion. It is good to have the opportunity, since it has been over a decade since Congress reauthorized the CFTC, for this discussion about reauthorization. I am pleased we are working together on a bipartisan basis, as we always do in this Committee, to be able to get this done.

The CFTC plays a critical role in providing certainty in our futures and swaps markets for Main Street businesses, consumers, and farmers.

As we know, a lot has happened since the CFTC was last reauthorized in 2008. We witnessed firsthand the disastrous consequences of financial deregulation. The global financial system broke down. Housing markets collapsed nationwide. Millions of families lost their homes and their financial security. Over 8 million jobs disappeared, while farmers and small businesses faced financial ruin.

The American people lost faith in the ability of banks to do what is right, and worse—the American people lost faith in the ability of our government to protect our economy.

Next month will mark the 9-year anniversary of the Dodd-Frank Act. Thanks to that legislation, we have a financial system that is stronger and more resilient. As we consider the reauthorization of the CFTC, we must not roll back the important reforms that have been implemented since the financial crisis.

CFTC reauthorization also gives us a chance to be forward looking. It is critical that we consider the opportunities as well as the challenges of tomorrow.

Cybersecurity is arguably the greatest systemic risk that our financial system faces today. Top executives in the global financial sector agree, and are devoting unprecedented resources to protect against cyberattacks. We cannot allow the American economy to be endangered by any shortcomings in the security of our financial system. Our financial system must take the necessary steps to protect against cyberattacks.

The CFTC also must protect its own information systems, especially against cyberattacks by foreign adversaries and other bad actors. In 2016, the SEC was attacked by Ukrainians and Russians attempting to gain access to confidential earnings reports. More recently, the CFTC reported an increase in phishing attempts aimed at stealing sensitive agency information. It is critical that the American people and market participants have confidence that the CFTC's systems are secured at all times.

As we look forward to CFTC reauthorization, we must prioritize certain key issues. Our futures and swaps markets help create American jobs and support economic stability for our farmers, manufacturers, and consumers. We need to do everything we can to ensure that the CFTC keeps our markets strong and free of fraud, manipulation, and disruptive practices.

Customer protection needs to continue as a top priority.

We must ensure that the CFTC has the enforcement tools it needs to bring wrongdoers to justice.

Finally, I have long been an advocate for providing the CFTC with the resources it needs to fulfill its critical responsibilities. Yet the CFTC continues to be underfunded, which leaves our financial system at risk. It is our responsibility to solve this problem, and, Mr. Chairman, I look forward, as always, to working with you on this issue.

Chairman ROBERTS. I thank the distinguished Ranking Member. I would like to welcome our panel of witnesses this morning.

Our first witness is Thomas W. Sexton, who serves as President and Chief Executive Officer of the National Futures Association. Mr. Sexton joined the NFA in July 1991, and has held several positions, including serving as NFA's general counsel and secretary from September 2001 through February 2017. In his role as general counsel, Mr. Sexton oversaw major regulatory initiatives affecting NFA's member firms and various enforcement matters.

He holds a bachelor of arts degree in government from Notre Dame, an MBA degree from Loyola University Chicago, and a law degree from the University of Notre Dame Law School.

Welcome, Mr. Secretary.

[Laughter.]

Mr. SEXTON. That is Okay.

Chairman ROBERTS. Just do not tell Sonny I said that, all right? I look forward to your testimony.

Next we have the honorable Walt Lukken, who is President and Chief Executive Officer of the Futures Industry Association. Prior to joining the FIA, Mr. Lukken was the CEO of New York Portfolio Clearing. Before joining the private sector in 2009, he served as a CFTC commissioner beginning in 2002, and then as acting Chairman of the Commission for 18 months, a period that included the financial crisis of 2008. Tough waters back then.

Mr. Lukken also spent time on Capitol Hill where he served five years as counsel on the staff of U.S. Senate Agriculture Committee under then—Chairman Dick Lugar, who is smiling right at you today.

He received his bachelor of science degree with honors from the Kelley School of Business at Indiana University and his law degree from the Lewis & Clark School in Portland, Oregon.

Thank you for being here today, Mr. Lukken, and I look forward to your testimony.

Next we have Mr. Joe Barker, the Director of Brokerage Services for CHS Hedging, which is the commodity trading subsidiary of CHS, Inc. Mr. Barker has spent the last 19 years providing risk management services for agriculture clients. He started as a commodity broker in the Indianapolis office of CHS Hedging in 2000. From 2007 through 2014, he was the branch manager of the Kansas city office.

Today, Mr. Barker works in Inver Grove Heights, Minnesota headquarters office where, in addition to directing the brokerage services is also the Chairman at CHS Hedging's senior management team.

He grew up on a farm east of Noblesville, Indiana, and completed his bachelor's degree at Kansas State University, where he majored in animal science with a business option. He also earned an MBA from Indiana Wesleyan University. He began his career in agriculture in live hog production for Seaboard Farms in Kansas.

Welcome, and thank you for being here today.

Our final witness today is Mr. Dennis Kelleher. Mr. Kelleher is President, Chief Executive Officer, and Co-Founder of Better Markets. Prior to Better Markets, Mr. Kelleher held senior staff positions in the U.S. Senate, including General Counsel and Deputy Staff Director on the Health Committee, and Chief Counsel and Senior Leadership Advisor to the Chairman of the Senate Democratic Policy Committee.

Mr. Kelleher has been a partner with the international law firm of Skadden, Arps, where he had a practice specializing in crisis management and complex corporate matters that focused on governance and securities and financial markets.

Notably, Mr. Kelleher served four years of active duty, enlisted in the Air Force as a crash rescue firefighter medic. We thank you for your service, sir. He graduated from Brandeis University and from Harvard Law School.

Welcome, Mr. Kelleher, and thank you for your service to our country, again. Mr. Sexton, why don't you kick things off.

STATEMENT OF THOMAS W. SEXTON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL FUTURES ASSOCIATION, CHICAGO, ILLINOIS

Mr. SEXTON. Thank you, Mr. Chairman. Chairman Roberts, Ranking Member Stabenow, members of the Committee, thank you for the invitation to testify at this important hearing. I am President of the National Futures Association, which is the industry-wide self-regulatory organization for the derivatives industry.

Our responsibilities include registering all firms and industry professionals on behalf of the CFTC, passing rules to ensure fair dealing with customers, monitoring our members for compliance with those rules, and taking enforcement actions against those members that violate those rules.

The CFTC oversees every single aspect of our regulatory authority, and as the industry SRO for the derivatives market, we have one overriding objective, to help the CFTC. We and the CFTC act as strong partners in regulating the derivatives industry, and as partners I want to, at this time, take the opportunity to thank Chairman Giancarlo for his strong support of self-regulation during his time there, and we certainly look forward to working with Dr. Tarbert when he becomes chair of the CFTC in a few weeks.

Reauthorization is always an important process for the industry as a whole, and for NFA in particular. NFA firmly believes that customer protection issues should be front and center with regard to reauthorization, and we certainly encourage this Committee to work to reauthorize the CFTC.

The last few reauthorization bills voted out of this Committee and the House Agriculture Committee have included a key customer protection provision relating to FCM bankruptcies, which we continue to strongly support and believe any future reauthorization bill should contain. Over 30 years ago, the CFTC adopted rules regarding FCM bankruptcies. Among other things, those rules provided that if there was a shortfall in customer-segregated funds, the term "customer funds" would include all assets of the FCM until customers were made whole.

Several years ago, a district court decision, the Griffin Trading Decision, cast doubt on the validity of the CFTC's rule. Although that decision was subsequently vacated, a cloud of doubt continues to linger over this issue. Congress should remove that doubt and ensure that customers have priority if there is a shortfall in customer funds, and can do so, we believe, by amending Section 20 of the Commodity Exchange Act, which gives the CFTC authority to adopt regulations regarding commodity brokers that are debtors in Chapter 7 of Title 11 of the United States Code.

Our request is simple: please amend Section 20 to clarify that the CFTC has the authority to adopt the rule that it did. We believe there is a broad base of industry support for this approach, and we would be happy to work with Congress on specific proposed language.

Other areas that I wanted to highlight, covered in our written testimony, the first is with regard to our swap dealers. I certainly want to thank Congress and this Committee for having confidence in the CFTC and NFA to regulate swap dealers. Our written testimony details, specifically, how, in light of Dodd-Frank, our responsibilities have increased significantly throughout the last few years.

With regard to swap dealers, in partnership with the CFTC we have developed a regulatory oversight program that reviewed, in detail, their policies and procedures upon registration, performed regular examinations of U.S. and non-U.S. swap dealers, collected certain risk information from these firms, and approved and monitored these firms' initial margin models for uncleared swaps.

We will continue to evaluate our program and enhance this program with the CFTC, as necessary, in the future.

I appreciate Senator Stabenow's mention of cybersecurity. It is an issue that is of critical importance to all of us. I can assure you that NFA makes every effort possible to secure our data and the CFTC data that we hold. Our technology staff and budget have grown significantly throughout the past few years. We adopt best practice frameworks and standards, engage independent parties to conduct security testing, and continually assess the data that we hold and whether or not it is critical for our mission, and if it is not, we no longer collect that data.

We have imposed specific cybersecurity requirements on our NFA members, requiring them to have written information systems security programs and to do a risk assessment of their particular cybersecurity risk. During our examinations we review these risks and work with our members to understand these requirements so that they can comply.

Our testimony also highlights customer protection issues that we have partnered with the CFTC to resolve in the last few years. Detecting and combating fraud is central to our mission. These issues involve the oversight of firms and individuals, safeguarding of customer funds, swaps proficiency requirements, which we hope to launch in early 2020, virtual currencies, and coordination between the CFTC, SEC, and NFA, particularly with regard to commodity pools that are duly registered.

In conclusion, we look forward to working with this Committee to reauthorize the CFTC, and will continue to work with the CFTC and Congress to tackle regulatory challenges posed by an industry that is constantly changing.

I would be happy to answer any questions at the appropriate time.

[The prepared statement of Mr. Sexton can be found on page 30 in the appendix.]

Chairman ROBERTS. We thank you for your testimony. Mr. Lukken.

STATEMENT OF THE HONORABLE WALTER L. LUKKEN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FUTURES INDUSTRY ASSOCIATION, WASHINGTON, D.C.

Mr. LUKKEN. Thank you, Chairman Roberts, Ranking Member Stabenow, and members of the Committee. Thank you for the opportunity to testify on CFTC reauthorization and the state of the derivatives markets.

I am the president of FIA, the leading trade association for the regulated futures options and centrally cleared derivatives markets. I have had the privilege of being significantly involved in the last two CFTC reauthorizations. In 2008, I was serving as Acting Chairman of the CFTC, and I worked with this Committee to ensure the agency had the proper regulatory and enforcement tools to oversee these markets. In 2000, as mentioned, as part of the Commodity Futures Modernization Act, I worked as a staff member of this Committee under the leadership of the late Chairman Richard Lugar, to help modernize and reauthorize the CFTC.

This experience has provided me a first-hand appreciation of the importance of the CFTC reauthorization process, because it provides an important congressional stamp of approval on this agency's mission and legal authority.

Today I want to highlight certain market trends and recommendations to aid in your deliberations.

To begin with, our markets have grown significantly in the decade since the last reauthorization. Global volume on futures and options transactions has increased 70 percent over that period of time. In 2018, our industry traded over 30 billion contracts for the first time in its history. There are more products and more participants in more locations, using these markets to hedge and manage risk than ever before.

Second, post-crisis reforms have made the derivatives markets safer. With the implementation of Dodd-Frank, a large percentage of the over-the-counter derivatives are now submitted to central counterparties for clearing. According to CFTC data, 90 percent of interest rate swaps and 62 percent of credit derivatives are now cleared. This reduces the amount of risk in the financial system and provides greater transparency for both regulators and market participants alike.

Third, our markets have become much more global. Today, all major global exchanges have anywhere from one-third to 90 percent of their volume coming from outside their home location. Importantly, these transactions from foreign participants add vital liquidity to domestic markets that keeps costs affordable for customers hedging risk.

Last, like most economic sectors, this industry has been transformed by technology, whether it is the way market participants trade futures, whether it is the way that trades are processed and cleared, or the way that regulators surveil the markets. Technology has provided our industry with greater efficiencies that enable more people to access these products globally, at significantly lower costs.

To keep pace with these changing market dynamics, regulators must have flexible tools and authority. FIA supports the CFTC's principles-based approach to regulation, which has served the agency well for the past 20 years. The core principles of the CEA provide the CFTC with outcomes-based tools that can be tailored to the ever-changing global marketplace. I encourage the Committee to preserve this flexibility.

Ensuring the protection of customers and their funds must also remain a priority for our industry. FIA joins the National Futures Association, as Tom, in his comments, mentioned, in recommending to this Committee clarifications around the definition of customer property, which was made uncertain by the Griffin Trading bankruptcy decision.

Protecting customer data is another important priority worthy of this Committee's consideration. In June, the CFTC's Inspector General published a report that the agency has numerous weaknesses in the way that it stores data used to regulate the markets. FIA supports providing the CFTC with the resources, authority, and direction to enhance their data collection methods, given the sensitivity of the data collected from market participants.

Last, it is imperative that the regulatory framework for this industry accommodates its global nature. FIA supports a deference approach to cross-border regulation that allows authorities to recognize and defer to foreign supervision when their rules are deemed comparable and comprehensive. Both the EU and the CFTC are considering proposals that will impact cross-border regulation of clearinghouses, and we encourage both authorities to recognize the home nation's oversight that avoids needless duplication of supervision and regulation.

In closing, I hope these high-level trends and recommendations will help this Committee as it begins its reauthorization process, and I look forward to your questions.

[The prepared statement of Mr. Lukken can be found on page 37 in the appendix.]

Chairman ROBERTS. We thank you for your testimony. Mr. Barker.

STATEMENT OF JOE BARKER, DIRECTOR OF BROKERAGE SERVICES, CHS HEDGING, ST. PAUL, MINNESOTA

Mr. BARKER. Chairman Roberts, Ranking Member Stabenow, and members of the Committee, thank you for holding this hearing as you work on reauthorization of the Commodity Futures Trading Commission. In particular, I appreciate the opportunity to discuss the role of derivative markets in helping farmers and agribusiness manage commodity price risk.

Currently, our agriculture markets are extremely volatile. This is being fueled by ongoing uncertainty in international markets and an extremely wet spring that has caused the slowest corn and soybean planting progress on record.

Trade issues have led to dramatic price swings for grain, livestock, and dairy. In my written testimony, I gave an example of the volatility in the dairy market over the last year. To further highlight this point, I would like to draw your attention to the soybean market, where, from March 2, 2018 to July 16, 2018, the price of soybeans at the Chicago Mercantile Exchange dropped from $10.71 to $8.10 per bushel. This is a price drop of over 24 percent of the notional value of the U.S. crop in less than five months.

That is only the futures component of the price that a farmer receives. The dramatic drop in exports this past winter caused basic levels in the Midwest to new record lows. At one point this winter, the price of soybeans being bid to farmers in parts of North Dakota was under $7 per bushel. The extreme swings in price have meant the difference between producing their crop at a profit or a loss.

Given the volatility, the agriculture industry must rely on exchange traded and over-the-counter derivatives to manage their price risk exposure. More producers are looking to their co-ops to provide tools to manage price risks at the farm level and assist in locking in margins. In fact, some NCFC members are seeing record levels of risk management usage among their producers. This includes structured contracts that give producers the pricing tools that meet their marketing objectives.

Agriculture must have access to sound, well-functioning commodity derivatives markets. The CFTC ensures the integrity of those markets. The Commission's responsibility in that regard has expanded dramatically over the past decade. Yet until recently, adequate funding had not kept up. While not in the scope of this Committee, we encourage Congress to provide sufficient funding for the CFTC's important functions.

In doing this, we caution against the imposition of any user fee on the industry to fund the CFTC. Agriculture is a high-volume, low-margin industry. Incremental costs, whether passed on or imposed directly upon market participants, trickle down to farmers. We fear a further increase in the cost would have an unintended consequence of discouraging prudent hedging practices. To be clear, a user fee would result in increased risk being absorbed by agriculture.

Additionally, we would like to caution Congress from setting up a situation where the CFTC would see its budget directly impacted by the volume of trading in the products it is tasked with regulating.

NCFC has supported elements of the Dodd-Frank Act that bring more transparency and oversight to markets. However, throughout its implementation, NCFC noted that the ag industry does not fit in a one-size-fits-all regulatory regime meant for Wall Street. We appreciate the work of the Commission in addressing our many concerns with the Dodd-Frank rules.

This Committee's oversight of CFTC, as they have written those rules, has been instrumental in protecting farmers' and end users' access to needed risk management tools, and I would like to thank you for your work in this area.

While most of Dodd-Frank has been implemented, the position limits rule is not yet finalized. Any Federal speculative position limit rule should not unduly burden the commercial end user of these markets. Specifically, we have continued to advocate that CFTC recognize common hedging practices such as anticipatory hedging and cross hedging as bona fide hedge activity. Given the nature of the various commodity markets, there should not be a one-size-fits-all approach to determining position limits.

We understand that the Commission has committed to Congress to finalize that rule, and we will provide additional input when available, for comment. While we are confident the Commission will consider hedgers' concerns, I would like to encourage the Committee to continue to monitor this rulemaking.

Thank you again for the opportunity to testify today before this Committee. We appreciate your role in ensuring our industry has the risk management tools needed to support our businesses and those of our farmer members.

I look forward to answering any questions you may have.

[The prepared statement of Mr. Barker can be found on page 43 in the appendix.]

Chairman ROBERTS. Thank you, Mr. Barker. Mr. Kelleher.

STATEMENT OF DENNIS M. KELLEHER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BETTER MARKETS, WASHINGTON, D.C.

Mr. KELLEHER. Good morning, Chairman Roberts, Ranking Member Stabenow, members of the Committee. Thank you for the invitation to testify today. It is an honor to testify in the Senate and before this Committee.

I am going to take a different approach to talking about these issues at somewhat of a macro level. I believe the best way to think about the CFTC, its reauthorization, its funding, and derivatives regulation more broadly is by thinking about what has become a dirty four-letter word—TARP.

Those of you who were here in the Senate, or in the House at the time, had to take one of the most searing and consequential votes of your careers, with no time and little information. You had to decide to vote for or against sending 700 billion taxpayer dollars to bail out the largest financial institutions in this country, including every one of the largest derivative dealers.

I was on the Senate floor during those days of debates and votes in September and October 2008, with Senator Grassley and Senator Thune and Senator Casey, and actually most of you here, and I well remember the agony and anger of members being forced to make momentous decisions in a time of extremely limited information, where the facts were changing daily, sometimes hourly, on an hourly basis, and where the gravity of the situation grew more ominous by the moment.

The entire financial system was going to collapse, you were told. The payment system was going to stop. Your constituents were not going to be able to cash their paychecks. Indeed, the country was likely to fall into an economic abyss that was so bad there was going to be a second Great Depression, you were told.

Those were truly dark, dangerous, and downright scary days and weeks, as one unimaginable event after another happened. Financial giants were collapsing. Others were teetering on the brink of collapse, the stock market plummeting.

This ignited the worst panic since 1929. That was because the markets, the financial giants that ruled the markets and their products, had been largely deregulated. As a result, no one—not market participants, not regulators, not policymakers, and not elected officials—knew what was happening, or worse, what was going to happen next.

In the middle of all that, with events happening quickly, little information, widespread fear, you were asked to send 700 billion taxpayer dollars, your constituents' money, to bail out the largest financial institutions in this country and prevent an economic catastrophe.

Seventy-four U.S. Senators voted for TARP, and days later, 125 billion of taxpayer dollars went out the door into the accounts of just nine of the largest financial institutions, including all the big derivatives dealers. That was just the tip of the bailout iceberg. Trillions more—with a T—trillions more were spent, lent, pledged, guaranteed, or otherwise used by the government to prop up and bail out the financial system. Most of that was done by the Federal Reserve, and it was kept secret from the public, including you, the elected officials, for many years.

Those were not the only bailout costs. There were also widespread economic and human costs. Better Markets did a study showing that the cost of the crisis is going to exceed $20 trillion in lost GDP, and counting.

Now as you know, derivatives are at the core of causing and spreading the disaster, requiring the TARP vote and inflicting so much pain and misery. In fact, the central role derivatives played in that crisis is why I have suggested that derivatives should be thought of as a conveyor belt, distributing, as Warren Buffett said, the financial weapons of mass destruction throughout the U.S. and global financial systems.

Without unregulated, nontransparent, over-the-counter derivatives, and the enormous risk they spread and amplified, the 2008 crash would have been very, very different, and almost assuredly would have been much less severe. That is why the Dodd-Frank Financial Reform Act spent so much time on regulating derivatives, ensuring transparency, trading, competition, oversight, accountability.

While other agencies have roles to play, the primary agency standing between that derivatives nightmare from happening again is the CFTC. The primary people ensuring that the CFTC has the authority and resources to prevent that derivatives nightmare from happening again is you and your colleagues in the Senate and in the House.

So in closing, when thinking about that, I would urge you to look at page 20 of our testimony—and I apologize, it is page 20 and not page 4 or 5—of my written testimony. There is a list of the 42 financial institutions that received more taxpayer money from TARP than the CFTC's entire budget in 2019. That is why reauthorization and properly funding the CFTC today are as important as your TARP vote in 2008, because only getting that right will reduce the likelihood of future votes where you again send taxpayer money to bail out Wall Street's derivatives dealers, and that should be uppermost in your mind. That is why we need authorization. That is why we need a CFTC with funding and resources and authority.

Thank you. I look forward to your questions.

[The prepared statement of Mr. Kelleher can be found on page 47 in the appendix.]

Chairman ROBERTS. Thank you, Mr. Kelleher. That was unique testimony with 20/20 hindsight and a rear-view mirror. I voted no, just for the record. How did you vote? Oh, I am sorry. I should not——

[Laughter.]

Senator STABENOW. I also voted no.

Chairman ROBERTS. She also voted no, so we had a very clear insight. I remember talking with her about it on the floor. Okay.

I am going to start the questions and I beg the indulgence of my colleagues. I am going to try to go pretty quickly. Chairman Grassley, do you have any advice for us before we start the questions? Good morning to you.

Senator GRASSLEY. I hope I get to ask questions before 10:45.

[Laughter.]

Chairman ROBERTS. We will try to make that happen. Thank you, sir.

Mr. Barker, since the beginning of my chairmanship I have made it clear that the needs of end users are a priority for myself and this Committee. As you interact with those end users in the countryside do they have efficient, effective, and fair access to our futures markets? I would specifically like to hear about the effect that any fees have on this access, as well as another issue affecting access, that being position limits, including having a clear definition of a bona fide hedge.

Is the issue of position limits a priority for end users? How important is that for our rural communities and ag producers? It is extremely important they have efficient, effective, and fair access. So my response would be it is very important. I think that is probably what you ought to say, but go ahead.

Mr. BARKER. Thank you for the question, Senator. I actually believe today we have access to efficient and well-functioning markets. I believe the markets are quite good today. The concern about access fees or user fees is that eventually this trickles down to the American farmer.

I was recently at a CME event where they were discussing the volume of trading in different commodities, and I was struck by the fact we trade our corn crop 36 times. The funny thing is, if you enact a fee on every transaction, 36 times that fee will trickle down to the American farmer, because that is how this works. The farmer is the price taker.

So eventually somewhere along the food chain someone might say, "I am going to step out of this transaction," and liquidity might reduce, and that is the fear. Because with markets this volatile, our individual farmers who are running their own businesses and making independent decisions need the ability to properly manage their risk when they choose to, to manage their business. The reduction in volatility could impact the ability of our markets to function efficiently and have the liquidity needed in all of our different commodities. So that is why we are against user fees.

Chairman ROBERTS. I thank you for your answer. I am sorry. Did I interrupt you?

Mr. BARKER. Well, you asked about position limits, and if it is important, and it is important. When you operate an agribusiness and your job is to buy grain by the truckload, move it by the trainload, and sell it by the shipload, you are not always trading something that is perfectly hedgeable.

I like the example of durum wheat. There is no futures market for durum wheat. We have spring wheat in Minneapolis, we have hard red winter wheat in Kansas City, and we have soft wheat in Chicago. If I need to hedge the risk of durum wheat as I am going to load a shipload of wheat and ship it to Italy or anywhere else, I have to cross-hedge. I have to use some other futures market to do that, and we would like that to be defined as a bona fide hedge.

Chairman ROBERTS. Final question. Are the Wildcats going to win six games?

[Laughter.]

Mr. BARKER. I do believe we will be in a bowl game this year.

Chairman ROBERTS. Thank you.

Mr. Lukken, in your testimony you talk about what is going on with EMIR 2.2. As you may know, Senator Stabenow and I wrote Chairman Giancarlo last year raising serious concerns about the European Union's legislation to regulate our U.S. clearinghouses. Unfortunately, it has come to our attention in the past couple of months that this legislation is in the final stages, and as written, has not changed, but would still impose overly burdensome, subjective criteria on U.S.-based clearinghouses wishing to operate in the EU. This is, of course, in direct conflict with the equivalence agreement reached by the CFTC and the EU, the European Commission, in 2016.

As the Ranking Member and I alluded to in our letter, is there anything within the context of reauthorization that should be done to address these concerns?

Mr. LUKKEN. Certainly, we support the EU coming out with the full deference approach within the EMIR 2.2 regulation. They do have the authority to defer to the CFTC and its regulation of clearinghouses. As you mentioned, CFTC regulation is, of course, equivalent. The clearinghouse regulation in the United States is very strong. That was recognized two years ago in this agreement between the EU and the CFTC.

So we think it certainly should be ESMA's duty to find a United States equivalent and defer to U.S. regulation in this area. Congress can play an important role in encouraging ESMA to find that, and if not, there could be consequences, as you mentioned. We are pretty confident and we are hopeful that the EU would do the right thing and defer to U.S. regulation here.

Chairman ROBERTS. I appreciate that response.

Chairman Grassley, I am looking at several questions I may just submit for the record so we can get to your 10:45 deadline here.

Hang on.

For the entire panel, when you answer that just remember Chairman Grassley's situation here.

With the recent announcement that Facebook has plans to offer its own cryptocurrency sometime in the near future, and Bitcoin's re-emergence as a valuable commodity, worth over $10,000 per coin, virtual currencies and the underlying technology of blockchain are once again grabbing headlines. As blockchain technology and its transformative potential continues to emerge, what role should regulators play, particularly in the realm of virtual currency. Mr. Sexton?

Mr. SEXTON. Mr. Chairman, thank you. The role that I believe regulators should play is to allow for innovation, but cautiously allow for innovation in this particular area. Over the past year, we have tackled some virtual currency issues with the CFTC, and mandated particular disclosures with regard to customer protection, which we are always very concerned about.

We are focused on the derivatives markets, obviously, and the futures trading with regard to Bitcoin, but also focused on the fact that our members may be engaged in other types of underlying virtual currency transactions, and we know that is a relatively unregulated environment today.

There has been talk about an SRO also, with regard to virtual currencies, and with regard to that, if Congress is going to look at that I think it is very important that that be done in legislation, that there be government oversight, mandatory membership, and strong enforcement powers. So thank you.

Chairman ROBERTS. Mr. Lukken.

Mr. LUKKEN. The CFTC has authority over any commodity and any derivative, so those cryptocurrencies that are considered commodities, the CFTC has adequate authority to regulate those derivatives and to make sure, and they have broad manipulation and enforcement authority over those products as well.

I think the unique thing about cryptocurrencies is unlike agriculture or energy, which have regulators at the cash level, cryptocurrencies right now really have no regulatory structure at the cash level. New York has a bit license that you can apply for, but I think the CFTC, as it regulates these entities, has difficulty ensuring that these things cannot be manipulated at the cash level, which is something I think this committee should think about as it goes forward.

Chairman ROBERTS. Thank you. Mr. Barker.

Mr. BARKER. Since I am in FCM the focus is on agriculture risk management. We have not allowed our customers to trade Bitcoin so I am not an expert in this, but I do agree with both Mr. Sexton and Mr. Lukken that it is important that this be regulated and it is inside the CFTC's scope.

Chairman ROBERTS. Mr. Kelleher.

Mr. KELLEHER. I would first like to recognize that Chairman Giancarlo and Chairman Clayton have done a very good job of getting out in front on investor protection in this area, both on the enforcement side and on the policy pronouncement side, and they should be recognized for that and they should be encouraged to do more. In addition to that, they need resources to do more. They cannot possibly keep up with what is a technology arms race here, where we have private actors moving into the monetary space and the financial space across the board.

So, yes, innovation, but there has to be a role for government. You look at what Facebook announces—28 corporations, on a board, governing their new currency, and it is going to be run out of Switzerland and based out of Switzerland. We have money-laundering problems, tax evasion problems, terrorist financing problems, rogue state problems.

These cannot be addressed by private-sector actors who are seeking to profit maximize. There is a role for the government and this committee needs to make sure that the CFTC continues to do its job on the customer protect side, but more importantly has the resources to comprehensively address the risks and realities that are going to be visited upon all of our neighbors and families and businesses in the not too distant future.

You are either going to be responding to crises later on and over-budgeting to kind of address what did not happen or you are going to get in front of it now. It is not a matter of if you are going to address these, it is when, and the time is now.

Chairman ROBERTS. Thank you all for your responses. I am going to recognize Chairman Grassley, our distinguished President Pro Tempore out of order. Chuck, why don't you proceed.

Senator GRASSLEY. Whoever I am offending by going ahead, get mad at the Chairman.

Senator STABENOW. You are welcome, Senator Grassley.

[Laughter.]

Chairman ROBERTS. It is what it is. A Chairman has to do what he has got to do, Chuck.

Senator GRASSLEY. Okay. First of all, Mr. Barker, and then a short question for all the panel.

You mentioned that current events like trade negotiations and wet spring have caused volatility of our markets and the need to rely on derivatives. The reason this hearing is in the Agriculture Committee rather than Banking is because the long history of derivatives being important tool of managing prices for agriculture. The role of the CFTC has grown over time to include many financial derivatives, and most recently because of Dodd-Frank.

I note your comments that the one-size-fits-all regulatory regime that treats agriculture the same as Wall Street does not work, and you cited a couple of specific issues. Could you speak more about whether there are specific changes that need to be considered in the next CFTC reauthorization to make sure that the CFTC has the appropriate flexibility to fairly regulate transactions by everything from small farmers to Wall Street?

Mr. BARKER. Thank you, Senator. Like we talked about, the position limits rule and the definition of a bona fide hedge are key going forward. Hedgers get an exemption to manage the risk of the commodities of which they trade, so I will go back to durum wheat. If we are able to get a true definition that cross-hedging is a bona fide hedge, then we can work around the position limits rules that would allow a large trader of durum wheat, like I said, that may be exporting shiploads of it, can adequately manage its risk. So that is very important and that would trickle its way all the way down to the individual farmer and the acre of land in which they are harvesting. Because if the company they are selling their grain to cannot manage the risk, it becomes difficult for them to offer the proper tools for the farmer to market their crop.

Now you talked about trade and wet spring, and, of course, I am not here to talk to you about trade policy. The impact of the trade policy has had a dramatic impact on our markets. I talked both about the dairy markets, and that goes to the USMCA mostly, and the soybean market, which goes quite a bit to the China situation, and how that impacts the individual grower. When we lose that liquidity in the marketplace, or when the farmer has to choose between raising their crop at a profit or a loss, we need to have the tools available, and so that is why we are in favor of reauthorizing the CFTC formally, in legislation.

Senator GRASSLEY. Thank you. Then to all the panelists, how has the speed and frequency of automatic trading affected the ag commodity markets? Does the CFTC need any additional tools to address the increasing use of automated trading by algorithms rather than real people?

This was first brought to my attention two or three years ago by cattle feeders in Iowa, who felt that so much trading in the last half hour or few minutes of a day really impacted the market negatively to those people, the producer.

Mr. SEXTON. Senator Grassley, thank you for the question. I could tell you, from NFA's perspective, with our members who engage in automatic order-routing trading and also with regard to algorithms, we have the tools in place, we believe right now, if there was an issue with regard to what our members were doing in that area.

As far as the CFTC, I know that Chairman Tarbert has, at least at his confirmation hearing, indicated that he may look at some form of reg, what they call Reg AT again, and NFA is looking forward to working with the Commission if that is one of his initiatives that he wants to undertake.

Senator GRASSLEY. Mr. Lukken?

Mr. LUKKEN. Yes. Automated trading actually has provided a lot of liquidity in the markets which has lowered costs in general, but specifically there are times when they can abuse the markets, as you mentioned, especially at the time when price is being set in the last half hour. The CFTC does have adequate tools to enforce that. You gave them the authority in Dodd-Frank on spoofing and banging the close and a variety of different ways that people can manipulate the markets.

The CFTC certainly should be looking out for that manipulative behavior at the end, for those automated traders. In general, I think automated trading has actually provided liquidity to the markets that have helped farmers.

Senator GRASSLEY. Mr. Barker.

Mr. BARKER. Well, as a former member of the Kansas City Board of Trade who used to trade open outcry I do miss those days. High-frequency trading has brought better liquidity. I do agree with Mr. Lukken on that. The hedger relies on the CFTC to play the referee and keep the playing field level and fair, and that is why it is so important that they have the resources they need, that we can trust that they are doing their role.

Senator GRASSLEY. Mr. Kelleher?

Mr. KELLEHER. Senator Grassley, you put your finger on another issue, not unlike cryptocurrency and other issues, where the technology is so far ahead of our regulators and their budget and their resource and their technological capacity. Everybody says, "oh, this is great." The FTC has got the authority and the CFTC should do this, and they should do this. You would think they had a limited budget and they were full of technologists and enforcement lawyers.

So, yes, I agree. They should do all of that and they cannot do any of that, and they are being set up for failure.

The HFT, yes, it provides liquidity. It often provides liquidity during a flood, and nothing during a drought. Get liquidity when you do not need to more often. You also get all sorts of abusive and manipulative behavior. I agree with Walt, some of which is provided for specifically within the Dodd-Frank. Our position is it is also amply covered under the anti-manipulation authority that could be used. On the other hand, the technology is moving very fast, and the CFTC needs greater authority and, more importantly, additional resources so they can keep up with it, because high-frequency trading is, just as we have seen in the securities markets, and that is the future of the commodity and derivatives markets.

You are going to see the high-frequency trading-ization of these markets, where they are going to take over the vast majority of the trading, and we are all going to be watching as the machines run over people, and run over our markets, and run over our farmers, and run over our physical purchases and producers, while they are cashing out and they are leaving a bunch of destruction in their way, and we are going to say, what happened?

Well, what happened is we did not have the resources, we did not have the authority, and we were not able to keep up. That is our fault, and we need to get in front of that too.

Senator GRASSLEY. Thank you. Thank you, Mr. Chairman.

Chairman ROBERTS. Senator Stabenow.

Senator STABENOW. Thank you very much, Mr. Chairman. This is a very important discussion and thank you all for your testimony.

Let me start with Mr. Sexton. As I mentioned, in my opening statement, the frequency and sophistication of cyberattacks really is staggering. I am deeply concerned that we are just not prepared for the catastrophic effects those attacks could have on our financial markets.

Your organization is taking steps in securing your own systems, and I wonder if you could talk a little bit more about that, and about the fact that you are ensuring that swap dealers and other CFTC registrants have strong cyber protections. You indicated that you are devoting more resources to cybersecurity, but I am very concerned that we are not providing the resources that are needed. I think that is something that we really need to look at in reauthorization.

Could you speak to what you are doing and what you think should be happening?

Mr. SEXTON. Thank you, Senator Stabenow. You are correct. Our testimony covered quite a bit of what we are doing in this area, and we view it similar to you, as an extremely high-risk area. When you think about it, one employee clicking on the wrong thing can essentially let a bad actor in that can steal data and do all kinds of nefarious things to your systems.

Over the last few years—I am very fortunate to work for an organization who has a board that strongly supports our cybersecurity efforts and our technology efforts. Over the last few years, our head count in technology itself has gone up 90 percent. Our budget in technology has gone up 140 percent. Just next year, we are adding five or six additional people just for security, because the patching is so critically important today, to patch your systems, and we have a very aggressive patching schedule to do so.

We follow several types of national standards, various NIST standards and others, with regard to our security. As I indicated, we have independent third parties come in and test our systems annually. Last year we went through a SOC 2 audit and obtained an unqualified opinion with regard to certification there. We recognize the importance of data protection, for our own data and for the CFTC data that we hold.

With regard to our members, we, several years ago, adopted guidelines with regard to our members, requiring them to have policies and procedures in place with what we call an information system security program. They have to do an assessment of the risks. They have to look at what tools they should have, protective measures, in light of those risks, do annual training with regard to their employees. Our examinations obviously have focused on that area. We largely took an approach, in the past few years, of educating our members about that risk.

Our notice, I should note, covers the largest financial institutions but also the introducing brokers located in the Midwest, and so we want to make sure that they are aware of that risk and have tailored their particular protections according to their particular risks. So we are continuing to work with our members.

Just recently we reviewed our cybersecurity requirements and put in place a requirement that member firms, if they have a breach with regard to their commodity interest business, have to notify NFA. We followup then and we see what kind of protective steps they are going to take.

Senator STABENOW. Wonderful. Well, thank you very much. I noted with interest you were saying that you had increased your budget in this area by 140 percent—that is, NFA's budget for this, 140 percent.

Which leads me to Mr. Kelleher and the question of CFTC funding, because CFTC funding certainly has not gone up 140 percent as it relates to enforcement in these areas. We are lucky to stay even.

All of these responsibilities—digital currency markets that are largely unregulated, as well as the other responsibilities—are so critical for the CFTC. Could you just take a moment to talk about the resources again? What should we be doing to improve the situation?

Mr. KELLEHER. Well, you know, we applaud the NFA and others who have the ability and had the wisdom to increase their resources dramatically and increase their capabilities dramatically, but they, too, are leaving the government and the public servants in the dust. They do not have the resources, and we know that. They are not even keeping up with inflation.

If you look at—and we put this in our testimony, in my written testimony—if you look at the budget, the increases to the CFTC, they are barely above inflation, and yet if you compare them to the additional responsibilities, and quite grave responsibilities have been thrust upon the CFTC, in Dodd-Frank, and as a direct result of the financial crash, and unregulated out-of-control derivatives market that they are now responsible for making sure that does not happen again. Both they are ensuring transparency, competition, enforcing the rules, the rules of the road that benefit everybody.

Every NFA member benefits tremendously by the CFTC being on the job, doing their job effectively and consistent with all their requirements. That is why we advocate not just increasing their resources, we advocate for a user fee. That is the only financial regulator that is not funded by the industry, and it should be.

I understand Mr. Barker's concerns, and I think that the assumption that a user fee is going to destroy markets and injure all sorts of market participants, I think, it has been historically proven to be false every time it has been raised. That does not mean it is not relevant. I agree it is relevant and it should be foremost in everybody's mind. A user fee that adequately funds the CFTC to do its job, like the SEC—which has been doing this since its creation in 1934, in the Exchange Act, when it was passed.

I do not know if you have noticed but those markets are doing, you know, pretty okay, and if they are not doing okay it is not because of this de minimis user fee. Better Markets provided an analysis in 2013, when you were considering reauthorization then, that showed how de minimis a user fee would actually be to adequately fund the CFTC.

So we would encourage you, in any reauthorization, to provide the resources, and we would suggest that you provide them according to a user fee. If not, then provide them directly. Because if you think about it, as I said in my opening statement, it is like paying for an insurance policy today. You pay for an insurance policy on your house. Your house is worth $300,000. You pay a couple hundred dollars for insurance. As we show on page 20, 42 financial institutions in this country received more TARP money in 2008 than the entire budget of the CFTC in 2019. I mean, that just goes to show the disparity in finding and the need.

Senator STABENOW. Thank you. Mr. Chairman, I want to ask one other question for the record, to Mr. Lukken—he can respond in writing, but I would like to just ask the question.

Mr. Lukken, I wanted to talk to you about customer protection. The CFTC recently announced that it plans to consider new rule amendments related to cross-border issues, including the treatment of clearinghouses located outside the United States. I find it very troubling that these rules may be pushed through before the CFTC's new Chairman takes office—even though the current

Chairman's term has already expired, and the Senate already confirmed the new Chairman with a strong, bipartisan vote of 84–9, earlier this month.

I am deeply concerned about the policy implications of changes that may come in terms of consumer protection and other markets. I will be watching very closely to see who benefits from any last-minute rules changes, and I would appreciate it, in writing, if you would respond regarding the three proposals that the outgoing Chairman is potentially taking action on next month. Thank you.

Chairman ROBERTS. I thank the Senator, and Senator Boozman.

Senator BOOZMAN. Thank you, Mr. Chairman. This is really an important hearing in regard to the benefit of our farmers, as we all know, so thank you all for being here.

Mr. Kelleher, I do not understand your analogy in regard to the entities receiving TARP money. Did they pay it back?

Mr. KELLEHER. I believe most of TARP was paid back, although I would say that the analysis, in my view, and the point of view should be at the time of the vote, when you actually did not know whether it was going to work, whether it was going to be paid back, how much was going to be paid back. So we now know that with the benefit of hindsight.

Similarly, we sit here today facing unseen risks that are not addressed because of lack of resources. So you are kind of in the same position. You will not know until 20 years from now whether or not inadequate funding caused the problems that people are concerned about.

Senator BOOZMAN. No, and I am not really arguing about that. I think when the law was passed, the safeguards were put in place, the interest rate, the whole bit.

I used to be chair of the Financial Services and had jurisdiction over CFTC. I do not remember them ever giving anything back. That is not to say that they are not underfunded and work very, very hard and have a huge job, which is growing on a daily basis.

Mr. Lukken, in your testimony you note that a number of firms providing clearing services has dropped considerably in the past few years. What is your take on why the consolidation is happening, and how should the Committee address this during the reauthorization process?

Mr. LUKKEN. Well, my guess is it is several factors playing into why FCMs have been shrinking over time. I think in my testimony it is 84, I think, in 2008, and we are down to 55 FCMs now.

The critical issue to understand with that is that FCMs play a critical role in the safety net of clearing. The first absorption of losses are the FCMs, when a member defaults. So the fewer of them—it is just like insurance. If there are fewer people in the insurance pool, the insurance is not socializing that risk.

So we have concerns that it is due to technology, to costs. It is becoming, as Joe mentioned, a low-margin business. Part of it is capital. Right now a lot of the banks that do the clearing are facing capital charges that hold capital against clearing. Our view, the G20 came out with two pillars of reform. One is to put more things in the clearing and one is to raise bank capital. Both are admirable goals. However, in one instance they are working against each other, where clearing actually is being—banks are being forced to hold capital against initial margin.

The Basel Committee, last week, in fact, came out with a recommendation to have an offset of initial margin against that capital, and we are hopeful that prudential regulators implement that in the current proposal that is before them now.

Senator BOOZMAN. So again, we hear a lot from constituents about how harmonizing rules would lessen the paperwork and burden that firms face. Again, this is something that seems to be something that would be very doable.

Mr. Sexton, I had a question about cybersecurity and I think it was asked and was answered well. In your testimony, though, you said that not holding unnecessary data in the first place is the best mitigation of risk, and I would agree with that totally.

We have gone through a period—I think it has backed off a little bit, but there for a while there just seemed to be an insatiable gathering everything we could gather, and in asking what we were going to do with that data and this and that, not only with CFTC but with so many other agencies. There really were not any answers, just that we need to gather it. Can you comment about that?

Mr. SEXTON. Thank you, Senator, and as we indicated in our testimony that perhaps the best risk mitigation is not collecting data that we simply do not need. We certainly commend Commissioner Stump's efforts at the CFTC, recent efforts to look at the data that the CFTC is collecting and kind of undergo this process. We, ourselves, undergo this process. As I said, if we do not need the data we should not be collecting it. It has to serve the regulatory purpose that is smart.

Senator BOOZMAN. Thank you, Mr. Chairman.

Chairman ROBERTS. Senator Smith.

Senator SMITH. Thank you, Chair Roberts, and also Ranking Member Stabenow for holding this hearing today, and thanks to all of you for being here. I appreciate. I would like to extend a special greeting to Mr. Barker, my fellow Minnesotan. I appreciate you being here.

So we have experienced significant economic growth since the 2008 financial crisis. Many Minnesotans have felt this, yet many Minnesotans are still continuing to suffer from the consequences of that crisis. Better Markets, I think it is notable, has estimated that that crisis cost the economy $20 trillion in economic productivity.

I think, believe, and think the evidence is there, that the crisis was caused, in large part, by the fact that there was effectively no regulatory regime in place to oversee the swaps market, with hundreds of trillions of dollars of notional value.

So in 2008 and 2010, this Committee authorized legislation to resolve this issue by finally giving the CFTC authority to oversee the swaps market. There are still lots of unanswered questions about what will happen in the inevitable future downturn.

So Mr. Kelleher, let me ask you first. Do you think that the CFTC has the resources to effectively oversee this market and the tasks that we, Congress, have given it?

Mr. KELLEHER. I think any comparison of the duties and responsibilities, just narrowly speaking, the statutory duties and responsibilities from the CEA, as it has been amended through Dodd-

Frank, that they are grossly, grossly underfunded and cannot possibly do it. I agree with Senator Boozman and Mr. Sexton about you do not want to collect any data that you do not need.

One of the things that was needed desperately was data and information that regulators would have. I can tell you, I remember when Walt was acting Chairman during the crisis and came up to the U.S. Senate to brief members, and I think Senator Durbin will remember this. The CFTC and its leadership team, their answers were mostly, "Well, we do not have that information. We do not have that information. We do not know what is happening. We do not have the information."

Senator SMITH. Mm-hmm.

Mr. KELLEHER. The good news is you change the law. The law requires the gathering of that information, and its protection and its analysis and its use, so you can have data-driven rulemaking and decisionmaking, and yet you underfund the CFTC to be able to deal with the information and have the analysis and the technology to do it.

So, I am sorry, it is a long answer, but the short answer——

Senator SMITH. We have the data——

Mr. KELLEHER [continuing]. is they just do not have the resources.

Senator SMITH [continuing]. so you are saying we have the data but we do not really have the resources to use that data.

Mr. KELLEHER. A lot of the data is flowing in, and I think you will agree the data is flowing in but it is not being optimized anywhere near, from an analytic point of view and from a decisionmaking point of view, that we all had hoped it would and that it should.

Senator SMITH. So—and this is the line of questioning that Senator Stabenow was on, but, you know, I am struck as I think about how this market works. You know, there is important self-regulation, and then there is also the role of the public, the taxpayers, the consumers, that is expressed through the role of government, the government's role here.

So I would be interested in just hearing whether you think that balance—do we have the right balance? Is the balance out of whack? What should it look like?

Mr. KELLEHER. Well, you are absolutely right. There should be a balance between self-regulatory organizations that are authorized and overseen by government entities that, importantly, are controlled by you, elected officials. The self-regulatory agencies are not, and they are profit-maximizing private entities. God bless them. That is what they should do. That is what we want them to do.

Senator SMITH. That is the point, right.

Mr. KELLEHER. We want them to do it in agriculture. We want them to do it elsewhere. Those priorities are not necessarily the priorities of the government, and they may not be the priorities of elected officials overseeing the government.

So it is important to get the balance right, and we do not have it right.

Senator SMITH. Is that primarily because of the resource imbalance or is it authority imbalances also, in your view?

Mr. KELLEHER. I would say it is both, but it is primarily driven by resource imbalance. You know, it is great that the NFA is increasing, as I said earlier, increasing its budget and its personnel, and, you know, even the trade groups, they are all increasing their budgets, their personnel, and technological savvy. Yet we are choking the CFTC.

I want to say—just take a minute and say, you know, God bless the men and women working at the CFTC, not just today but over the years, all the way back through Walt's term and others, through the financial crisis and since, through Dodd-Frank, doing rulemaking after rulemaking. Whether you agree or disagree with them, they have done an unbelievable job. They are public servants of the highest order and have done a terrific job, under circumstances that should not exist. They should get the support, the money and the authority they need to do the job that you have statutorily required them to do.

Senator SMITH. I have just a second or two left, but I just want to see if anybody else would like to have a comment on that overall question of what is the appropriate balance between self-regulation and the role of the public sector here.

Mr. SEXTON. Thank you, and as a self-regulator on the panel I think that the role of self-regulation is essential for these markets.

Senator SMITH. As do I.

Mr. SEXTON. We do not maximize profits. We are not a maximizing-profit entity. As I said, along with self-regulation, I think what is also critically important is strong oversight of self-regulators, which we have in the CFTC.

So I described our relationship as a partnership, Senator. It truly is a partnership, looking at all the various issues that we have tackled in the last six years, since Dodd-Frank, and we look forward to working with the Commission and this Committee in the future in doing so.

Senator SMITH. Thank you.

Chair Roberts, I know I am out of time. I have a followup question on position limits which I will submit for the record.

Chairman ROBERTS. Without objection.

The distinguished Senator from Illinois.

Senator DURBIN. Mr. Chairman, I am trying to get use to where I am sitting here. I feel like I am part of a panel.

[Laughter.]

Senator SMITH. I cannot get use to sitting on this side of you, Senator.

Mr. KELLEHER. I defer to let Senator Durbin answer for me.

[Laughter.]

Senator DURBIN. I do not mean to block you.

I would like to ask the panel, originally, the Commodity Futures Trading Commission focused on commodities. What percentage of the business in this industry now relates to agricultural commodities?

Mr. LUKKEN. We collect that data. It is actually in my testimony. I think it is around seven to eight percent, around that area.

Senator DURBIN. Interesting that we are in the Ag Committee discussing the Commodity Futures Training Commission, where 92 percent of their business does not have anything to do with agriculture commodities.

So a few years ago, when I was in a position to do so, as the Chairman of the FSGG Subcommittee of Appropriations, I called my friend, Herb Kohl, and said, "You have, in the Ag Subcommittee, the CFTC. I have the SEC. Would you mind if I had the CFTC too?" He said, "Be my guest." So now, from the appropriations viewpoint, they are married, in terms of where they are headed.

To Mr. Kelleher's earlier point, when it came to funding it was a totally different story. There was plenty of money in the SEC, in fact, a surplus of money at some point, more money being collected than they were actually spending for inspection and regulation purposes.

I found, as you have alluded in your testimony, there was resistance to funding the CFTC. I think that is a mistake. If we want to maintain the integrity of our Commodity Futures Trading Commission and the industry that it regulates, we certainly want enough cops on the beat to be credible, and I do not think we are keeping up with that demand.

So we can argue about the source of it, but I certainly think the bottom line is CFTC needs more resources in order to deal with the volume of work that they are undertaking, 92 percent of which has nothing to do with agriculture.

I would like to ask question, and I do not know who would be the right person, so I will just give it to the panel, about Brexit. As this Brexit dynamic continues and as the remaining EU member states look to draw business away from the UK, creating new regulatory regimes for trading and clearing derivatives, that move away from the 2016 CFTC EU equivalence agreement, the U.S. exchanges and clearinghouses that have done business in the EU countries for decades could be harmed if an agreement to avoid disruption is not reached. The Chicago Mercantile Exchange estimates it could stand to lose up to 30 percent of its current business without this agreement.

So maybe Mr. Lukken, since you appear to be knowledgeable on this topic, what is under consideration to ensure the contours of an equivalence deal are maintained.

Mr. LUKKEN. Let me start by saying that this mutual recognition regulatory approach has been around a long time, and you probably remember, many years back, the Foreign Board of Trade Regime, which Congress gave the CFTC the ability to recognize foreign boards of trade to allow people and consumers in the United States to access foreign boards of trade where they might need to hedge or participate in those markets.

So this has been an approach that has been largely accepted as an international standard, and the EU and the United States had entered into an equivalence agreement, as you mentioned, two years ago. As they are developing their regulatory structure in the EU, Brexit occurs, so now the financial center of Europe will be located outside of the EU's economy, and they do not want that to happen. So they are looking for ways to maintain control over that.

Unfortunately, the United States is also located outside of the EU, and we are going to be subject to this same criteria that they are putting on the UK and their clearinghouses there.

So we think there is a pragmatic approach here, that they should recognize the equivalence agreement that was agreed to in 2016. They have the authority, in the law, EMIR 2.2, to do so, and we have been encouraging the EU to do that.

Now we do not know for certain whether they are going to do that. They have the tools and it is out for comment right now. Certainly the industry, the CME, ICE, and others are lobbying them very hard to make sure—and there is a House hearing tomorrow on this—to make sure that EU does the right thing.

Senator DURBIN. Give me, if you can, kind of snapshot. When it comes to futures derivatives and such, what percentage is actually flowing through the United States and what percentage in other parts of the world?

Mr. LUKKEN. You know, it is a tough one to measure, but I would say two-thirds, one-third of the derivatives markets somehow touched the United States in some capacity, and it is significant.

Senator DURBIN. So if the UK—I am trying to sort this out in my mind—if the UK does withdraw from EU, Brexit, and at that point whatever trading took place in the UK, EU would like to have at home, in the EU countries, give me a snapshot of what that looks like.

Mr. LUKKEN. Well, first off it is going to hurt the EU. I mean, that is the ironic part, is that their customers are going to lose access to global markets, and it is going to hurt EU businesses. So we have encouraged them to adopt this approach that allows EU customers to have access to the UK, the United States markets, through this recognition approach, which has largely been the standard for 20, 30 years.

So, ironically, though the EU is trying to get business to come into the EU, they are hurting their own selves by doing so.

Senator DURBIN. Thank you.

Chairman ROBERTS. I thank the Senator for a most pertinent observation.

Senator Hoeven—well, as I speak, Senator Hoeven, you are recognized.

Senator HOEVEN. Mr. Chairman and Ranking Member, thanks, as always, for calling this hearing.

I would just start out by asking the panel, and maybe each of you can respond, do you foresee improvement in crop prices, based on what is going on in the market, and if so, do you see a reaction in the futures market?

Please be specific. You can round to the nearest dime.

[Laughter.]

Mr. BARKER. We have seen extreme volatility in agriculture markets. We have already seen the price of corn rally close to $1. Soybeans are up more than $1 from the lows this spring, based on the really slow planting progress, really across the Grain Belt, I mean, South Dakota, Iowa, Missouri, Illinois, Indiana, and Ohio.

Just two weeks ago I drove from St. Louis to Detroit, of all things, visiting clients out in the country, as we say, and there are some areas, specifically in northeast Indiana, northwest Ohio, that are looking quite rough, where the corn in that area, what did get planted, which, in some cases, is less than 25 percent of intentions, is less than four inches tall. There is an old saying, we would like our corn knee-high by the Fourth of July. It is unlikely we will actually get there.

Depending on what happens with trade and some other factors, I can see a situation where the price of grain may go higher if the crop failure does come to fruition. Our markets are forward-looking, but our markets also like to see data as we go along. So most recently, in the last USDA report, when the USDA decreased the acres of corn and also do you see a reaction in the futures market?

So to answer your question as best I can, not to the nearest dime, but there is potential for our ag markets to go higher in the grains. Then livestock, the hog market is quite focused on the disease situation in China and how that may impact the price of pork. The dairy markets could use some help from the USMCA, and we have seen dairy prices come up in the last couple of months, if that helps.

Senator HOEVEN. Both Mr. Sexton and Mr. Lukken are in the futures market, so you guys should have it diced. What is your forecast? The preventive plant program is going to have an impact too, is it not, in terms of supply and demand, or price, right?

Mr. SEXTON. Senator, as a regulator I learned a long time ago not to forecast crop prices, so I think I am going to take a pass on this particular question.

Senator HOEVEN. All right. Mr. Lukken?

Mr. LUKKEN. I was just going to say, I think for us we are sort of agnostic to prices, but we want to make sure the markets are reflecting the proper supply and demand that are occurring in the marketplace, and certainly we are hopeful that farmers are getting high prices. Our main job is to make sure the markets are free of manipulation and that they are properly reflecting supply and demand.

Senator HOEVEN. Yes, I get that, but, you know, we have been in a tough cycle for quite a while on commodity prices, and I am just wondering if any of you see some improvement. Are you seeing some signs, some indications that we may get some strengthening in these markets?

Thank you, Mr. Barker. You did a good job on it, and I hope you are right, but just any other thoughts? Mr. Kelleher?

Mr. KELLEHER. The only thing I would say is I think Mr. Barker has referred a number of times to the volatility in the markets, and there are a lot of factors going into the volatility and there are a lot of factors going into price, none of which am I an expert on.

One thing we do know, there is excess speculation in these markets, and we need a strong, robust, effective position limit rule so that we can try and get these markets back to serving the constituency they were created for, which is the actual physical purchasers and producers of commodities. We have a financialization of these markets where there is excess speculation across the board.

Better Markets did a study a couple of years ago that showed that if you go back a couple of decades, speculative interest in the markets were roughly 30 percent, and physical traders were roughly 70 percent. That has now flipped. Speculation is now—oh, this is a rule of thumb, roughly. If you look at different markets it is different, obviously. Rule of thumb, roughly 70 percent spec interest, 30 percent actual physical producers and purchasers in these markets.

Any reasonable look at these and you can see there is excess speculation. That is affecting prices. That is harming the ability to hedge. That is driving up the cost to hedge, and it causing the loss of credibility and faith in some of these markets. I think the CFTC needs to get the position limit rule done, done right, and done robustly so that we can get these markets back to serving the people that they were created for, were intended to serve. Those are Mr. Barker's constituents.

Senator HOEVEN. Are the futures markets working well for our ag producers right now, or not?

Mr. BARKER. I believe they are functioning efficiently, and when the farmers make their independent decisions to market their crop I believe the markets are there for them today. The farmers do rely on the CFTC to be that referee, to make sure that our markets are fair and adequate. So we do encourage additional resources for the CFTC to ensure these markets are there and fair.

Senator HOEVEN. Are there changes that should be made that would improve it?

Mr. BARKER. Well, I would like a little bit of time to research that, specific changes that could be made to improve it. I do think resources are certainly needed, and I will just stop there.

Senator HOEVEN. Same question, Mr. Lukken?

Mr. LUKKEN. We certainly support a well-funded CFTC, and I think that has been talked about quite a bit here. So that is something I think will help the agency oversee the marketplace.

I do not think there is a need for specific changes to the law itself. As I mentioned in my opening statement, the CFTC has adequate authority. It has a principles-based regime that allows it to change its rules over time. So I do not think there are any specific changes the CFTC needs in order to make sure these markets are healthy and efficient.

Senator HOEVEN. Mr. Sexton or Mr. Kelleher?

Mr. SEXTON. I will go back to my written testimony, and one FCM bankruptcy is too many. Customers should be protected in FCM bankruptcies and we are strong supporters of the fix that is described with regard to the Griffin Trading matter, with regard to customer protection, and that is the change that I think is necessary to protect farmers and ranchers and other customers.

Senator HOEVEN. Say that again—specifically?

Mr. SEXTON. The Griffin Trading case. It is in our testimony, sir.

Senator HOEVEN. Yes, Okay. Mr. Kelleher?

Mr. KELLEHER. Well, I certainly agree. You know, I think people can argue whether or not the current authorities are adequate for customer protection. We think they are. We think the court case was an outlier, but we certainly agree with making it clear that that is the case.

The one thing I would say is, you know, I think there is unanimity that the CFTC needs resources and some authorities, but certainly resources. What I would like to see is as much lobbying effort go into getting the CFTC the resources they need as they go into other aspects of the lobbying, from entities who are over at the CFTC looking to get them to do what they should do and do their job well and on time. Their ability to do that goes down day by day.

So I would encourage everybody to put funding at the top of the list so that many of the things we all hope to happen here, we all agree on, happen.

Senator HOEVEN. Thank you. Thank you, Mr. Chairman, and again to the Ranking Member for the hearing today. I appreciate it.

Chairman ROBERTS. Well, thank you, Senator Hoeven.

I am going to hold the thought that I had in mind with regards to funding, and just leave it out there for people to wonder what the heck I was going to say.

[Laughter.]

Chairman ROBERTS. So with that, that will conclude our hearing today. To our panel of witnesses, thank you for sharing your views on an important topic. You all gave very pertinent testimony. Thank you. You have given this Committee much to think about as we continue to work toward CFTC reauthorization.

For those in the audience and all of our stakeholders whose opinions we value, if you want to provide additional views on reauthorization we have set up an address on the Senate Agriculture Committee's website to collect your input. Please go to ag.senate.gov and click on the CFTC Reauthorization Hearing box on the left-hand side of the screen. I wonder why it is not on the right-hand side, but never mind.

Please note that link will be open for five business days following today's hearing. To my fellow members, we would ask that any additional questions you may have for the record be submitted to the Committee clerk five business days from today, or by 5 p.m. next Tuesday, July 2nd.

The Committee is adjourned.

[Whereupon, at 11:16 a.m., the Committee was adjourned.]

APPENDIX

JUNE 25, 2019

NFA

TESTIMONY OF THOMAS W. SEXTON
PRESIDENT AND CHIEF EXECUTIVE OFFICER
NATIONAL FUTURES ASSOCIATION

BEFORE THE UNITED STATES SENATE COMMITTEE ON AGRICULTURE, NUTRITION & FORESTRY

June 25, 2019

Chairman Roberts, Ranking Member Stabenow, Members of the Committee, thank you for the opportunity to testify at this important hearing. I am the President of National Futures Association. For those new to the Committee, NFA is the industrywide self-regulatory organization (SRO) for the derivatives industry. Our membership includes swap dealers (SD), futures commission merchants (FCM), commodity pool operators (CPO), commodity trading advisors (CTA), introducing brokers (IB), retail foreign exchange dealers and all of the associated persons of intermediary firms. NFA's Membership currently numbers approximately 3,500 Member firms and close to 50,000 associated persons. NFA's responsibilities include registering all firms and industry professionals on behalf of the Commodity Futures Trading Commission (Commission or CFTC), passing rules to ensure fair dealing with customers, monitoring Members for compliance with those rules and taking enforcement actions against those Members that violate our rules. Every aspect of our regulatory authority is closely overseen by the CFTC.

As the industry SRO for the derivatives market, we have one overriding objective—to help the CFTC. Although we work independently of the CFTC, we are subject to CFTC oversight, and we and the CFTC act as strong partners in regulating the derivatives industry. Over the years, the CFTC has asked for our assistance and delegated a number of responsibilities to NFA. For example, besides the registration process, the CFTC has delegated to NFA the responsibility for reviewing all CPO and CTA disclosure documents, CPO annual pool financial statements and swap valuation dispute information from SDs. We communicate daily with the CFTC on a number of regulatory issues and closely coordinate with them. For example, we meet regularly with the CFTC's Division of Enforcement to coordinate our investigatory resources and also with the Division of Swap Dealer and Intermediary Oversight on our exam process and rule development. Moreover, if our exams or investigations uncover emergency situations, then we immediately coordinate our responses with the CFTC.

The Commission's responsibilities are enormous and we will continue to help in any way we can. At this time, I certainly want to thank CFTC Chair Giancarlo for his support of

NFA and self-regulation over his past five years serving as a CFTC Commissioner. Additionally, as the CFTC transitions to new leadership under Dr. Tarbert, we certainly look forward to working with Chair Tarbert and applaud the Senate's confirmation of him a few weeks ago. Similarly, we also applaud this Committee's work to give the CFTC a full five member Commission, which we believe brings a diversity of views and knowledge to confront today's regulatory challenges and enables the CFTC to successfully carry out its important work.

Reauthorization is always an important process for the industry as a whole and for NFA in particular. NFA firmly believes that customer protection issues should be front and center as Congress works to reauthorize the CFTC. The last few reauthorization bills voted out of this Committee and the House Agriculture Committee have included a key customer protection provision relating to FCM bankruptcies, which we continue to strongly support. I would first like to address this provision and reiterate the reasons for our strong support. The remainder of my testimony will discuss changes to NFA's oversight responsibilities, cyber security and customer protection issues that we have addressed with the CFTC's support since the CFTC's formal authorization expired in September 2013.

Strengthening Customer Protections in FCM Bankruptcy Proceedings

As I mentioned, a key customer protection provision relating to FCM bankruptcies has been included in previous reauthorization bills voted out of this Committee and the House Agriculture Committee.

NFA fully supports this provision, which would strengthen customer protections and provide customers with priority in the event of an FCM bankruptcy, and we urge this Committee to include this key statutory change in any future reauthorization bill. Over 30 years ago the CFTC adopted rules regarding FCM bankruptcies. Among other things, those rules provided that if there was a shortfall in customer segregated funds, the term "customer funds" would include all assets of the FCM until customers had been made whole. Several years ago, a district court decision cast doubt on the validity of the CFTC's rule. Although that decision was subsequently vacated, a cloud of doubt continues to linger over the validity of the CFTC's rule. Congress should remove that doubt and ensure that customers have priority if there is a shortfall in segregated funds, and can do so by amending Section 20 of the Commodity Exchange Act. Section 20 gives the CFTC authority to adopt regulations regarding commodity brokers that are debtors under Chapter 7 of Title 11 of the United States Code. We suggest that Congress amend Section 20 to clarify that the CFTC has the authority to adopt the rule that it did. We believe there is a broad base of industry support for this approach, and we would be happy to work with Congress on specific proposed language.

Changes to NFA's Oversight Responsibilities

In light of Dodd-Frank, NFA's responsibilities have grown significantly and it is a much different organization today than in 2013. By raw numbers, NFA's budget in FY 2013 was $63.2 million and in FY 2020 it will be $107.2 million. Our employees numbered approximately 331 in FY 2013 and today we have 536 employees. Although the majority of that increase is attributable to staffing our OTC Derivatives Department to oversee SD Members (as described below), we also significantly increased our Technology Department to both support the OTC Derivatives Department, as well as address other technology and cyber security related issues. Specifically, NFA's Technology Department grew (90%) from 59 employees in 2013 to the current staff of 112 for FY 2020. The technology budget also grew significantly (140%) from $10.2 million for FY 2013 to $24.4 million for FY 2020.

Swap Dealer Members

The most significant change to NFA's self-regulatory role occurred in late 2012 when we assumed regulatory authority over SDs after the CFTC required them to become NFA Members. We currently have over 100 SD Members, the vast majority of which are either large U.S. banks or financial institutions, foreign banks or affiliates of one of these entities. In FY 2020, SDs are projected to contribute approximately $33 million to fund NFA's oversight of their activities. Since late 2012, we have added over 100 employees as we developed our SD regulatory oversight program, which has the following major components:

Policy and Procedure Reviews—Beginning in early 2013, we worked closely with the CFTC to review the policies and procedures for all 100 new SD registrants. Our review was extremely detailed in nature and was designed to ensure that each SD had adopted written policies and procedures to ensure that it complied with the CFTC's Implementing Regulations under Section 4s of the Commodity Exchange Act.

Examinations—We performed our first examinations of SDs in 2014, and since then we have examined all U.S. SDs and nearly all non-U.S. SDs for compliance with NFA's Rules, which adopt the CFTC's core requirements applicable to SDs. In examining non-U.S. SDs, we work cooperatively with the CFTC and non-U.S. regulators and have performed on-site examinations in the U.K., Australia, Canada and Sweden. Our examinations of U.S. SDs have focused on regulatory requirements related to the chief compliance officer function, risk management, business conduct standards, SDR reporting and the segregation of counterparty collateral. In light of the CFTC's substituted compliance framework, our examinations of non-U.S. SDs have focused on a narrower subset of these areas.

Data Collection—In January 2018, we started collecting monthly market and credit risk data from SDs and standardized data for swap valuation disputes (SVD). The risk data metrics allow NFA to monitor the SDs' risk exposures by requiring them to report monthly risk metrics, including value at risk, credit valuation adjustments, market sensitivities, current exposures and the exposure to their fifteen largest counterparties. The SVD data includes detailed information about the dispute including the counterparties involved, dispute amount and date of resolution, if any. The monthly risk and SVD data is available to the CFTC, and we use the data to identify firms that may pose heightened risk.

Margin Model Approvals—The CFTC's margin rules for uncleared swaps allow SDs subject to the CFTC's rules to choose between calculating initial margin using a standardized grid or an internal risk-based model approved by the CFTC or NFA. The CFTC's rules have a five-year implementation period based on the size of an SD's swaps business. In early 2016, the CFTC requested that NFA approve the use of SDs' initial margin models, which required NFA to perform a detailed review of each SD's model to determine if it met the standards set forth in the CFTC's margin rules. To complete these reviews, we hired staff with quantitative expertise, engaged consultants and worked closely with the CFTC. We subsequently approved the initial margin models of more than 30 of the largest SDs by the first implementation date of September 1, 2016. Since that time, we have approved models of a few additional SDs with later implementation dates and newly registered SDs immediately subject to the CFTC's margin rules. We are currently working with several smaller SDs that are seeking model approval by the final implementation date of September 1, 2020. We have also developed and implemented an oversight program to assess whether each SD's ongoing use of the model is in compliance with NFA's approval conditions and the CFTC's margin rules.

NFA's SD oversight program is just over six years old, and we will continue to evaluate and enhance this program as necessary in the future.

Swap Execution Facilities

Dodd-Frank required the registration of swap execution facilities (SEF), which are electronic trading platforms for swaps. These SEFs are SROs and have an obligation to surveil their markets. Since the early 2000s, we have contractually offered to perform certain surveillance functions on behalf of electronic futures markets. After Dodd-Frank, many SEFs requested that NFA perform similar functions for them. To do this work, we tripled the size of our Market Regulation Department, which performs these services for contract markets and SEFs. Today, we perform market surveillance for 13 SEFs, which among them have 97% of the SEF traded interest rate market and close to 100% of the SEF traded CDS index market. In performing these services, we work closely with the SEFs acting as SROs and the CFTC's Division of Market Oversight.

We also applaud the CFTC's willingness to review the SEF trading structure five years after SEF trading was launched. NFA does not operate a market and is not a market participant and, therefore, we did not comment on many of the market structure issues in the CFTC's November 2018 proposal. We did, however, express concerns about some portions of this proposal since we felt they would seriously erode regulatory accountability over individuals and firms that accept or solicit orders for swaps transactions. We look forward to further discussing those issues with the CFTC if necessary.

Cyber Security

Cyber security is an issue that is of critical importance to all of us—Congress, regulators, market participants and the general public. Currently, security comprises over 20% of our technology budget and similar to most organizations, this cost continues a steady rise. NFA makes every effort possible to secure our technology systems and protect NFA Member data and data held on behalf of the CFTC. In doing so, we adopted best practice frameworks and standards (*i.e.*, National Institute of Standards and Technology and the Center for Internet Security) to form a foundation that supports prompt security risk assessment and mitigation. We also engage independent third parties to perform security testing. Last year, we engaged two independent examiners to perform separate reviews of our security program. The first, our annual security assessment, focused on the technical aspects of NFA's applications and network infrastructure, and the second, the SOC2 Certification audit, focused on the framework of policies and procedures that serve as the foundation for NFA's security program. We constantly stress the need for our staff to adhere to our security protocols, and our security measures are constantly reviewed by our security compliance and applications development staff, by NFA's Board and by the CFTC.

Technology and expert security personnel assist greatly in mitigating NFA's cyber security risks. However, not holding unnecessary data in the first place is the best mitigation of risk. We continually assess whether the sensitive data we collect is necessary for us to fulfill our regulatory responsibilities, and if it isn't then we stop collecting it. Moreover, we use our best efforts to delete sensitive data when the regulatory need no longer exists.

Like NFA, our Member firms face cyber security risks each day. Our Members range in size from large multinational corporations with sophisticated security programs to sole proprietorships. In 2015, NFA's Board imposed specific cyber security requirements on NFA Members by requiring them to have a written information systems security program (ISSP). Although we allow Members flexibility to adopt specific measures appropriate for their business and size, all Members are required to conduct a security and risk analysis, deploy protective measures against identified threats and vulnerabilities, develop a response and recovery plan from threatening events, train their employees and review their programs at least every twelve months. Since making the ISSP requirements effective in early 2016, we have worked with our Members during examinations to ensure that they comply, and we have made further changes to the requirements that we felt were appropriate. For example, we recently imposed a requirement that Members notify NFA of certain breaches involving their commodity interest business and implemented a more comprehensive cyber security examination program that includes additional testing of Members' cyber security readiness. Given the nature of this threat, we will continue to be vigilant about Members' compliance with our cyber security requirements.

Customer Protections Issues

Detecting and combating fraud is central to our mission. No system of regulation can ever completely eliminate fraud, but we must always strive to achieve that goal. We are constantly working to refine and improve regulatory protections. Given the evolving nature of the derivatives industry, we are currently engaged in a review of NFA Requirements to ensure that they appropriately address the commodity interest activities of all our Members and recently amended our existing rules that were limited to futures activities to cover SDs and the swaps activities of all Members.

At this time, I will highlight just a few of the customer protection issues we have addressed since the CFTC's formal authorization expired in September 2013. The CFTC's assistance in addressing these issues was critical.

> *Oversight of Firms*—Our employees are committed to protecting customers and safeguarding the derivatives markets. They understand that the examinations NFA conducts on our Member firms are not just about crossing "T"s and dotting "I"s—they are about detecting violations of NFA rules—including our anti-fraud rules. To that end, the vast majority of our compliance professionals are certified fraud examiners, which involves extensive training, testing and continuing education requirements. Moreover, in 2016, NFA and CME Group engaged a consultant and worked with the CFTC to develop a set of examination standards that conform to applicable auditing standards issued by the Public Company Accounting Oversight Board. NFA examiners follow these standards to carry out examinations, and these standards help ensure that our exams are reliable, accurate and consistent.
>
> *Safeguarding Customer Funds*—All FCMs that hold customer funds report their customer segregated, secured and cleared swaps collateral funds balances to NFA or CME Group daily. In 2013, NFA and CME Group phased in a process to confirm all these balances on a daily basis by obtaining confirmation information directly from depositories. We also perform detailed reviews during our examinations of an FCM's internal controls, and since CPOs also hold customer funds we recently adopted a requirement, reviewed by the CFTC, that CPOs implement an internal controls framework that is designed to protect customer funds, produce reliable and accurate financial statements and ensure that the CPO is in compliance with CFTC and NFA requirements.
>
> *Swaps Proficiency Requirements*—Individuals engaging in swaps activities with customers and counterparties should meet basic proficiency requirements. NFA is currently developing proficiency requirements for individuals acting as APs at SDs and those registered APs engaged in swaps activities at our intermediary firms. These requirements will be in the form of an online learning program that consists of a series of modules, each with a training and testing component. NFA's Swaps Proficiency Requirements will launch in January 2020 with a

Compliance Date of January 31, 2021. The CFTC has supported this initiative and reviewed NFA's rules to effectuate these requirements.

Virtual Currencies—In late 2017, a number of CFTC regulated trading venues launched derivatives on virtual currency products, including bitcoin. NFA, working with the CFTC, issued an investor advisory so customers fully understood the nature of virtual currencies and virtual currency derivatives, the substantial risk of loss related to these products given their volatility and the limitations of NFA's regulatory authority over spot market virtual currency products. We subsequently adopted additional requirements, which required NFA Members engaged in these products to provide detailed additional disclosures to customers. Through specific reporting requirements, we carefully monitor our Members' activities in these products, which have been modest to date.

Regulatory Coordination—Approximately 760 NFA Member CPOs are also registered with the SEC as investment advisers (IA). We firmly believe that the expertise to oversee these firms' derivatives activities is much different than the expertise to oversee their securities activities, and therefore it is essential that CFTC/NFA and the SEC continue to carry out their respective regulatory oversight of these entities. However, we support a framework that maximizes regulatory coordination including a formal process for NFA and the SEC to share examination schedules and reports for dually registered CPOs/IAs and conduct joint examinations when feasible. NFA also supports streamlined reporting for dually registered CPOs/IAs by permitting these firms to file either Form PQR with the CFTC or Form PF with the SEC with the agencies sharing the information. We look forward to working with the CFTC and SEC on these coordination efforts.

In conclusion, NFA's mission today is the same as it was thirty-seven years ago. Our overriding objective is to help the CFTC to protect customers, protect market integrity and protect the public's confidence in the derivatives markets. We are proud of our regulatory partnership with the CFTC, and we will work closely with Congress and the Commission to respond to the regulatory challenges posed by an industry that is constantly changing. I would be happy to answer any questions.

United States Senate
Committee on Agriculture, Nutrition, & Forestry
Statement of Walter L. Lukken
President and Chief Executive Officer
FIA

Intro

Chairman Roberts, Ranking Member Stabenow, and Members of the Committee, thank you for the opportunity to testify about the reauthorization of the Commodity Futures Trading Commission (CFTC), and the state of derivative markets.

I am the President and Chief Executive Officer of FIA. FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, law firms and other professionals serving the industry.

FIA's mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and to promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members help reduce systemic risk in global financial markets. Equally important, our clearing firm members provide access to the commodity futures markets, which allows a wide range of companies in the commodity supply chain to manage their price risks.

Prior to serving as the President and CEO of FIA, I had the honor of serving as a Commissioner of the CFTC from August 2002 to June 2009. During that time, I served as the Acting Chairman from June 2007 to January 2009.

The CFTC was last reauthorized in 2008 as part of the Farm Bill. At that time, I was serving as Acting Chair of the CFTC. It was a privilege to work with my fellow Commissioners and the members and staff of this Committee to ensure the agency had the regulatory and enforcement tools necessary to continue to effectively oversee the markets.

Prior to 2008, the CFTC was last reauthorized in December 2000, as a part of the Commodity Futures Modernization Act of 2000. At that time, I had the privilege of serving as a professional staff member for this Committee under the leadership of the late Chairman Richard Lugar.

This varied experience has provided me a firsthand understanding of the importance of the CFTC reauthorization process because it provides a Congressional stamp of approval on this agency's important mission and legal authority. Today, I am honored in my current capacity to once again work with this Committee as you deliberate reauthorization and possible changes to the Commodity Exchange Act (CEA).

Market Trends

Markets Have Grown Significantly

In the decade since the last reauthorization in 2008, our markets have grown significantly with volume of futures and options increasing 70 percent over this time. Today there are more products and participants using these markets to hedge and manage risk than ever before. Demand for these risk-management products remain high.

Markets Are Safer

Thanks to the implementation of the post-crisis reforms to the OTC derivatives markets, a large percentage of interest rate and credit default swaps are now submitted to central counterparties for clearing. According to CFTC data, 90 percent of interest rate swaps and 62 percent of credit derivatives are now cleared, respectively. This reduces the amount of risk in these markets and provides greater transparency for both regulators and market participants.

Markets Are Increasingly Global

Since the last reauthorization, our markets have become much more global. The CFTC first allowed U.S. customers direct electronic access to foreign exchanges in 1996, and today all major exchanges in the U.S. and abroad have anywhere from one-third to ninety percent of their volumes coming from outside their home location. Importantly, these transactions from foreign participants add important liquidity to a market that keeps costs affordable for domestic customers hedging risk.

Technology Has Transformed Markets

Like most economic sectors, this industry has been transformed by technology, whether it's the way market participants trade futures, the way trades are processed and cleared, or the way regulators surveil the markets. Technology has provided the markets with greater efficiencies that enable more people to access these products globally at significantly lower costs.

FIA Views on CFTC Reauthorization

Preserve Flexible Core Principles

To keep pace with technological advances and changing market dynamics, FIA supports the CFTC's existing principles-based approach to regulation, which has served the agency well for the past twenty years. The core principles of the CEA provide the CFTC with outcomes-based tools that can be tailored to an ever-changing global marketplace driven by technology. It allows the agency to focus on the risk of activities across a broad array of market participants and products. This Committee has equipped the CFTC with these important tools that have allowed the agency to evolve with changing market dynamics, and this flexibility should be preserved.

Maintain Access to the Global Markets

Earlier this month, this Committee held a hearing titled "Certainty in Global Markets for the U.S. Agriculture Sector." As producers need access to global commodity markets to sell their physical commodities, they too need access to global derivatives markets to hedge risk in times of uncertainty. Knowing that they can rely on well-regulated futures and options markets gives American farmers the protection from price volatility that they need to compete in the global markets for corn, wheat and soybeans.

The reverse is also true: companies all over the world use the agricultural and energy contracts listed on U.S. futures markets as the benchmarks for global trade in these commodities. That brings additional liquidity to these markets, and that is a win-win for customers here in the U.S.

FIA, however, is closely monitoring several areas of concern that could impact access to European and U.S. markets as the Brexit debate continues. Recent revisions to the European Market Infrastructure Regulation legislation (EMIR 2.2) on clearinghouse supervision may require direct compliance with substantial elements of EU law and supervision by EU regulators for U.S. clearinghouses deemed systemic unless EU regulators find U.S. supervision equivalent. If implemented without the proper recognition of home country supervision, this could lead to contradictory requirements, duplicative supervision and counter-reactions by global regulatory authorities. These EU consultations, which are currently out for public comment, may impact access to global markets if not properly clarified and implemented. The current Chairman of the CFTC has also announced his intention to strengthen the CFTC's ability to recognize and defer to home country supervision for foreign CCPs. FIA stands ready to comment on all these proposals to ensure the proven regulatory deference and recognition approach remains the standard for cross-border regulation.

Regulatory Harmonization

In today's markets, there is an increased need for harmonization amongst regulators both domestic and global. With firms conducting more cross-border transactions and more cross-asset trading strategies, CFTC, SEC, and global regulators will need greater coordination when it comes to information sharing and approaches to market oversight. Markets function effectively and with less disruption when the rules of engagement are clear, simple and transparent. At a time when U.S. firms are facing regulatory fragmentation both domestically and abroad, we should encourage regulators within the U.S. and abroad to work together to harmonize rules and frameworks.

Customer Protection

FIA joins the National Futures Association (NFA) in supporting legislative clarification to resolve legal uncertainty in futures commission merchant bankruptcies as to the definition of "customer property" created by a bankruptcy court decision in the Griffin Trading case. The sanctity of segregated customer funds remains an important tenet of the CFTC's customer protection regime and FIA stands ready to assist the Committee on this clarification.

Cybersecurity and Data

In May 2019, CFTC Chairman Christopher Giancarlo testified before the Senate Appropriations Subcommittee on Financial Services and General Government that the CFTC faces 200,000 separate cyber-attacks per month. In June 2019, the CFTC Inspector General published a report that the agency has "numerous weaknesses" in the way it stores data used to regulate the markets.

FIA supports providing the CFTC with the resources, authority and direction to review and enhance their data collection methods and practices given the sensitivity of the data collected and the potential for unauthorized access. This includes reviewing whether there is duplicative or unnecessary collection of data taking place and how data collected by the agency is being retained. Further, we support efforts to amend the CEA to ensure that data housed by the CFTC is encrypted and confidential. In addition, FIA believes that highly sensitive source code data developed by firms to run their trading systems deserves the same protections under the law as any other form of intellectual property.

FIA Supports Efforts to Modernize the CFTC

The last CFTC Reauthorization was enacted the same year Apple launched its App Store. The technology advancements by market participants since that time has been incredible.

FIA commends CFTC Chairman Giancarlo for the agency's LabCFTC initiative to promote financial technology (fintech) innovation and encourages his successor to continue this forward-thinking approach.

Unfortunately, it has been a challenge for the CFTC to keep pace with the technology developments. According to the Chairman of the CFTC, "The CFTC lacks the legal authority to partner and collaborate with outside entities engaging directly with fintech within a research and testing environment, including when the CFTC receives something of value absent a formal procurement."[1]

FIA supports efforts to improve the research and development capabilities of the CFTC. This includes legislative efforts, such as those led by Representative Austin Scott (R-GA), that would provide the CFTC transaction authority to engage in public-private partnerships with financial technology developers. NASA, the Department of Defense, and other federal agencies already have this type of authority. This authority would assist the CFTC so it can fully vet and test potential rules and regulations on the technology being utilized by industry.

Crypto-Assets

As you know, several CFTC-regulated trading venues have introduced futures and options based on the value of Bitcoin, and several more venues are preparing to come to market. FIA is a strong supporter of innovation and competition in markets, but we also believe that the introduction of these products may create risks that should be carefully reviewed and thoroughly discussed by all industry stakeholders who may share in the risk of a default. We stand ready to engage with Members of this Committee on any specific proposals that may be considered related to emerging crypto-assets and the derivatives markets.

Impact of Capital on Client Clearing

Although the CFTC was last reauthorized in 2008, the CEA underwent significant changes when, under the Dodd-Frank Act, Congress determined to extend clearing beyond futures to swaps. As such, the role of the futures commission merchants (FCMs) has also expanded.

The new clearing mandates of Dodd-Frank sought to mitigate systemic financial risk by increasing central clearing. FIA supports that goal because central clearing serves as a highly effective safety mechanism for the futures, options and now swaps markets. As an industry, we have made great progress in our efforts to increase central clearing. According to remarks earlier this year from Dietrich Domanski, Secretary General of Financial Stability Board, "in 2009, the clearing level was around 24% for interest rate derivatives and just 5% for credit derivatives. By June 2018 these levels had risen to approximately 62% for interest rate derivatives and 37% for credit derivatives. Today, 90% of new OTC single currency interest rate derivatives are now centrally cleared in the U.S."[2]

[1] https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo66
[2] https://www.fsb.org/wp-content/uploads/S270219.pdf

From a public policy perspective, one of the great benefits of central clearing is that it provides protections from systemic risk that are borne by the market participants and not by taxpayers. According to CCP12, a global association of central counterparties, the total amount of initial margin held at clearinghouses worldwide was $702.46 billion at the end of last year. In effect, this is the money that market participants have posted as protection against losses arising from adverse movements in the markets. This is the first line of defense for a systemic type of default. Second, there are additional funds deposited by the industry in clearinghouse default funds that serve as a further backstop to the clearing system and safety mechanism.

These are positive trends, but there is a worrisome trend in the number of clearing firms that support this global network of clearinghouses. According to CFTC data, the number of firms providing clearing services for customers in the U.S. futures markets dropped from 84 in 2008 to 55 in 2018. There are even fewer firms providing clearing services for swaps. When mandatory clearing for swaps took effect in 2014, there were 22. Now there are only 17. This decline in the number of clearing firms results in fewer choices for customers and greater concentration of risk. This is concerning and should be considered by Congress as it evaluates any reforms to the CEA.

There are many reasons for this decline in the number of clearing firms. Consolidation, advances in technology, the low interest rate environment and the evolution of markets to more global in nature have all played a role in this decline. But it is also important to recognize unintended consequences of Basel III, which is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the financial crisis that have contributed to clearing firms making the decision to exit the business.

One of the central elements of post-crisis reforms was to increase the amount of capital supporting the banking system. Unfortunately, the central banks that developed Basel III did not consider the potential impact on client clearing. In contrast to the type of risk-taking activities that led to the financial crisis of 2008, client clearing is a relatively low risk service that some banks provide to their clients. To ensure that it remains low risk, these banks require clients to provide collateral to cover their margin requirements.

Any margin paid to a clearing member from a customer for cleared derivatives transactions is legally considered to belong to the customer. This margin must be segregated from the bank's own funds. The clearing member cannot use segregated client margin in any circumstance. Yet under the current rules, there is no recognition for the initial margin under the supplemental leverage ratio (SLR) and very limited recognition under the risk weight assets (RWA) capital requirements.

Under the capital requirements implemented by the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC), banks are required to set aside a considerable amount of capital for client clearing activity. In effect, this is creating a powerful disincentive for banks to provide this service to their customers. It is also in direct conflict with the clearing mandates mandated by Dodd-Frank.

FIA strongly believes that this capital charge needs to be recalibrated so that it reflects the true amount of risk in this activity. We are encouraged to learn that last week the Basel Committee on Banking Supervision agreed on providing client initial margin to offset the exposure amounts under the leverage ratio. We look forward to the U.S. prudential regulators implementing this global revision.

The U.S. prudential regulators are currently consulting on a rulemaking related to the methodology used to calculate the capital rules. This proposed methodology—called the standardized approach for counterparty credit risk (SA-CCR)—must be recalibrated to ensure that banks are not discouraged from providing this essential service, as mandated by Dodd-Frank. FIA thanks the current Commissioners of the CFTC for their leadership on this issue, and for their recent bipartisan comment letter to the prudential regulators calling for a recalibration of the SLR calculation that allows initial margin to offset potential future exposures. FIA agrees with the current Commissioners that this would remove an unnecessary obstacle to banks offering client clearing services, consistent with G20 mandates and Dodd-Frank. Beyond better recognition of the exposure reducing initial margin, we encourage the Committee to consider other necessary changes to the proposed rule that will have a negative impact on clearing, especially for commercial end-users.

Conclusion

I am fortunate to represent a wide array of stakeholders in the listed, cleared and regulated derivatives industry – all of whom want to see this industry continue to support the price discovery and risk management needs of their customers in a productive way. It is an honor to be with you today and to work with this Committee as you craft a reauthorization of the CFTC and explore possible reforms to the Commodity Exchange Act (CEA) that strengthen our markets.

Statement of
Joe Barker
Director of Brokerage Services, CHS Hedging

SENATE COMMITTEE ON AGRICULTURE,
NUTRITION & FORESTRY
WASHINGTON, DC

June 25, 2019

Chairman Roberts, Ranking Member Stabenow, and members of the Committee, thank you for the invitation to testify today with respect to the reauthorization of the Commodity Futures Trading Commission (CFTC) and, in particular, several key issues concerning the agriculture industry's ability to use and offer risk management tools.

I am Joe Barker, Director of Brokerage Services of CHS Hedging, the commodity brokerage subsidiary of CHS Inc. CHS Inc. is a farmer-owned cooperative and a grain, energy and foods company. We are owned by approximately 140,000 individual farmers and ranchers, in addition to about 1,100 local cooperatives who represent another 480,000 producers. CHS is committed to helping its customers, farmer-owners and other stakeholders grow their businesses through its domestic and global operations. CHS has over 11,000 employees and locations in 19 countries. CHS Hedging has been registered with the CFTC as a futures commission merchant (FCM) since 1986 and is a clearing member of the Chicago Mercantile Exchange and the Minneapolis Grain Exchange. We provide risk management services to agriculture producers, local cooperatives, and commercial customers. We specialize in the providing market insight and advice focused on the grain, livestock, dairy, energy and crop nutrient markets.

Today, I am testifying on behalf of the National Council of Farmer Cooperatives (NCFC). NCFC represents roughly 2,000 farmer-owned cooperatives across the country whose members include a majority of our nation's more than 2 million farmers. I also serve as NCFC's representative to CFTC's Agricultural Advisory Committee.

Farmer cooperatives – businesses owned, governed and controlled by farmers and ranchers – are an important part of the success of American agriculture. According to the USDA data from 2016, farmer-owned cooperatives had total net sales of about $189 billion and employed 300,000 Americans, mostly in rural areas. Cooperatives are a trusted partner that helps individual farmers and ranchers through the ups and downs of weather, commodity markets, and technological change. Through their cooperatives, producers are able to improve their income from the marketplace, manage risk, and strengthen their bargaining power, allowing them to compete globally in a way that would be impossible to do individually.

In particular, by providing commodity price risk management tools to their member-owners, farmer cooperatives help mitigate commercial risk in the production, processing and selling of a broad range of agricultural, energy and food products. America's farmers and ranchers must continue to have access to new and relevant risk management products that enable them to feed, clothe and provide fuel to consumers here at home and around the world. This year's flooding, which is impacting so many producers so severely, coupled with the challenging international trade environment, once again illustrate the need for multilayered risk management strategies in agriculture.

Cooperatives' Use of Derivative Markets

As processors and handlers of commodities and suppliers of farm inputs, farmer cooperatives are commercial end-users of the futures exchanges, as well as the over-the-counter (OTC) derivatives markets. They use exchange-traded futures and options and OTC derivatives to hedge the price risk of commodities they purchase, supply, process or handle for their members.

In addition to the exchange-traded contracts, OTC derivatives have become increasingly important to hedge price risks. Especially when there is significant market volatility, cooperatives can use these products to better manage their exposure by customizing their hedges. OTC derivatives also gives cooperatives the ability to provide customized products to farmers and ranchers to help them better manage their risk and returns. Much like a supply cooperative leverages the purchasing power of many individual producers, a marketing cooperative pools the production volume of hundreds or thousands of growers and aggregates its owner-members' small volume sales or forward contracts into trainload and ultimately vessel-load quantities of food that feed the world. Doing this efficiently requires a substantial amount of commodity price risk management expertise and effort.

In addition, there are farmer-owned cooperative FCMs, such as CHS Hedging, that provide brokerage services to farmers, ranchers, and commercial agribusiness. These operations perform a critical service of providing price risk management to a customer base comprised largely of physical commodity hedgers.

Currently our agriculture markets are in a period of increased volatility fueled by ongoing international trade negotiations and an extremely wet spring that has cause the slowest corn and soybean planting progress on record. The trade issues have led to dramatic price swings in the prices of grain, livestock and dairy markets over the past 12 months. For example, the spot price of cheddar cheese at Chicago Mercantile Exchange traded as high as $1.7475/pound on October 1, 2018, then as low as $1.33/pound on December 11, 2018, and then as high as $1.80/pound on June 13, 2019. To manage such large commodity price risks and movements, cooperatives rely on highly functioning derivatives markets.

NCFC members are also seeing record levels of risk management usage among their producers, both in the traditional forward contracting programs and in the new Crop Insurance Dairy Revenue Protection program. They report their risk management volumes are at record levels and more and more members are using their programs. Additionally, they are experiencing significantly more interest in producers hedging their purchased feed needs, either through a milk-feed margin type forward contract or via a swap transaction. The primary reasons given for increased hedging volume are 1) stronger commodity milk pricing opportunities in the second half of 2019 and 2020, which are high enough for many dairy farmers to lock into a profit margin on their dairies; and, 2) uncertainty and concerns over potential volatility similar to what they experienced last year.

CFTC Reauthorization

It is essential to the agriculture industry to have sound, well-functioning commodity derivatives markets. The CFTC plays the critical role of ensuring the integrity of those markets on the price discovery and risk management functions for our industry.

When the Committee previously looked to reauthorize the CFTC in 2016, NCFC supported the Committee's Commodity End-User Relief Act, which as you know was not enacted. At the time, there were a number of outstanding issues the agriculture industry faced with rules written by CFTC to implement the Dodd-Frank Act. That bill addressed those concerns, such as undue recordkeeping requirements on end-users. Today, I'm pleased to report to the Committee that those issues have since largely been resolved administratively by the Commission. We greatly appreciate the oversight role the Senate Agriculture Committee played in addressing those provisions. Your work in encouraging CFTC to ensure that the agriculture industry has affordable access to risk management tools is commendable.

Throughout Dodd-Frank implementation, NCFC has advocated that the agriculture industry does not fit in a one-size-fits-all regulatory regime meant for Wall Street. As such, we continue to encourage you to help ensure that regulatory burdens don't impede the ability of farmers, their cooperatives and others involved in the agriculture industry to have access to the risk management tools they need.

Costs to End Users

Aggregate regulatory costs and market liquidity are an ongoing concern for farmers and their cooperatives. Agriculture is a high-volume, low-margin industry, and incremental increases in costs, whether passed on from an exchange or imposed directly on a cooperative trickle down and impact farmers. Taken incrementally, the costs may not seem unreasonable, but to those who have to absorb or pass on the collective costs of numerous regulations it is evident. Even as end users, significant resources must be used just to comply with the additional paperwork requirements called for under Dodd-Frank. In fact, a number of NCFC members have had to greatly increase spending on compliance staff and technology due to additional regulations. For example, CHS Hedging has more than doubled the size of staff focused on the daily, monthly and annual audits over the last three years.

The CFTC performs the critically important role of helping safeguard U.S. futures and swaps markets, which benefits all Americans with more stable prices and a sound financial system. And while the Commission's responsibilities have expanded dramatically over the past decade, until recently adequate funding has not kept up. While outside the jurisdiction of this Committee, we encourage Congress to provide sufficient funding through appropriations for CFTC to perform its important functions. However, we would like to caution the Committee against imposition of any type of user fee on the industry to fund the CFTC. We fear a further increase in cost structure due to higher transaction costs would discourage prudent hedging practices. To be clear, a user fee would result in an increase in risk being absorbed in the agriculture community, and would likely reduce the desire for participants, such as agricultural producers, to hedge their price risk.

The Position Limits Rule

We appreciate the work of the Commission in addressing many of our concerns in the Dodd-Frank rule-writing process. While Dodd-Frank rules are largely finished and implemented, the position limits rule has yet to be finalized. The initial rule imposing speculative position limits for swaps and futures was vacated by a court decision in September 2012. Since that time, CFTC has released a number of proposals, opened comment periods, and held roundtables and advisory committee meetings to receive input.

It is NCFC's view that any federal speculative position limits rule should not unduly burden commercial end-users who utilize derivatives markets for economically appropriate risk management activities. Specifically, we have continued to advocate that the CFTC recognize common commercial hedging practices, such as anticipatory hedging and cross hedging, as bona fide hedges in that rule. We have asked that the CFTC craft more principles-based regulations than previously proposed, taking into account the legitimate hedging needs of farmer cooperatives and other commercial end users. Given the nature of the various commodity markets, there should not be a one-sized fits all approach determining position limits.

We understand that the Commission has committed to Congress to finalize that rule and we look forward to providing further input when a proposal is made available for public comment. While we are confident that the Commission will take commodity hedger's views and concerns into account, I would encourage this Committee to also keep a close eye on the bona fide hedge definition as the rule is rewritten.

Thank you again for the opportunity to testify today before the Committee on behalf of farmer-owned cooperatives. We appreciate your role in ensuring that farmer cooperatives will continue to be able to effectively hedge commercial risk and support the viability of their members' farms and cooperatively owned facilities. I look forward to answering any questions you may have.

Thank you.

Dennis M. Kelleher
President and CEO Better Markets, Inc.
"The State of the Derivatives Market and Perspectives for CFTC Reauthorization"
U.S. Senate Committee on Agriculture, Nutrition and Forestry
June 25, 2019

Good morning Chairman Roberts, Ranking Member Stabenow, and members of the Committee on Agriculture, Nutrition and Forestry. Thank you for the invitation to testify today. It is an honor to appear before you and this Committee.

Better Markets, Inc. ("Better Markets") is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support financial reforms of Wall Street, and make the financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

To that end, Better Markets has filed approximately 250 comment letters with U.S. securities, banking, and derivatives regulators, many addressing the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1] We have also published numerous letters, reports, and white papers on public policy issues pertinent to U.S. financial markets and had hundreds of meetings with U.S. regulators and others. Much of our attention has focused on critical issues before this committee, including maintaining the integrity of U.S. agricultural and other commodities markets and properly and fully implementing financial reforms to the U.S. derivatives markets. Our website, www.bettermarkets.com, includes information on these public interest activities.

My name is Dennis Kelleher, and I am the President and CEO of Better Markets. Prior to that, I had the privilege to work with a number of you as a senior staffer in the U.S. Senate for three different Senators: as Deputy Staff Director and General Counsel for what is now known as the Health, Education, Labor & Pensions Committee; as Legislative Director and Leadership Advisor to the Secretary of the Democratic Caucus; and as Chief Counsel and Senior Leadership Advisor to the Chairman of the Democratic Policy Committee. Prior to the U.S. Senate, I was a litigation partner at Skadden, Arps, Slate, Meagher & Flom, where I specialized in securities and financial markets in the U.S. and Europe. Prior to obtaining degrees at Brandeis University and Harvard Law School, I enlisted in the U.S. Air Force while in high school and served four years active duty as a crash-rescue firefighter. I grew up in central Massachusetts.

Introduction

I want to explore two important themes in my testimony today.

First, the 2008 financial crash was the worst since the Great Crash of 1929 and caused longstanding damage to the U.S. economy and indeed, the worst dislocation of workers and economic fallout from financial sector excesses since the Great Depression. In the end, that crash will have cost the U.S. at least $20 trillion in lost gross domestic product as well as untold human suffering. It stands as a powerful and enduring reminder that effective regulation of the financial markets is essential to protect the American people and taxpayers from the risks and abuses that threaten the stability of our financial system, and

[1] Public Law 111-203, 124 Stat. 1376 (2010).

ultimately the prosperity of our country and all hardworking Americans. It is a matter of historical fact that non-regulation and de-regulation across the financial markets significantly contributed to the 2008 financial crisis. And it is equally indisputable that the impact was catastrophic, destroying the financial lives of Americans all across the country, including throwing tens of millions of workers into long-term unemployment, thrusting millions of homes into foreclosure, driving tens of thousands of small businesses into bankruptcy, and creating incalculable economic misery in every state. Without adequate financial regulation and enforcement, we will inevitably face another financial and economic calamity that may even surpass the one that swept over the country just ten years ago. This need for regulation and enforcement is especially critical with respect to the complex and risk-laden over-the-counter ("OTC") derivatives markets, which played a key role in incubating, causing, intensifying, and spreading the 2008 financial crash and crisis.

Second, the Commodity Futures Trading Commission ("CFTC"), overseen by this committee, is an absolutely critical financial regulator with the foremost mission of ensuring that such a catastrophe is never inflicted on this country again. It is primarily responsible for overseeing a vast marketplace, comprised not only of the futures and options markets but also much larger and more complex swaps markets. It has the primary role in setting standards of conduct, promoting transparency, detecting illegal and abusive practices, taking enforcement action when necessary to punish and deter unlawful behavior in those markets, and ultimately, containing systemic risk. Without these safeguards for the derivatives markets—which only the CFTC can provide—our financial markets and our entire economy are at heightened risk of another financial crisis.

Notwithstanding these two critical points, the CFTC has not been reauthorized in more than a decade and continues to explain, on a bipartisan basis across party lines, that it cannot effectively do its job without significant additional funding. It is therefore imperative that Congress give the agency the resources—and, where appropriate, the additional authority—it needs to adequately protect the American people from risks and abuses in the markets it is statutorily responsible for policing.

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I. The enduring consequences of the 2008 financial crisis are a reminder of Congress' responsibility to ensure that federal regulators, including the CFTC, have sufficient funding and authority to promote transparency, competition, stability, and fairness in the U.S. derivatives markets.

The Dodd-Frank Act was signed into law nine years ago next month as a response to the near-complete collapse of the U.S. financial system. By virtually every measure, the 2008 events led to the worst financial crisis since the 1929 stock market crash and the ensuing Great Depression;[2] it almost caused a second Great Depression; it cost the U.S. more than $20 trillion in lost GDP;[3] it resulted in the U.S. government and ultimately, U.S. taxpayers spending, lending, committing, guaranteeing, pledging, assuming, and otherwise putting at risk at least $29 trillion in bailouts for the financial industry;[4] it produced prolonged imbalances in the U.S. economy and distorted U.S. fiscal and monetary policies; and it led to widespread distrust of U.S. financial institutions.

The ultimate consequence, however, was enormous economic and incalculable human harm to tens of millions of Americans, many of whom have suffered and are still suffering from un- and under-

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2 Former Chairman of the Board of Governors of the Federal Reserve System ("Federal Reserve"), Ben Bernanke, and others have noted that the 2008 crash was worse than the Great Depression in certain respects. See B. Bernanke, T. Geithner, and H. Paulson, Firefighting: The Financial Crisis and Its Lessons, 110, 200 (2019) ("The stress of the 2008 crisis was, in some ways—including the declines in stock prices and home prices, and the falls in output and employment—even worse than the early stages of the Great Depression . . .").

3 See R. Barnichon, C. Matthes, A. Ziegenbein, Federal Reserve Bank of San Francisco, Economic Letter 2018-19, The Financial Crisis at 10: Will We Ever Recover?, available at https://www.frbsf.org/economic-research/files/el2018-19.pdf (finding "a large fraction of the gap between current GDP and its pre-crisis trend level is associated with the 2007–08 financial crisis" and concluding that "GDP is unlikely to revert to the level implied by its trend before the crisis"). For another study of the devastating effects of the 2008 financial crisis, see T. Atkinson, D. Luttrell, and H. Rosenblum, Federal Reserve Bank of Dallas, Staff Paper No. 20, How Bad Was It? The Costs and Consequences of the 2007-09 Financial Crisis (July 2013), available at https://www.dallasfed.org/~/media/documents/research/staff/staff1301.pdf. See also Better Markets, The Cost of the Crisis: $20 Trillion and Counting (July 2015), available at https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis_1.pdf.

4 See J. Felkerson, A Detailed Look at the Fed's Crisis Response by Funding Facility and Recipient, Public Policy Brief, Levy Economics Institute of Bard College, No. 123 (2012), available at https://www.econstor.eu/bitstream/10419/121982/1/689983247.pdf (calculating "the total amount of loans and asset purchases made . . . from January 2007 to March 2012" and determining that the Federal Reserve's cumulative 2008 financial crisis interventions were "over $29 trillion"). For a discussion of this figure and the endless industry disagreements on the precise final number, see Better Markets, Wall Street's Six Biggest Bailed-Out Banks: Their RAP Sheets & Their Ongoing Crime Spree, Special Report (April 9, 2019), available at https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Wall%20Street%27s%20Six%20Biggest%20Bailed-Out%20Banks%20FINAL.pdf. As we emphasize in that report, the $29 trillion figure is based on a reasonable methodology for calculating the **cumulative** Federal Reserve and U.S. government interventions, but "the precise amount isn't as relevant as its magnitude and long-term impact: It was inconceivably high and will be costing the U.S. and its people for a generation or more." Id. at 33.

employment,[5] low wages,[6] excessive student loans,[7] damaged credit records,[8] foreclosures and lost equity in their homes,[9] and more.[10] The devastation caused by the 2008 financial crisis has required one of the

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5 In the immediate aftermath of the 2008 financial crisis, the U6 total unemployment and underemployment rate published by the U.S. Bureau of Labor Statistics reached a peak of 17.1%, which was more than twice the highest measure in 2007. See U.S. Bureau of Labor Statistics, Total unemployed, plus all marginally attached workers plus total employed part time for economic reasons [U6RATE], retrieved from FRED, Federal Reserve Bank of St. Louis (March 15, 2019), available at https://fred.stlouisfed.org/series/U6RATE. Unemployment and underemployment rates increased dramatically during and after the 2008 financial crisis and remained high by historical standards well into 2010, when they began a decline. Id. However, the U6 rate did not return to 2007 levels for ten years, only in 2017, and even then, with substantial geographical variation. Id. The headline U1 unemployment rate followed a similar trend, reaching its peak in 2010 and declining to 2007 levels for the first time in 2017 (although those top line numbers did not capture the wage depression and ongoing massive under-employment suffered by tens of millions of Americans). See U.S. Bureau of Labor Statistics, Persons Unemployed 15 weeks or longer, as a percent of the civilian labor force [U1RATE], retrieved from FRED, Federal Reserve Bank of St. Louis (March 15, 2019), available at https://fred.stlouisfed.org/series/U1RATE. See attached Appendix A.

6 Median household income dropped significantly in the aftermath of the 2008 financial crisis, reaching its low in 2012 before beginning a return to pre-crisis levels over the next five years. See U.S. Census Bureau: U.S. Department of Commerce, Economics and Statistics Administration, Household Income: 2017 (ACSBR/17-01), G. Guzman (Sept. 2018), available at https://www.census.gov/content/dam/Census/library/publications/2018/acs/acsbr17-01.pdf. Notably, it took almost a full decade after the 2008 financial crisis for U.S. households to again achieve 2007 median income levels, again with substantial geographic variation. Id. See also U.S. Census Bureau: U.S. Department of Commerce, Economics and Statistics Administration, Income and Poverty in the United States: 2017, Current Population Reports (P60-263), pg. 11, Figure 4, K. Fontenot, J. Semega, and M. Kollar (Sept. 2018) (noting that, in the aftermath of the 2008 financial crisis, the number of families in poverty reached its highest recorded level since 1959), available at https://www.census.gov/content/dam/Census/library/publications/2018/demo/p60- 263.pdf.

7 Total outstanding student loan debt, accumulated significantly due to diminished employment prospects in the aftermath of the 2008 financial crisis, reached an aggregate balance of $1.46 trillion in 2018; serious delinquencies on student loan debt remain well above pre-crisis levels. See Federal Reserve Bank of New York, Research and Statistics Group, Quarterly Report on Household Debt and Credit: 2018: Q4 (Released Feb. 2019), available at https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/hhdc_2018q4.pdf.

8 Total delinquent balances on household debt, including severely derogatory balances, dramatically increased in the aftermath of the 2008 financial crisis, reaching a peak in 2009 and remaining well above 2006 levels to date. Id at 11.

9 By 2011, Zillow data indicated that more than 30% of outstanding mortgages were in negative equity, meaning mortgage balances were higher than expected sales prices on the underlying homes. That figure remained above 15% well into 2015. See Appendix C. See also, e.g., Federal Housing Finance Agency, U.S. House Price Index Report—4Q 2018, National Statistics Appendix, Pgs. 7-12 (Feb. 2, 2019), available at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2018Q4_HPI.pdf (measuring significant declines in the "FHFA House Price Index History for U.S." during and immediately after the 2008 financial crisis). See also J. Gallin, R. Malloy, E. Nielsen, P. Smith, and K. Sommer, Federal Reserve Board, Divisions of Research & Statistics and Monetary Affairs, Measuring Aggregate Housing Wealth: New Insights from an Automated Valuation Model (2018-064), Staff Working Papers in the Finance and Economics Discussion Series, 30-31, Fig. 3: Aggregate Own-Use Housing Wealth (Aug. 2018), available at https://www.federalreserve.gov/econres/feds/files/2018064pap.pdf (comparing the dramatic loss of housing wealth across three measures and noting that "the ACS measure fell by 14 percent from peak to trough, the Financial Accounts fell by 29 percent from peak to trough, and the AVM measure splits the difference between these two, falling by 21 percent from peak to trough").

10 The 2008 financial crisis had immense personal and social consequences, potentially influencing suicide, divorce, child neglect, substance abuse, and other rates. These human tragedies are too often overlooked when considering the impacts of financial crises, and although they can be difficult to measure, they are very real. See, e.g., Child neglect linked to parental unemployment (Nov. 2017), available at http://www.ox.ac.uk/news/2017-11-02-child-neglect-linked-parental-unemployment (finding that the crisis-linked unemployment measurably increased rates of child neglect); see also, e.g., P. Agrawal, D. Waggle, D. Sandweiss, Suicides as a response to adverse market sentiment (1980-2016) (Nov. 2, 2017), available at https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0186913 (noting the increase in suicides as a result of the Great Recession of 2008 and finding a correlation between changes in gross domestic product as a result of such financial crises and certain stress-induced behavioral changes).

longest continuous expansions in U.S. economic history just for many families to begin an incremental recovery from these effects.[11] Many families still have not recovered. One recent Federal Reserve staff study concluded that the vast majority of American families remain economically worse off today by certain measures than they were in 2007; it also concluded that measures of wealth inequality had considerably worsened.[12] Of course, none of this measures the economic distress, insecurity, and anxiety felt across the country.

The 2008 financial crisis and resulting economic despair have proven yet again that (other than war) nothing devastates a country more than the economic ruin that follows financial crises.

In the midst of this anomalous period of economic expansion, it is worth pausing to consider the tendency for most people—including, of course, those in the financial industry and their many allies, lobbyists, and representatives—to forget even the very recent past and to yield to pressures from shareholders, management, and others to "get up and dance while the music is playing."[13] But this time is not different.[14] The music will stop, inevitably exposing undetected, misunderstood, or ignored imbalances and risks within the financial system. **The CFTC must be properly equipped by Congress—both in terms of resources and authority—to responsibly execute its primary responsibilities to anticipate and prepare for that inevitability and to limit the damage** that will be inflicted on those participating in and depending on the derivatives markets when it does. If Congress fails to meet this challenge responsibly, it will be the American public that inevitably bears the consequences.

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11 See U.S. Bureau of Labor Statistics, Gross Domestic Product [GDP], retrieved from FRED, Federal Reserve Bank of St. Louis (March 15, 2019), available at https://fred.stlouisfed.org/series/GDP/. If gross domestic product remains positive throughout the next two months, the U.S. will have entered its longest continuous economic expansion without an intervening recession in modern U.S. history.

12 L. Dettling, J. Hsu, and E. Llanes, A Wealthless Recovery? Asset Ownership and the Uneven Recovery from the Great Recession (Sept. 13, 2018), available at https://www.federalreserve.gov/econres/notes/feds-notes/asset-ownership-and-the-uneven-recovery-from-the-great-recession-20180913.htm (finding that data from the Federal Reserve Board's triennial Survey of Consumer Finances "suggests the wealth gaps uncovered . . . may persist despite the continued economic recovery, as those families [in the bottom 90% of the wealth distribution] will not experience wealth gains from the rise in housing and stock prices . . .").

13 This is a reference to a statement made prior to the 2008 financial crisis by Chuck Prince, former Citigroup Chairman and Chief Executive. Prince famously stated as follows: "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing," M. Nakamoto, Citigroup chief stays bullish on buy-outs, Financial Times (July 9, 2007), available at https://www.ft.com/content/80e2987a-2e50-11dc-821c-0000779fd2ac. Recognizing the potential for things to get "complicated," Prince continued to permit the very trading activities that ultimately resulted in Citigroup receiving the single largest taxpayer-funded bank "bailout" package in the entire 2007-09 financial crisis period. For additional information, see Special Inspector General for the Troubled Asset Relief Program, Extraordinary Financial Assistance Provided to Citigroup, Inc. (SIGTARP 11-002) (Jan. 13, 2011), available at https://www.sigtarp.gov/Audit%20Reports/Extraordinary%20Financial%20Assistance%20Provided%20to%20Citigroup,%20Inc.pdf. For a more detailed explanation of Prince's quote, see Better Markets Comment Letter to the CFTC and other financial regulatory agencies Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 2-5 (October 17, 2018), available at https://bettermarkets.com/sites/default/files/Better%20Markets%20Comment%20Letter%20on%20New%20Volcker%20Rule%20Proposal.pdf.

14 See C. Reinhart and K. Rogoff, This Time is Different: Eight Centuries of Financial Folly (2009) (cataloguing serial debt crises over eight centuries and discussing common narratives in each post-crisis generation that market stability will persist indefinitely). However, see J. Cassidy, The Reinhart and Rogoff Controversy: A Summing Up (April 26, 2013), available at https://www.newyorker.com/news/john-cassidy/the-reinhart-and-rogoff-controversy-a-summing-up (discussing a number of methodological issues and potential policy implications of maintaining high debt burdens relative to gross domestic product).

A. The U.S. derivatives markets exist to serve the productive economy and should and can serve critical hedging purposes. However, they must be properly supervised, transparent, fair, and competitive or they inevitably will facilitate excessive speculation and risk-taking.

The OTC derivatives markets historically have been controlled by a small group of Wall Street dealers, but those markets do not exist for them. Derivatives have become inextricably tied to the non-financial economy—the productive economy—through their potential to impact the pricing of a broad range of everyday commodities and the less understood, but real, risks incidental to global trade, debt-enabled business expansions, and credit issuances. In the standardized derivatives markets, like the futures markets, those commodities range from traditional agricultural commodities, like wheat that feeds our families, to the oil that heats our homes and fuels almost every aspect of daily life. In the swap markets, those commodities more commonly include deconstructed financial risks that—when properly used and regulated—can be designed to help companies manage borrowing costs and credit exposures; they can, in turn, encourage real economy lending that assists companies in expanding plants, investing in research and development, improving technology, scaling operations, and employing people.

However, this nexus of the derivatives markets to the real economy contains both promise and peril. If the derivatives markets are properly regulated and used for risk-reducing activities (and the market-making and limited speculative activities necessary to facilitate them), derivatives can serve these socially useful purposes. **But if they are not, derivatives can perversely increase the very risks they exist to reduce.** They can also transfer resources to financial institutions that would be better used to make investments in the real economy; in essence, siphoning resources away from more productive economic activities. The externalities, or negative effects, in such cases reach far beyond any immediate effects on financial institutions and markets. **The ultimate effects fall on farmers and factory workers seeking to feed their families, for example, which is why Congress has provided for transparency and other consumer and financial stability protections on contracts for the future delivery of agricultural commodities since at least the 1930s.**[15] Congress has long recognized that open, transparent, liquid, and fair derivatives markets are the most critical safeguard against financial downturns and other risks and abuses in the derivatives markets.

That Congressional judgment has proven sound over time, and the best evidence may be the performance of the transparent, regulated futures markets during the 2008 financial crisis. The futures markets remained for the most part orderly in the course of the most significant financial crisis in generations.[16] That is why Congress modeled OTC derivatives markets reforms, in part, on its statutory framework for the futures markets and why the Dodd-Frank Act was intended to fundamentally transform—

[15] See 7 U.S.C. § 6(a). For a concise review of the regulation of agricultural commodities since the 1930s, see Commodity Futures Trading Commission, 75 Fed. Reg. 65586 (Oct. 26, 2010), available at https://www.govinfo.gov/content/pkg/FR-2010-10-26/pdf/2010-26951.pdf (discussing implementation of Public Law 74–675, 49 Stat. 1491 (1936), which, among other things, set forth the original list of enumerated commodities and changed the name of the "Grain Futures Act" to the "Commodity Exchange Act").

[16] For example, clearinghouses associated with most standardized derivatives trading venues "proved resilient during the [2008 financial] crisis, continuing to clear contracts even when bilateral markets dried up . . . Lehman had derivative portfolios at a number of [clearinghouses] across the world and, with one exception, these were auctioned, liquidated or transferred within weeks of the default without exhausting the collateral Lehman had provided . . . One example is the unwinding of Lehman's interest rate swaps portfolio cleared in London (66,390 trades, $9 trillion notional), which used up about a third of the margin held, so that neither the [clearinghouse] nor its members sustained any losses." U. Faruqui, W. Huang, E. Takats, Clearing risks in OTC derivatives markets: the CCP-bank nexus, BIS Quarterly Review, 73 (Dec. 2018), available at https://www.bis.org/publ/qtrpdf/r_qt1812h.pdf.

not codify—the OTC derivatives markets as they existed in 2008. The new Dodd-Frank regulatory framework was intended to address OTC derivatives market deficiencies that played such a significant role in transmitting risks and panic across the financial system in the lead-up to and during the 2008 crisis—especially the proliferation of complex, leveraged, and opaque positions between a concentrated set of dealers.[17]

B. The U.S. government's extraordinary efforts to prevent the global collapse of the financial system are too frequently omitted from Wall Street's self-interested narrative, which emphasizes (and almost always overstates) the supposed direct financial costs of financial reforms but not the immeasurable consumer, financial stability, and other benefits of avoiding another financial crisis.

In considering the importance of the OTC derivatives markets reforms, we must recall the facts and events that necessitated reforms to the U.S. derivatives markets in the first instance. In 2008, faced with the prospect of widespread suffering among American families across the U.S. economy, the U.S. government was all but extorted to spend, lend, guarantee, pledge, assume, or otherwise use or put at risk multiple trillions of U.S. taxpayer dollars to protect Wall Street from the devastation instigated largely by its own practices.[18]

It is virtually certain that every major Wall Street financial institution and a number of systemically important and interconnected financial vehicles (e.g., money market funds exposed to Wall Street's short-term debt[19]) would have collapsed but for the bailouts and other actions taken by the U.S. government on behalf of the American taxpayers. Years after the 2008 financial crisis, when Freedom of Information Act requests were litigated, appealed, and finally ordered granted,[20] it was revealed that JPMorgan, Bank of America, Citibank, Wells Fargo, Goldman Sachs, and Morgan Stanley alone were borrowing hundreds of

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[17] Board of Governors of the Federal Reserve System, Financial Stability Report, 7 (November 2018), available at https://www.federalreserve.gov/publications/files/financial-stability-report-201811.pdf (noting that "[r]eforms to derivatives markets have rendered them less opaque and have reduced credit exposures between derivatives counterparties"). The Government Accountability Office's ("GAO") concise explanation of the role of derivatives in the 2008 financial crisis is also worth considering: ". . . FSOC noted that OTC derivatives generally were a factor in the propagation of risks during the recent crisis because of their complexity and opacity, which contributed to excessive risk taking, a lack of clarity about the ultimate distribution of risks, and a loss in market confidence. In contrast to other OTC derivatives, credit default swaps exacerbated the 2007-2009 crisis, particularly because of AIG's large holdings of such swaps, which were not well understood by regulators or other market participants. Furthermore, the concentration of most OTC derivatives trading among a small number of dealers created the risk that the failure of one of these dealers could expose counterparties to sudden losses and destabilize financial markets. See Government Accountability Office, Report to Congressional Requesters: Financial Regulatory Reform, Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act (Jan. 2013), available at https://www.gao.gov/assets/660/651322.pdf.

[18] See fn. 4 supra, noting the cumulative $29 trillion cost of Federal Reserve assistance alone.

[19] The U.S. Department of the Treasury ("U.S. Treasury") and the Federal Reserve provided unusual U.S. government assistance to slow an apparent run on money market funds in the immediate aftermath of the Lehman Brothers failure. See National Commission on the Causes of the Financial and Economic Crisis in the United States ("FCIC"), Financial Crisis Inquiry Report, "Dealers Weren't Even Picking Up Their Phones" (January 2011), available at https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf ("Over the next two years [after Lehman Brothers' failure and default on commercial paper], money market funds—36 based in the United States, 26 in Europe—would receive such [parent company] assistance to keep their funds from breaking the buck."). See also Id. (noting that by Friday, September 19, 2008, the U.S. Treasury "would guarantee the $1 net asset value of eligible money market funds . . . [a]nd the Fed would provide loans to banks to purchase high-quality-asset-backed commercial paper from money market funds"). The FCIC-cited two programs loaned banks $150 billion to support money markets long before a TARP-type bailout was discussed with Congress, much less authorized.

[20] Bloomberg L.P. v. Bd. of Governors of the Fed. Reserve Sys., 649 F. Supp. 2d 262, 265 (S.D.N.Y. 2009), aff'd, 601 F.3d 143 (2d Cir. 2010); however, see also Fox News Network, LLC v. Bd. of Governors of the Fed. Reserve Sys., 639 F. Supp. 2d 384, 388 (S.D.N.Y. 2009), vacated, 601 F.3d 158 (2d Cir. 2010).

billions to avoid bankruptcy through then-***secret*** Federal Reserve revolving facilities **in addition to** the well-publicized hundreds of billions of dollars in direct and indirect financial support through the TARP and other programs.[21]

In fact, the Federal Reserve's commitments to facilities across the finance sector totaled a staggering \$7.77 trillion by March 2009 (not including the swap lines the Fed funded[22]), and the U.S.'s biggest banks borrowed a combined total of \$1.2 trillion on a single day in December 2008.[23] **These facilities were kept, in material part, secret, even from Congress, during the 2008 financial crisis and for years thereafter.**[24]

Wall Street's largest institutions simply would not exist in the form that they do today – if they existed at all – but for the U.S. government and the American taxpayers assuming truly **extraordinary risks** to prevent a near-complete collapse of the U.S. financial system and economy.

The extent of financial assistance undertaken to support bailouts, buyouts, and other transactions involving the nation's leading financial institutions revealed both the depth of the 2008 financial crisis and the magnitude of the risks and liabilities forced upon U.S. taxpayers. Consider the turbulent month of September 2008 alone. Early that month, the U.S. government placed Fannie Mae and Freddie Mac into a conservatorship and committed to provide them as much as \$200 billion in additional capital. Later that month, and within days of Lehman Brothers' bankruptcy, the U.S. government effectively nationalized American International Group ("AIG") and Citigroup through various bailout measures totaling hundreds

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21 See B. Ivry, B. Keoun, and P. Kuntz, Secret Fed Loans Gave Banks \$13 Billion Undisclosed to Congress (Nov. 27, 2011), available at https://www.bloomberg.com/news/articles/2011-11-28/secret-fed-loans-undisclosed-to-congress-gave-banks-13-billion-in-income. See also Office of the Inspector General for the Troubled Asset Relief Program, Advancing Economic Stability Through Transparency, Coordinated Oversight, and Robust Enforcement, Quarterly Report to Congress (April 21, 2009). For a discussion of the recipients of these funds, see also Better Markets, Wall Street's Six Biggest Bailed-Out Banks: Their RAP Sheets & Their Ongoing Crime Spree, Special Report (April 9, 2019), available at https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Wall%20Street%27s%20Six%20Biggest%20Bailed-Out%20Banks%20FINAL.pdf.

22 See Better Markets, Notice of Request for Comments—Determination of Foreign Exchange Swaps and Futures (Nov. 29, 2010), available at https://bettermarkets.com/sites/default/files/TREAS-%20CL-%20Determination%20of%20Foreign%20Exchange%20Swaps%20and%20Futures-%2020101129.pdf; see also Better Markets, New Information on the Proposed Exemption of Foreign Exchange Swaps and Futures: Fed Data Show Collapse of Foreign Exchange Markets During the Financial Crisis (Feb. 25, 2011), available at https://bettermarkets.com/sites/default/files/documents/Treas-%20Comment%20Letter%20%28followup%29-%20Forex%20Swaps%202-25-11_0.pdf; see also Better Markets, Re: Meeting Follow-Up on the Exemption for Foreign Exchange Swaps and Futures (March 23, 2011), available at https://bettermarkets.com/sites/default/files/documents/Treas-%20CL-%20meeting%20followup-%20FX%20exemption%203-23-11.pdf.

23 This figure is a ***committed*** amount that does not reflect the outstanding credit balances at any given time. However, the availability of credit facilities in an amount that approaches 50% of U.S. gross domestic product demonstrates the depth of the 2008 financial crisis. Federal Reserve Chairman, Ben Bernanke, has challenged the use of aggregate credit figures as misleading due to the revolving nature of the Federal Reserve's facilities, but even he has acknowledged that peak lending in emergency facilities totaled at least \$1.5 trillion—a very large figure in its own right. See B. Ivry, B. Keoun, and P. Kuntz, Secret Fed Loans Gave Banks \$13 Billion Undisclosed to Congress (Nov. 27, 2011).

24 It has been claimed that the secrecy was necessary by certain U.S. government officials because publishing recipients of Federal Reserve facilities would discourage use of the credit lines and suggest to the public and market that the financial institutions borrowing these tens of billions of dollars were distressed, which might thereby induce the panic and runs and precipitate the very result the programs were created to prevent. Even though the Dodd-Frank Act mandated that certain of this concealed information be publicly disclosed, the request for release of certain, but not all, information on these emergency facilities was adjudicated in 2010 and made public by Bloomberg and others only in late 2011, more than three years after the onset of the 2008 financial crisis.

of billions of dollars.[25] Those measures, of course, were direct and indirect bailouts to Wall Street banks that had insufficiently managed and in many cases, did not even recognize growing credit exposures to these counterparties, among others, during the reckless but profitable years leading up to the crisis.

To prevent their imminent bankruptcies,[26] the largely unregulated investment banks of Goldman Sachs and Morgan Stanley were allowed to convert virtually overnight into bank holding companies (under dubious legal authority), thereby concretely signaling to the markets that the Fed would not let them fail and permitting access to the full panoply of federal safety-net programs that were supposed to have been limited to only regulated banks (including lending that was supposed to be only upon good collateral and otherwise unavailable).[27] Bank of America acquired Merrill Lynch, and Wells Fargo acquired Wachovia, in each case to prevent the failure of a massive investment bank and the fourth large bank holding company from exacerbating market panic. The nation's largest savings and loan institution, Washington Mutual, failed and was ultimately sold to JPMorgan at a price reflecting the desperate state of the markets. That was JPMorgan's second hurried acquisition in 2008;[28] it had already purchased Bear Stearns to prevent a panic earlier that year, which JPMorgan agreed to only after the Federal Reserve agreed to insure tens of billions of Bear Stearns' most toxic assets (this included $30 billion in Federal Reserve financial support separate and apart from $29 billion in mortgage-related Maiden Lane LLC asset purchases funded at primary credit[29] by the Federal Reserve Bank of New York[30]).

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25 Although limited by the information it was able to gather at the time, the FCIC report has a lengthy description and analysis of the 2008 financial crisis and the series of U.S. government, taxpayer-backed actions taken to contain the fallout from Wall Street's own recklessness. See National Commission on the Causes of the Financial and Economic Crisis in the United States ("FCIC"), Financial Crisis Inquiry Report, XVIII-XXIII, "Dealers Weren't Even Picking Up Their Phones" (January 2011), available at https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf; see also D. Cho, N. Irwin, and P. Whoriskey, U.S. Forces Nine Major Banks to Accept Partial Nationalization, the Washington Post (Oct. 14, 2008), available at http://www.washingtonpost.com/wp-dyn/content/article/2008/10/13/AR2008101300184.html?noredirect=on. However, as we noted earlier, certain actions taken by the Federal Reserve were not public at the time that the report was published and in some cases, may continue to be secret. In addition, because of partisan gridlock, limited ability to use subpoena power, and other reasons, the FCIC was unable to obtain certain other material information related to these events.

26 See Better Markets, Goldman Sachs Failed 10 Years Ago Today (September 20, 2018), available at https://bettermarkets.com/newsroom/goldman-sachs-failed-10-years-ago-today.

27 Richard S. Fuld, Chief Executive Officer of Lehman Brothers, would later lament the fact that Lehman had not been allowed to convert into a bank holding company on similar terms. Id at 341. He maintained that "Lehman would have been saved if it had been granted bank holding company status—as were Goldman Sachs and Morgan Stanley the week after Lehman's bankruptcy." Id. See also L. Ball, The Fed and Lehman Brothers: Setting the Record Straight on a Financial Disaster (2018).

28 JPMorgan's CEO Jamie Dimon has shamelessly complained frequently about the costs of these acquisitions and claimed that they were done only for selfless patriotic reasons. However, the facts show that both acquisitions were fabulously successful and profitable for JPMorgan, which had been seeking to purchase Washington Mutual and a prime brokerage business long before these once-in-a-lifetime bargain opportunities presented themselves. See Better Markets, Fact Sheet on the Jamie Dimon/JPMorgan Chase Settlement with the Department of Justice (Oct. 23, 2013), available at https://bettermarkets.com/newsroom/fact-sheet-jamie-dimonjp-morgan-chase-settlement-department-justice; see also P. Eavis, Despite Cries of Unfair Treatment, JPMorgan Is No Victim, The New York Times, Dealb%k (Sept. 30, 2013), available at https://dealbook.nytimes.com/2013/09/30/despite-cries-of-unfair-treatment-jpmorgan-is-no-victim/.

29 Primary Credit is one of the Federal Reserve's discount window lending programs for depository institutions. Primary credit is supposed to be extended by Federal Reserve banks to depository institutions in **generally sound financial condition**. Credit is typically provided on a very short-term basis, as a backup source of funding, at a rate of interest that is above the level of short-term market interest rates.

30 For more detailed information on these transactions, see Board of Governors of the Federal Reserve System, Bear Stearns, JPMorgan Chase, and Maiden Lane LLC, available at https://www.federalreserve.gov/regreform/reform-bearstearns.htm; see also G. Morgenson, Secrets of the Bailout, Now Told (Dec. 3, 2011), available at https://www.nytimes.com/2011/12/04/business/secrets-of-the-bailout-now-revealed.html (stating that documents received in

Each transaction in this extraordinary series of events was engineered or facilitated by various forms of explicit and implicit U.S. government financial assistance, with minimal expected, if not non-existent, risk-adjusted returns for the U.S. taxpayers at the time. No private lender in the world would have provided financial assistance on the terms offered by the U.S. government and on behalf of U.S. taxpayers at that time—or, frankly, any terms at all; indeed, many Wall Street banks were declined any substantial private financial assistance.[31] Moreover, the U.S. government and U.S. taxpayers were all but coerced into implementing further measures to prevent Wall Street losses and continuing fire-sales from spreading adverse effects to other interconnected financial institutions and sectors, including the $3.8 trillion money market fund industry.[32]

Thus, although much attention is focused on the $700 billion TARP bailout because it was a high profile, hotly contested, and endlessly covered, public legislative action with dramatic stock market consequences, it must be remembered that there were many more concealed, less noticed, and more costly emergency measures undertaken during 2008 financial crisis. Some of those, as I mentioned, were made public only years later, and some of those may remain secret to this day. In addition, the U.S. government and U.S. taxpayers directly and indirectly assisted foreign financial institutions, governments, and authorities, in effect insuring bank depositors in Germany, Switzerland, and the United Kingdom as well.[33]

Of course, a revisionist history of the 2008 financial crisis has been assiduously crafted and pitched to policymakers, the media, and academics on behalf of Wall Street's largest financial institutions and its many allies, lobbyists, and trade groups. Not only was TARP profitable, they misleadingly say, but many of the recipients of extraordinary assistance did not even need the financial support. Those claims are patently false and beyond the scope of my remarks today to comprehensively refute. However, one particularly revealing Federal Reserve Bank of New York ("FRBNY") internal email reminds us otherwise;

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connection with the Freedom of Information Act revealed that "the Fed provided Bear Stearns with $30 billion to see it through its 2008 shotgun marriage with JPMorgan" and noting that "[t]his was in addition to the $29.5 billion in assets purchased by the Fed from Bear to assist in the buyout by JPMorgan").

31 See, e.g., N. Friedman, Warrant Buffet Recounts His Role During 2008 Financial Crisis: The Berkshire Hathaway Chairman and CEO Explains Why He Turned Down AIG and Lehman in 2008, Wall Street Journal (Sept. 7, 2018), available at https://www.wsj.com/articles/warren-buffett-recounts-his-role-in-2008-financial-crisis-1536314400.

32 This, too, was a result of poor judgment and risk management practices. For example, one of the largest money market funds continued to lend to Lehman Brothers long after there were public signs of significant financial distress. See National Commission on the Causes of the Financial and Economic Crisis in the United States ("FCIC"), Financial Crisis Inquiry Report, 482 (January 2011) ("[T]he [oldest] money market mutual fund, apparently assuming that Lehman would be rescued, decided not to sell the heavily discounted Lehman commercial paper it held; instead, with devastating results for the money market fund industry, it waited to be bailed out on the assumption that Lehman would be saved.").

33 See, e.g., Appendix D attached, Total Maiden Lane II & III Lane Payouts to AIG Counterparties. See also Better Markets, Letter to the Honorable Randal K. Quarles, Re: Implementation of S. 2155: the Economic Growth, Regulatory Relief and Consumer Protection Act (Sept. 24, 2018), available at https://bettermarkets.com/sites/default/files/Ltr%20to%20Fed%20VC%20Quarles%20re%20Implementation%202155%209-24-18%20FINAL.pdf ("Fifth, a particularly dangerous suggestion is that implementing the Act should include automatically include a number of foreign banks operating in the US, many of which received very significant bailouts during the financial crisis. In fact, nine of the top twenty largest users of the Fed's emergency lending facilities during the crisis were foreign banks. For example, Deutsche Bank's U.S. subsidiary Taunus, was bailed out with 354 billion American dollars, which saved a bank that otherwise would have failed and required the emergency assistance of German taxpayers. Put differently, the U.S. government substituted US taxpayers for German taxpayers to bail out a German bank and prevent it from failing: because Deutsche Bank itself was in such financial distress and on the verge of failure, it simply did not have the ability to bail out its US operations and, therefore, the German government would have had to first bail out Deutsche Bank so that it could bail out its US subsidiary."). See also fn. 22 supra concerning Federal Reserve actions relating to the foreign exchange markets. For a comprehensive global review of the 2008 financial crisis and the extraordinary efforts of the U.S. and other governments, see A. Tooze, Crashed: How a Decade of Financial Crises Changed the World (2018).

Goldman Sachs—one of the largest U.S. investment banks—admitted that it would have been "toast" without a swift bailout of Morgan Stanley, in which case the FRBNY would have "definitely need[ed] to resolve both entities in one way or another" over the September weekend after Lehman had filed for bankruptcy.[34]

Remarkably but undeniably, Goldman Sachs' false or, at best misleading, statements to reassure investors, its imminent failure, or the secrecy surrounding the extent of financial support for Wall Street in general are not the most scandalous element of the 2008 financial crisis. **The true scandal is that every money-center derivatives dealer was "toast," leaving the U.S. government little choice but to intervene to prevent devastation from spreading even further to American families.** Permitting a financial meltdown was, and remains, unthinkable. In other words, the scandal is that the largest Wall Street banks——today collectively controlling 88.3% of OTC derivatives dealing[35]—have managed to create a "heads we win, tails you lose" proposition for U.S. taxpayers, and it cannot be surprising that they seek to strike the same deal again.

Congress and the U.S. taxpayers must reject that proposition. They must reject, too, the Faustian bargain from Wall Street that seeks to trade the safety and soundness of the U.S. financial system for purportedly increased financial activities (e.g., more lending, or greater "liquidity"). The benefits of such activities, even if realized to some extent, are certain to pale in comparison to the costs of undermining the safety and soundness of the U.S. financial system. Even the brief and incomplete recounting of the unprecedented actions, programs, and interventions I just described—representing trillions of dollars and immense U.S. taxpayer risks—were not sufficient to **promptly** stop the markets from spiraling downward. Indeed, as late as February 2009, economic and financial conditions remained in such a dangerous downward spiral that U.S. financial regulators took the extraordinary and unprecedented action of issuing a joint statement to collectively put the full faith and credit of the U.S. and all of its citizens behind the "financial system," "banks," and "systemically significant financial institutions;" nowhere in that statement was the commitment limited to the U.S. or U.S. institutions or banks. [36] In essence, the U.S. government was having U.S. taxpayers insure the global financial system.

Thus, although a combination of dozens of U.S. government actions ultimately prevented the global financial system from entirely collapsing, even today no one really knows which policy, program, intervention, action, or expenditure—or what combination or sequence of those measures—actually arrested the downward spiral definitely. The trial and error process of finding that out in the course of the next financial crisis is sure to come at a very substantial cost.

We collectively can learn from our mistakes and mitigate the risks of another crisis by focusing on the following key objectives:

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34 See Better Markets, Goldman Sachs Failed 10 Years Ago Today (September 20, 2018), available at https://bettermarkets.com/newsroom/goldman-sachs-failed-10-years-ago-today.

35 See U.S. Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities, First Quarter 2019 (June 2019), available at https://www.occ.gov/topics/capital-markets/financial-markets/derivatives/pub-derivatives-quarterly-qtr1-2019.pdf ("A small group of large financial institutions continues to dominate trading and derivatives activity in the U.S. commercial banking system. During the first quarter of 2019, four large commercial banks represented 88.3 percent of the total banking industry notional amounts and 86.2 percent of industry net current credit exposure").

36 See Joint Statement by the U.S. Department of the Treasury, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Board of Governors of the Federal Reserve System (Feb. 23, 2009), available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20090223a.htm; see also Better Markets, The World Changed With An Historic Announcement by the U.S. Government on February 23, 2009 (Feb. 27, 2013), available at https://bettermarkets.com/blog/world-changed-historic-announcement-us-government-february-23-2009.

- Ensuring that the safety and soundness of the U.S. financial system is not jeopardized through a series of Wall Street-backed regulatory "tweaks" that are, in actuality, designed to increase the profitability of a very concentrated set of Wall Street interests; and
- Providing the CFTC and other regulators with the authority, resources, and support to effectively execute on their critical duties and responsibilities to oversee the U.S. financial markets in the public interest.

I discuss these key objectives in the remainder of my remarks, although much more could be said with respect to the specific public policy issues confronting U.S. financial regulators, including the CFTC, at this time.

C. The Dodd-Frank Act has transformed the U.S. derivatives markets, protected the safety and soundness of the U.S. financial system, and set the stage for one of the longest continuous expansions of the U.S. economy in modern history. It was necessitated, however, by deregulatory zeal in the decade prior to the 2008 financial crisis.

Prior to these events, the U.S. did not experience economic crises on any scale approaching the Great Depression or the Great Recession for almost seven decades. One reason is that the post-Great Depression era was marked by substantial regulation of the financial sector. By 2000, however, newly empowered bank holding companies and financial holding companies were not just de-regulated but permitted to remain entirely **unregulated** in critical respects.

The consequences are now well known: the relative financial stability that remained for 70 years disappeared in just 7. It is not a coincidence that crisis followed shortly after the removal of important constraints on financial activities, most notably the repeal of the Glass-Steagall Act[37] through the Gramm-Leach-Bliley Act of 1999[38] and the misleadingly labeled Commodity Futures Modernization Act ("CFMA").[39] Although the 2008 financial crisis probably was not caused by a single provision in either law, a combination of regulatory gaps, supervisory deficiencies, inadequate risk management, grossly distorted incentives, deferential standards created by both laws, and decades of regulatory forbearance, neglect, and negligence if not dereliction contributed greatly. The CFMA's almost complete de-regulation of OTC derivatives, in particular, facilitated an OTC derivatives market structure that created, hid and exacerbated stresses, enabled the opaque over-issuance of securities with questionable credit quality, and served as a primary mechanism for the transmission of risks throughout the financial system.[40]

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37 See Better Markets, Fact Sheet: Repealing Glass-Steagall Contributed to the 2008 Financial Crash; Properly Reinstating It Can Be An Important Protection to Prevent Future Crashes and Taxpayer Bailouts (May 4, 2017), available at https://bettermarkets.com/sites/default/files/Fact%20Sheet%20Glass-Steagall%205-3-17%20FINAL.pdf.

38 See Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 101, 113 Stat. 1338, 1341 (1999) (repealing §§ 20 and 32 of the Banking Act of 1933, 12 U.S.C. §§ 377, 78 (1994)).

39 See Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763 (codified as amended in scattered sections of 7, 11, 12, and 15 U.S.C.). Professor Michael Greenberger provided a useful summary of the role of OTC derivatives in the 2008 financial crisis in 2010 testimony before the Financial Crisis Inquiry Commission. See M. Greenberger, The Role of Derivatives in the Financial Crisis, Testimony of Michael Greenberger, Law School Professor, University of Maryland School of Law, Financial Crisis Inquiry Commission Hearing, (June 30, 2010), available at https://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0630-Greenberger.pdf.

40 For more information on the role of the OTC derivatives in exacerbating the 2008 financial crisis, see National Commission on the Causes of the Financial and Economic Crisis in the United States, Financial Crisis Inquiry Report (January 2011). The FCIC concluded, unequivocally, that "over-the-counter derivatives contributed significantly to th[e] [2008 financial] crisis." Id. at xxiv.

The contributions of the pre-2008 de-regulatory zeal in the U.S. have been widely agreed and acknowledged even by the most vocal proponents of the laissez-faire model of financial regulation, including Former Federal Reserve Chairman Alan Greenspan.[41] **However, part of the reason for that de-regulatory zeal—which enabled Wall Street to engage in the activities that caused the 2008 financial collapse—was Wall Street's use of its economic power to gain political, academic, media, and other influence as part of a multi-decade effort to tear and water down the reasonable laws and restrictions that had served America well for decades.**

This reaches beyond the well-known relaxation of restrictions in the Glass-Steagall Act. As the U.S. Senate's Pecora investigations discovered, a host of new securities, derivatives, and banking laws were necessary to protect against Wall Street excesses, including conflicts of interest, reckless and fraudulent practices, and structural incentives that contributed to the Great Depression.[42] Yet, with all of those new laws and truly unprecedented and transformative regulation of the U.S. capital and derivatives markets at that time:

- The United States prospered;
- The U.S. facilitated the largest, broad-based increase in the middle class in the history of the world; and
- Wall Street, the U.S. financial industry, U.S. non-financial businesses, and the U.S. economy thrived.

Indeed, in this time period, U.S. capital markets propelled the U.S. to global leadership on financial reform issues and made them what some have characterized as the envy of the world.

In short, the Dodd-Frank Act was intended to **re-regulate** a previously highly regulated industry that had served the country and itself well for many decades. That re-regulation was designed to close regulatory gaps and strengthen existing requirements for the benefit of investors, the public, and the U.S. economy as a whole. Members of this committee, from both political parties, who voted for it were right to support financial reform. It was not a panacea for all that ails the financial markets and it was not perfect, to be sure. But it was a critical part of a solution to address the most salient problems contributing to the 2008 financial crisis.

None of that prevented the financial industry from making self-serving claims that the "end would be near" without a relaxation of reasonable constraints. However, the value of the Dodd-Frank Act and a comprehensive regulatory framework for derivatives and other financial activities can no longer be legitimately denied. Benefits include sparing the U.S. economy devastating consequences that another financial collapse would bring in the form of economic and monetary losses and human suffering. Such benefits are enormous, totaling tens of trillions of dollars, measured not just in terms of the 2008 financial crisis as a benchmark but also avoidance of future financial crises that have the potential to be even worse

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41 The former Federal Reserve Chairman acknowledged that he was "partially" wrong in his views on the self-regulating potential of the U.S. financial markets and noted that "[t]he whole intellectual edifice [of the modern risk management paradigm] . . . collapsed in the summer [of 2008]." See E. Andrews, Greenspan Concedes Error on Regulation (Oct. 23, 2008), available at https://www.nytimes.com/2008/10/24/business/economy/24panel.html.

42 See Stock Exchange Practices: Report of the Committee on Banking and Currency Pursuant to S. Res. 84 and S. Res. 56 and S. Res. 97,. Report No. 1455 (June 16, 1934), available at https://www.senate.gov/artandhistory/history/common/investigations/pdf/Pecora_FinalReport.pdf.

if financial reforms are sabotaged or not fully implemented. **Effective implementation of the Dodd-Frank Act means re-regulation of the financial industry to shift costs back *to* Wall Street banks and other financial interests *from* the American public, where the costs were shifted when the financial industry was de-regulated in the first place.**

That will necessarily result in the financial industry re-assuming costs that were imposed on the U.S. economy as a whole before passage of the Dodd-Frank Act. The transformative reforms to the derivatives market, for example, would be impossible to implement without imposing significant costs on market participants required to do things that they proved unable or unwilling to do on their own:

(1) hiring sufficient and appropriately expert staff to ensure proper risk management and implementation of trading policies, procedures, and controls;

(2) upgrading and maintaining technology systems to enable appropriate risk monitoring and mitigation of operational and other risks; and

(3) altering internal practices in compliance with the new regulatory framework.

These transformative reforms require financial institutions to allocate people, capital, and technology resources to the transformation process. As a consequence, derivatives reforms may have resulted in modestly reduced profits in some lines of business, but in the process, they have limited abusive or highly risky conduct (e.g., manipulation of interest rate benchmarks or London Whale-type speculative trades) and significantly reduced systemic risk. If that is the case, the U.S. financial system is better for it. The Dodd-Frank Act necessarily must prohibit fraudulent transactions and those based upon conflicts of interest; curtail other damaging behaviors, including excessive speculation; force the reallocation of funds to new uses, such as capital and margin; and increase transparency and competition through pre- and post-trade reporting, reducing likely profit margins in efficient, competitive markets.

Given the more than $20 trillion price tag of the last financial crisis, the enormous benefits of Wall Street re-regulation in mitigating the effects of any future financial crises, and the shifting of externalized costs back to the institutions from taxpayers, it is beyond reasonable dispute that the benefits of reform far exceed the costs and lost profits that industry will have to absorb as the price for protecting the American people, taxpayers, Treasury, and economy. Since the emergence of financial markets regulation, the financial services industry has always argued that new regulatory requirements will have a devastating impact on liquidity, lending, and other intermediation activities and impose unbearable compliance costs. Yet, Wall Street has always absorbed the cost of those new regulations and consistently remained one of the most profitable sectors in the US. economy.

A century ago, when securities regulation first emerged at the state level, Wall Street railed against it as an "unwarranted" and "revolutionary" attack upon legitimate business. However, in the years following this early appearance of financial regulation, banks and their profits grew handsomely. Subsequently, when the federal securities laws were adopted in the midst of the Great Depression, Wall Street staunchly opposed them, claiming that they would slow economic recovery by impeding the capital formation process and discouraging the issuance of new securities—virtually identical arguments that industry is making today. However, in the years after the enactment of the federal securities laws, the nation's securities markets flourished. The same pattern has been repeated with each new effort to strengthen financial regulation, including deposit insurance, the Glass-Steagall Act, mutual fund and money market reforms, the national market initiatives of the mid-1970s, and the derivatives market reforms in Title VII of the Dodd-Frank Act.

Of course, Wall Street's contentions are not only unsupported by the facts—but are contradicted by the facts. The financial industry itself is enjoying record-setting revenues, profits, and bonuses, as they easily absorb the costs of compliance with the Dodd-Frank Act. Viewed more broadly, regulated, transparent markets with less fraud and reckless conduct have restored confidence in U.S. financial markets and institutions, which, in turn, has improved economic growth. Moreover, industry's claims that financial reform will reduce market liquidity, capital formation, and credit availability, and thereby hamper economic growth and job creation, simply disregards a key and overriding fact: the financial crisis did more damage to those supposed concerns than any regulation possibly could. In September 2008, there was no market liquidity, capital formation, or credit availability and, for years thereafter economic stagnation prevailed. That is due to the Wall Street-created financial collapse and economic crisis. The financial reform and Wall Street re-regulation law seeks to prevent that from happening again and derivatives regulation is key to accomplishing that important goal.

II. The CFTC is the only police force on the derivatives beat, and it needs substantially more funding to protect the American people properly.

Surely, the starting point for any derivatives markets policy discussion should at least be that the CFTC and the Commodity Exchange Act's statutory framework should *exist*. Yet, the CFTC was last authorized more than a decade ago in the Food, Conservation, and Energy Act of 2008,[43] which extended the agency's authorization through fiscal year 2013. It has operated under lapsed authorization since that time, even though it is meant by statute to be reauthorized by Congress every five years. While this past neglect of a critical financial regulatory agency is regrettable, I commend the chairman and this committee for now prioritizing the CFTC's reauthorization.

The CFTC and other financial regulators are the cops on the beat, so-to-speak, establishing rules of the road; surveilling the markets to detect misconduct, abusive practices, and other violations of law; and taking enforcement action where appropriate to punish and deter violations of the law. To tackle the complex regulatory challenges that lie ahead and to serve as an effective deterrent to Wall Street's too frequent high-risk and abusive practices, however, the CFTC must be given sufficient ***resources*** and ***authority*** to carry out its responsibilities. If the CFTC and other financial regulators are not fully funded, they cannot hire and retain the expert personnel necessary to understand the markets that they oversee and they will increasingly struggle to obtain the technological tools necessary to consider, implement, and enforce data-driven laws in the future.

The CFTC's reauthorization, full funding, and authority to implement fees as necessary (like many other federal regulatory agencies) are essential to protecting investors and U.S. capital and derivatives markets. In addition, the CFTC must have the authority to police markets as they evolve in real time (e.g., it must have authority to oversee non-securities digital-asset intermediaries, some of whom have been involved in fraud and other forms of misconduct in recent years). Depriving the CFTC of the resources and authority it needs will increase the likelihood, imminence, and severity of another financial crisis.

Reauthorization of the CFTC is a first step. But the agency also must be empowered to protect the public interest by properly doing at least that which it is authorized to do. Consider the enormous responsibilities that the CFTC has been given in terms of the size and complexity of the markets it must oversee; the number of firms and individuals subject to its jurisdiction; the rapidly evolving—and potentially dangerous—products that are emerging; and the regulatory challenges that remain to be addressed, some of which are legacy issues representing unfinished business in implementing the Dodd-Frank Act.

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[43] Congress enacted the CFTC Reauthorization Act of 2008 in the Food, Conservation, and Energy Act of 2008, P.L. 110-246, 122 Stat. 1651 (May 22, 2008) ("Farm Bill").

Vast Markets, in Both Futures and Swaps

The CFTC is already responsible for ensuring the transparency and integrity of the futures markets that are so critical to this Committee, the agricultural markets it oversees, and the broader U.S. economy. Since the passage of the Dodd-Frank Act, its responsibilities for regulating those critical markets have been coupled with new responsibilities to oversee OTC derivatives markets that are approximately twenty times larger, and as I have explained, more dangerous. The CFTC needs a budget commensurate with the duty of responsibly policing both of **these markets, with a combined total of more than $300 trillion in notional value.**

Tens of Thousands of Market Participants and Rapidly Evolving Financial Products

Within the exchange-traded and OTC derivatives markets, the CFTC must monitor literally thousands of market participants, a task that has resulted in the CFTC delegating too many responsibilities to the National Futures Association. Consider the following recent number of CFTC registrants and registered entities:

CFTC Registrants and Registered Entities

Entity	Acronym	FY 2018 Actual
Trading Entities		
Designated Contract Market	**DCM**	15
Foreign Board of Trade[25]	**FBOT**	18
Swap Execution Facility	**SEF**	23
Clearing Entities		
Derivatives Clearing Organization[26]	**DCO**	16
Exempt Derivatives Clearing Organization	**Exempt DCO**	4
Systemically Important DCO	**SIDCO**	2
Data Repositories		
Swap Data Repository[27]	**SDR**	4
Registrants[28]—Intermediaries		
Futures Commission Merchant[29]	**FCM**	62
Major Swap Participant	**MSP**	0
Retail Foreign Exchange Dealer	**RFED**	2
Swap Dealer		101
Registrants—Managed Funds		
Commodity Pool Operator	**CPO**	1,567
Commodity Trading Advisor	**CTA**	2,127
Other Registrants		
Associated Person	**AP**	49,811
Introducing Broker	**IB**	1,188
Floor Broker	**FB**	2,935
Floor Trader	**FT**	533

Source: FY 2020 President's Budget, CFTC[44]

[44] See Commodity Futures Trading Commission, Fiscal Year 2020 President's Budget, Appendix 5—The Commission and the Industry It Regulates, 50 (March 2019), available at https://www.cftc.gov/sites/default/files/2019-03/cftcbudget2020.pdf.

Moreover, bitcoin and other emerging digital technologies, like Facebook's recently announced global Libra coin,[45] present a host of consumer protection, technology, cybersecurity, and even national security issues that must be considered by expert staff and technologists. This simply cannot be done on the cheap or outsourced to the industry itself.

In addition to overseeing the markets, the CFTC must resolve a number of critically important regulatory challenges, some of which represent unfinished business in implementing the Dodd-Frank Act due the previous resource shortfalls and constraints. For example, the CFTC must do each of the following as commanded by Congress:

- Finally adopt a strong position limits rule that effectively addresses the problem of excessive speculation in commodities markets, a practice that can intensify volatility and cause price distortions that harm businesses and ultimately American consumers;[46]

- Strengthen cross-border rules to better protect the American financial system from destabilizing risks originating in foreign firms and markets, while preventing a regulatory race to the bottom;[47]

- Provide an appropriate regulatory framework for the oversight, monitoring, and accountability of high-speed, algorithmic trading firms that carry the potential to destabilize the derivatives and related markets.[48]

In addition, the CFTC's most fundamental task should be defending and building on the progress made to increase financial stability, consumer protection, competition, and transparency in the U.S. derivatives markets across all rule areas.[49] Instead, in recent years, the CFTC's new initiatives have, at

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[45] See L. Laurent, Facebook's Libra Wanders into the Bitcoin Bear Trap: Putting aside all of the cryptocurrency risks, there are already lots of ways to transfer cash digitally. Does Libra offer anything new?, Bloomberg (June 18, 2019), available at https://ww.bloomberg.com/opinion/articles/2019-06-18/facebook-libra-cryptocurrency-tries-to-avoid-bitcoin-bear-traps.

[46] See, e.g., Better Markets, Position Limits for Derivatives (CFTC RIN: 3038-4D99) (Feb. 28, 2017), available at https://bettermarkets.com/sites/default/files/CFTC-%20CL-%20Position%20Limits%20for%20Derivatives-%2020170228.pdf.

[47] Better Markets has written extensively on cross-border issues in the derivatives markets, filing more than a dozen comment letters with the CFTC and SEC on relevant topics. For a catalogue of those letters and related materials, see Better Markets, The CFTC's Regulation of Wall Street's High Risk Global Derivatives Bets Must Protect U.S. Taxpayers, available at https://bettermarkets.com/blog/cftcs-regulation-wall-streets-high-risk-global-derivatives-bets-must-protect-us-taxpayers. Better Markets also published a useful summary of cross-border issues that is now dated but remains relevant to current public policy issues: Better Markets, Cross-Border Derivatives Regulation: Better Markets' Summary Presentation (June 21, 2013), available at https://bettermarkets.com/sites/default/files/CFTC%20Cross-border-%206-21-13.pdf.

[48] See Better Markets, Regulation Automated Trading RIN 3038-AD52 (May 1, 2017), available at https://bettermarkets.com/sites/default/files/CFTC-%20CL-%20Regulation%20Automated%20Trading-%2020170501.pdf.

[49] This means avoiding pretextual regulatory measures that retreat from the statutorily required reforms to the derivatives markets in the Commodity Exchange Act and the prohibitions and restrictions on proprietary trading in the Bank Holding Company Act. See, e.g., Better Markets, Public Comment on Swap Execution Facilities and Trade Execution Requirement (RIN 3038AE25); Public Comment on Request for Comment on Post-Trade Name Give-Up on Swap Execution Facilities (RIN 3038-AE79) (March 15, 2019), available at https://bettermarkets.com/sites/default/files/Better%20Markets%20Comment%20Letter%20on%20Swap%20Execution%20Facilities%20and%20Trade%20Execution%20Requirement_0.pdf. See also Better Markets, De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 27444 (June 12, 2018); RIN 3038-AE68 (Aug. 13, 2018), available at https://bettermarkets.com/sites/default/files/Better%20Markets%20Comment%20Letter%20to%20CFTC%20on%20De%20Minimis%20Exception.pdf; See also Better Markets, Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Oct. 17, 2018), available at

times, used benign-sounding code words for attempts at weakening rules to reduce the costs and burdens on the financial industry, without sufficient regard for the essential role that the rules play in protecting the public interest.[50]

Notwithstanding these and many other responsibilities with the potential to affect global financial markets and economies, the CFTC has been consistently deprived of adequate funding. In the decade leading up to passage of the Dodd-Frank Act, the CFTC faced a steadily increasing strain on its budget. From 2000 to 2009, the futures markets themselves expanded dramatically, with the number of actively traded futures and options contracts increasing six-fold by some measures, and the dollar volume of trading in futures and options increasing four-fold. **Yet, the CFTC's resources failed to keep pace with even those derivatives market activities; the number of CFTC staff—quite absurdly—actually contracted between 2002 and 2009:**

CFTC Total Number of Employees, 2002-2009

Year	Number of Employees
2002	567
2003	556
2004	517
2005	487
2006	493
2007	437
2008	449
2009	498

Source: Better Markets Analysis

CFTC staff has increased since that time, but remains nowhere near the level necessary to ensure adequate execution of the CFTC's responsibilities, as now explained by both Democratic and Republican Chairs of the commission. Indeed, in recent years, the CFTC's budget has not only remained flat but was actually **reduced in 2018:**

CFTC Appropriated Budget, 2015-2019

Year	Appropriated Amount
2015	$ 250,000,000.00
2016	$ 250,000,000.00
2017	$ 250,000,000.00
2018	$ 249,000,000.00
2019	$ 268,000,000.00

https://bettermarkets.com/sites/default/files/Better%20Markets%20Comment%20Letter%20on%20New%20Volcker%20Rule%20Proposal.pdf.

50 See Better Markets, Request for Information on Project KISS (Keep it Simple Stupid), RIN 3038-AE55) (Sept. 29, 2017), available at https://bettermarkets.com/sites/default/files/CFTC-%20CL-%20Project%20KISS%209-29-17.pdf.

Source: Better Markets Analysis

The CFTC is now facing an extraordinary challenge. In addition to its current oversight duties, the agency must now regulate a swaps marketplace that is twenty times the size of the futures and options market—representing a domestic notional value of over $300 trillion. This new responsibility has already put the agency under enormous strain as it has struggled to implement complex rules under Title VII of the Dodd-Frank Act and monitor compliance and risk throughout the markets, including its 102 global swap dealers, with complex global operations, and other new swaps market infrastructure firms and market participants, ranging from swap execution facilities to swap data repositories. Accordingly, the CFTC must have resources to do the following:

- Secure the additional policy experts, attorneys, and economists necessary to initiate or complete the rulemakings that are necessary to establish and maintain the essential guardrails in the futures and swaps markets;
- Retain technical experts that can properly review swaps trading practices and product offerings under the provisions of Dodd-Frank and make recommendations concerning trade execution and clearing mandates;
- Examine each category of market participants with sufficient thoroughness, expertise, and frequency to ensure that they remain in compliance with the Commodity Exchange Act and that investors and market participants are protected;
- Collect, sort, and analyze new data on swap transactions for risk monitoring and enforcement purposes, including data provided through more 100 individual data streams; and
- Investigate and take enforcement action against market participants that violate the law.

These challenges for the CFTC require this Committee not only to reauthorize the Commission but to fight for significant increases in its funding during the appropriations process.

The CFTC must be provided with significantly greater funding so that it can acquire the human resources and information technologies that are indispensable to effective oversight of our increasingly complex and data-driven derivatives markets. This is especially important now that the CFTC has primary responsibility for ensuring that OTC derivatives do not—again—become financial weapons of mass destruction.[51]

Of course, resources are limited, and priorities have to be made, but we are not just talking about funding an agency that should be mindlessly stacked up against other agencies. We are talking about protecting the American people and the country from another costly, resource-draining financial catastrophe and possible second Great Depression. The CFTC budget (and that of other financial regulators) must be thought of in the context of the tens of trillions of dollars used in bailout and rescue programs plus the lost GDP and all the human suffering that befell the country just ten years ago—all of which could well be required again in the future.

[51] See Berkshire Hathaway Inc., 2002 Annual Report, 15 (2003), available at http://www.berkshirehathaway.com/2002ar/2002ar.pdf ("We try to be alert to any sort of megacatastrophe risk, and that posture may make us unduly apprehensive about the burgeoning quantities of long-term derivatives contracts and the massive amount of uncollateralized receivables that are growing alongside. In our view, however, derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal.").

Consider that more than 40 banks received more taxpayer money from ***the TARP program alone*** in 2008-2009 than the CFTC's entire 2019 appropriation of $268 million:

No.	Bank	Total Disbursed
1	Bank of America	$47,199,976,359
2	Citigroup	$45,742,683,973
3	JPMorgan Chase	$28,109,044,102
4	Wells Fargo	$28,195,112,080
5	Goldman Sachs	$10,000,000,000
6	Morgan Stanley	$10,000,000,000
7	PNC Financial Services	$7,657,552,234
8	U.S. Bancorp	$6,780,316,729
9	SunTrust	$7,657,552,234
10	Capital One Financial Corp	$3,555,199,000
11	Regions Financial Corp	$3,500,000,000
12	Fifth Third Bancorp	$3,408,001,000
13	BB&T	$3,133,640,000
14	Bank of New York Mellon	$3,000,000,000
15	Keycorp	$2,500,000,000
16	CIT Group	$2,764,106,842
17	Comerica Incorporated	$2,250,000,000
18	State Street	$2,000,000,000
19	Marshall & Ilsley	$1,715,000,000
20	Northern Trust	$1,576,000,000
21	Zions Bancorp	$1,400,000,000
22	Huntington Bancshares	$1,398,071,000
23	Synovus Financial Corp	$967,870,000
24	Popular, Inc.	$935,000,000
25	First Horizon National	$866,540,000
26	M&T Bank Corporation	$600,000,000
27	Associated Banc-Corp	$525,000,000
28	First BanCorp	$424,174,000
29	City National	$400,000,000
30	Webster Financial	$400,000,000
31	Fulton Financial Corp	$376,500,000
32	TCF Financial	$361,172,000
33	South Financial Group	$347,000,000
34	Wilmington Trust Corporation	$330,000,000
35	East West Bancorp, Inc.	$306,546,000
36	Sterling Financial Group	$303,000,000
37	Citizens Republic Bancorp	$300,000,000
38	Susquehanna Bancshares	$300,000,000
39	Valley National	$300,000,000
40	Whitney Holding Corp	$300,000,000
41	UCBH Holdings	$298,737,000
42	First Banks, Inc.	$295,400,000

Source: ProPublica[52]

Viewed this way, the CFTC budget is like an insurance policy, not only to reduce the likelihood of a future crash, but also to reduce the likelihood that you and your colleagues will have to once again vote to send such gigantic amounts of taxpayer money to failed banks, including all of the major derivatives dealers.

Transaction or User Fees

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[52] For a useful breakdown of TARP recipients, see ProPublica, Bailout Recipients: Bailout Tracker, Tracking Every Dollar and Every Recipient (Feb. 25, 2019), available at https://projects.propublica.org/bailout/list. The figures and bailout recipients identified in the ProPublica tracker do not account for the many other Federal Reserve facilities and U.S. government programs and actions that must be considered part of the Wall Street "bailout" associated with the 2008 financial crisis.

Unless the CFTC and the other financial regulators have sufficient resources to regulate and oversee the swaps market effectively, our markets will remain far too vulnerable to the risky and abusive behaviors that spawned the last crisis and threaten a new one. One mechanism for funding the CFTC without drawing from the Treasury at all would be to establish transaction or user fees on trades executed in the futures, options, and swaps markets. This deficit neutral, self-funding approach has already been adopted for the benefit of other financial regulators and indeed has become the norm for those agencies. For example, transaction and other fees imposed on issuers and traders in the equity markets have long served as the funding mechanism for the SEC. Given the number of markets that the CFTC oversees, the volume of trading in those markets, and the high notional value of those contracts, an extremely modest user fee could produce ample revenue, capable of sustaining CFTC operations at significantly higher levels over the current appropriation.

In fact, several years ago, Better Markets provided an analysis showing that the CFTC's FY 2014 budget request of $315 million could have been fully met, without any taxpayer funds, by imposing a fee of as little as $1 per million dollars of notional value on each swap contract, and just 28¢ per million dollars of notional value on each futures and options contract transacted in the United States (for each party to the swap). That represents a 0.0001% transaction fee, a hundredth of a basis point, on swaps, and a fraction of that amount for futures and options.[53]

Contrary to the alarmist and unfounded claims of some industry advocates, such a small CFTC funding fee would not harm market liquidity. For instance, as our 2013 analysis showed, the average interest rate swap transaction had a notional size of approximately $58 million, and the private execution cost for such a swap was typically around $1,000.[54] Under those circumstances, the incremental CFTC funding fee would have been $58; and a farmer with 500 acres of corn crop could have hedged his entire yield (approximately 75,000 bushels) on the CME with 15 corn futures contracts.[55] The CME execution fees on this order would have exceeded $10, yet the incremental CFTC funding fee would have been just 10¢. Such small fee increments would have had no noticeable impact on liquidity or trading decisions. The decision to hedge or not can make a difference of tens if not hundreds of thousands of dollars to an individual farmer or business. It is inconceivable that true end-users or their customer-facilitating brokers would be driven away from the market by a modest fee in this general range. The case for CFTC self-funding through transaction fees has only gotten stronger over the last several years, as trading volume has steadily increased.

In fact, academic literature supports the notion that de minimis financial transaction fees have a negligible or zero impact on liquidity. For instance, recent research from the University of Massachusetts found that developed financial markets tend to tolerate transaction fees of up to 50 basis points with little or no impact on liquidity.[56] The CFTC funding fee proposed here would be a miniscule fraction of that amount.

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53 See Questions for the Record, Hearing on Reauthorization of the Commodity Futures Trading Commission, Sen. Comm. on Agriculture, Nutrition & Forestry (July 17, 2013).

54 Id. at 1.

55 Id. at 1-2.

56 Robert Pollin & James Heintz, Transaction Costs, Trading Elasticities and the Revenue Potential of Financial Transaction Taxes for the United States, Political Econ. Research Inst., Univ. of Mass. (Dec. 2011), available at http://www.peri.umass.edu/fileadmin/pdf/research_brief/PERI_FTT_Research_Brief.pdf.

It bears emphasis that the CFTC is the only financial regulator that does not impose fees to fund itself. And, if imposed, the general level of transaction fee necessary to adequately fund the CFTC would be, by far, the smallest fee among the financial regulators. For example, the SEC has recently established user fees of $20.70 per million dollars in most securities transactions, and even assesses fees on each round turn transaction in security futures, to raise well over $1 billion annually in revenues.[57] These fees have not impaired liquidity.

In short, an extremely small user fee established for futures, options, and swaps trades could easily raise the level of funding that the CFTC desperately needs to fulfill its wide-ranging responsibilities, all without harming liquidity or otherwise disrupting or burdening the markets or market participants.

III. Conclusion

As is so often the case, the facts speak eloquently for themselves:

- Financial reform was necessitated by the largest financial and economic collapse since the Great Depression of the 1930s, and it was enacted to prevent a second Great Depression.

- The benefits of avoiding another financial crisis are enormous, totaling tens of trillions of dollars, measured not just in terms of the current crisis but also in light of a potentially worse financial disaster that may befall our country if reform is not fully implemented.

- Effective financial reform that protects the American people required a re-regulation of the financial industry through the Dodd-Frank Act, which was intended to properly shift costs back to the financial industry from the American public, on whom they were foisted when the industry was de-regulated prior to the 2008 financial crisis.

- The financial industry has always complained about the alleged costs and disruptions associated with financial regulation, but history proves that these self-serving claims are without merit and, in fact, disproved by their own financial performance since the passage and enactment of the Dodd-Frank Act.

- Derivatives played a key role in precipitating and transmitting the financial crisis and collapse; derivatives regulation is an essential part of comprehensive financial reform and protecting the American taxpayer from again having to bail out the financial industry.

- The CFTC is the only police force on the derivatives beat and it needs a clean reauthorization, new authorities, and substantially more funding to protect the American people; right now, the CFTC is at risk of failing due to gross underfunding.

I thank you, Mr. Chairman, Ranking Member Stabenow, and other members of the committee for the opportunity to appear before the committee on this critical issue.

I look forward to addressing any questions you may have on the U.S. derivatives markets and CFTC reauthorization.

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[57] See Securities and Exchange Commission, Fee Rate Advisory #2 for Fiscal Year 2019, Release 2019-30 (March 12, 2019), available at https://www.sec.gov/news/press-release/2019-30.

Sincerely,

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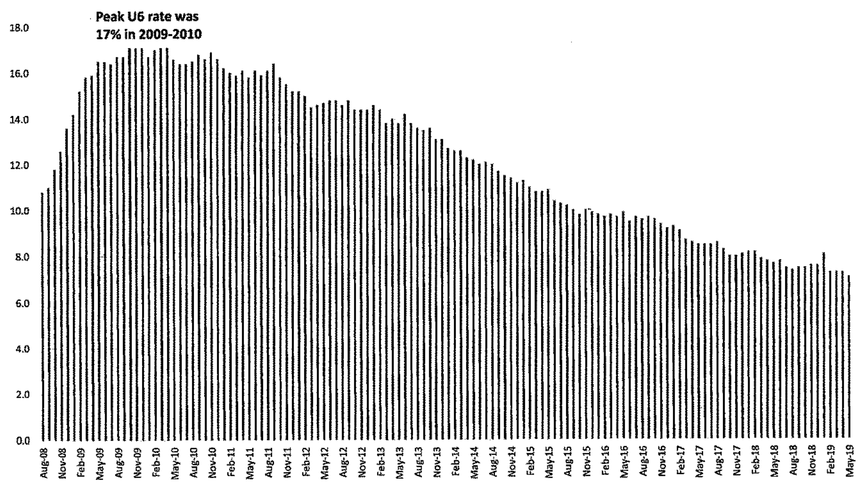
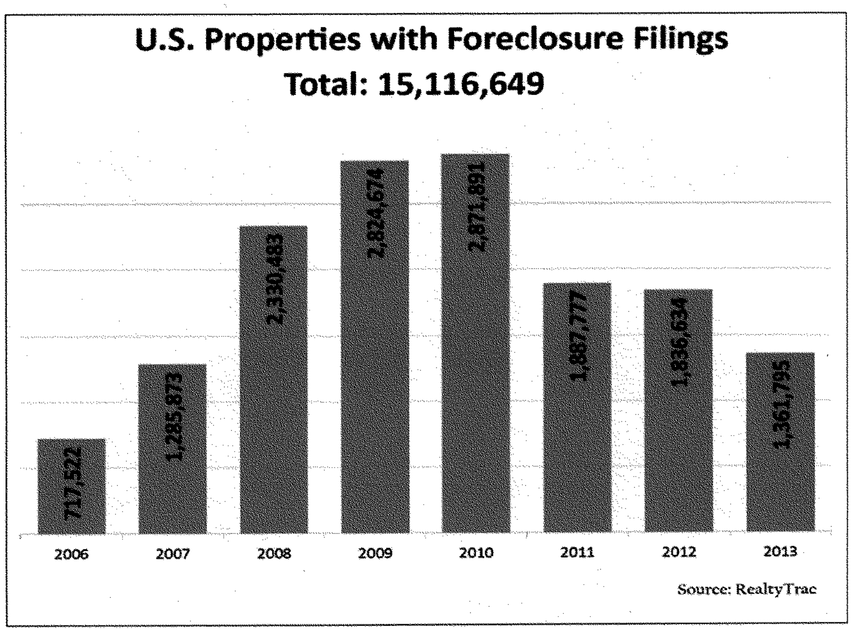
Appendix A

Total Un- and Under-Employed
(At One Month Peak: Almost 27 Million Americans)



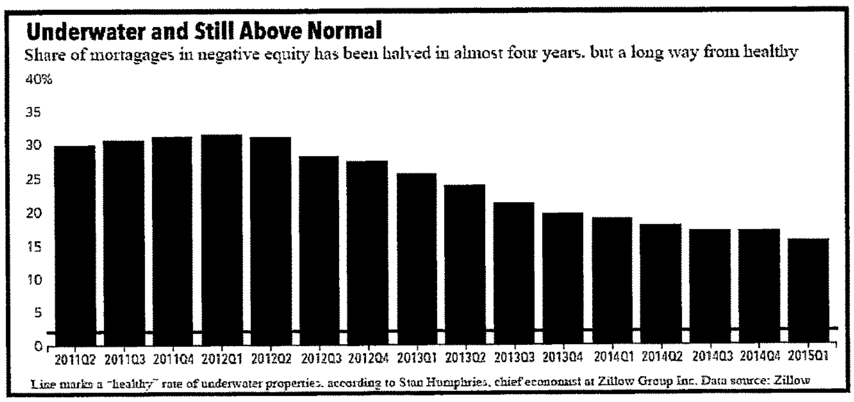
Source: FRED

Appendix B


U.S. Properties with Foreclosure Filings
Total: 15,116,649
717,522
1,285,873
2,330,483
2,824,674
2,871,891
1,887,777
1,836,634
1,361,795
2006
2007
2008
2009
2010
2011
2012
2013
Source: RealtyTrac

Appendix C

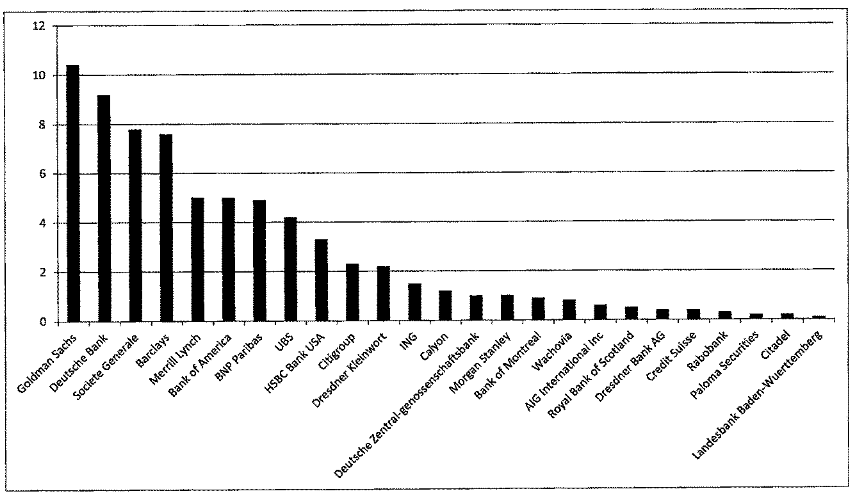
Underwater Homes: Mortgages More Than Homes Could Sell For



Appendix D

Total Maiden Lane II & III Payouts to AIG Counterparties

($ Billions)



DOCUMENTS SUBMITTED FOR THE RECORD

June 25, 2019

ISDA® Safe, Efficient Markets

Written Statement of Scott O'Malia
Chief Executive Officer
International Swaps and Derivatives Association
U.S. Senate Committee on Agriculture, Nutrition and Forestry
June 25, 2019

Chairman Roberts, Ranking Member Stabenow and Members of the Committee, ISDA is grateful for the opportunity to submit a written statement on the reauthorization of the Commodity Exchange Act (CEA).[1]

The reauthorization process provides an important opportunity for Congress to review the Dodd-Frank regulatory framework established after the financial crisis. It also enables Congress to assess progress that has been made by the Commodity Futures Trading Commission (CFTC) and other U.S. regulatory agencies in implementing that framework, measure improvements in the safety and robustness of the financial system, and potentially recalibrate regulations to ensure they support their original objectives and have been implemented in a cost-effective manner.

We commend the Committee's leadership in monitoring the progress of the reforms and ensuring the CFTC operates on a sound footing when performing its important oversight functions.

As outlined in this statement, further work is required to ensure the regulatory framework achieves its objectives. There are numerous examples of where the rules have led to inefficiencies and higher costs for derivatives users, and have resulted in fragmentation of markets and liquidity. The statement will highlight areas where further action is required and propose recommendations. The statement also describes how these regulatory changes have led to the development of transformational industry solutions designed to ensure consistent and efficient implementation of certain requirements.

Background

The Dodd-Frank Act was enacted in 2010 to reduce systemic risk and ensure markets function safely and efficiently. The Act expanded the CFTC's authority to include the regulation and oversight of swaps, in addition to its existing authority over futures and options.[2] It also expanded the CFTC's longstanding broad anti-fraud and anti-manipulation authority to swaps.[3]

Since then, substantial progress has been made by the CFTC and other U.S. regulatory agencies to implement derivatives regulations related to clearing, margining, trade execution, trade reporting and capital, in line with the provisions of the legislation. U.S. derivatives

[1] Public Law 93-463, Section 12(d) (Oct. 23, 1974); Public Law 104-9, 109 Stat. 154, Section 1-2 (Apr. 21, 1995)
[2] Commodity Exchange Act (CEA) § 2(a), 7 U.S.C. § 2(a)
[3] CEA § 9(a)(2)-(3), 7 U.S.C. 13(a)(2)-(3); CEA § 4c, 7 U.S.C. § 6c

markets are now more transparent and more resilient than ever before, and the market is functioning more safely and more efficiently.

In clearing, 88.9% of interest rate derivatives notional traded in the first quarter of 2019 and reported to U.S. trade repositories was cleared. Approximately 81% of credit derivatives traded notional was cleared.[4] In fact, ISDA analysis shows that market participants are clearing more than what is required under the CFTC's clearing mandate, highlighting the intrinsic benefits of clearing.[5]

In reporting, regulatory standards have been implemented in the U.S. and 20 of the other 24 Financial Stability Board (FSB) jurisdictions, and regulators now have more data at their disposal to understand the derivatives market and identify systemic risk than ever before.[6]

With regards to trading, 60% of interest rate derivatives and 77.5% of credit derivatives notional traded in the first quarter and reported to U.S. repositories was traded on a swap execution facility (SEF).

New margin rules for non-cleared derivatives are being phased in, contributing to a reduction in counterparty credit risk. Variation margin (VM) requirements were introduced in 2017, and the largest 20 market participants had collected $858.6 billion in VM for their non-cleared trades at the end of 2018, according to ISDA analysis.[7] Initial margin (IM) rules have been phased-in since September 2016, and approximately $157.9 billion in IM had been collected by the 20 biggest firms at the end of 2018 – a 47% increase versus a similar survey conducted in March 2017.

On capital, the large internationally active banks have added over $2 trillion of Tier 1 capital to their balance sheets since 2011, making them much more resilient to market stress. U.S. banks are today stronger and better capitalized than ever.

A lot of work has gone into developing, implementing and complying with these rules. Without doubt, the financial system is more robust, more resilient and more transparent as a result.

ISDA and its members are proud of this progress, and we recognize that it has been achieved through unprecedented levels of cooperation, both at the legislative and regulatory level and at the industry level.

It is important to state clearly that we are not advocating turning the clock back on regulatory reform, nor do we believe there would be any support in the industry for such a move.

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[4] SwapsInfo First Quarter of 2019 Review, April 2019, https://www.isda.org/a/RNUME/SwapsInfo-Q1-2019-Review.pdf

[5] ISDA Research Note, Actual Cleared Volumes vs. Mandated Cleared Volumes: Analyzing the U.S. Derivatives Market, July 2018, https://www.isda.org/a/6yYEE/Actual-Cleared-Volumes-vs-Mandated-Cleared-Volumes.pdf

[6] Financial Stability Board, OTC Derivatives Market Reforms: Thirteenth Progress Report on Implementation, November 2018, https://www.fsb.org/2018/11/otc-derivatives-market-reforms-thirteenth-progress-report-on-implementation/

[7] ISDA Margin Survey Year-End 2018, https://www.isda.org/a/nIeME/ISDA-Margin-Survey-Year-End-2018.pdf

However, we do think it is appropriate for the regulatory framework to be continually assessed, and for specific, targeted changes to occur where necessary to ensure the rules do not impose unnecessary costs and burdens on derivatives users.

Outstanding Issues and Recommendations

ISDA commends this Committee, the Administration and the various regulators including the CFTC for reviewing the legislative and regulatory framework, and taking steps to identify and make modifications where necessary to ensure the derivatives markets continue to function efficiently.

In response to a series of executive orders, including Executive Order 13771,[8] the U.S. Department of the Treasury announced in April 2018 that it eliminated or proposed to eliminate or modify more than 300 regulations. More than 250 Treasury recommendations had been made to reform and reduce the burdens of financial regulation.[9]

We agree it is vital that unnecessary costs and complexity do not hamper the use of derivatives by U.S. corporates, pension plans, insurance companies and asset management firms that rely on these instruments to hedge the risks associated with their commercial operations. ISDA urges the Committee to continue playing an active role in monitoring progress on these recommendations going forward.

<u>Margin Requirements</u>

- Phase Five IM Implementation: Looming Operational Challenge

The upcoming application of IM requirements to a wider cross-section of market participants is a key area where action is needed to ensure the rules are applied consistently, without imposing unnecessary costs and burdens on smaller, non-systemically important institutions.

According to ISDA analysis, more than 1,100 entities will come into scope of IM requirements in September 2020, when the threshold for compliance falls from $750 billion to $8 billion in aggregate average notional amount of non-cleared derivatives. This represents over 9,500 trading relationships.[10]

Under the rules, new documentation would need to be negotiated with every counterparty and two custodial accounts for each relationship would need to be set up. Despite this, ISDA analysis shows over 70% of newly in-scope counterparty relationships globally will not be required to post IM, because their exposures fall below a $50 million IM exchange threshold.[11]

[8] Executive Order 13771, Reducing Regulation and Controlling Regulatory Costs, January 2017, https://www.federalregister.gov/documents/2017/02/03/2017-02451/reducing-regulation-and-controlling-regulatory-costs
[9] Regulatory Reform Accomplishments Under President Trump's Executive Orders, U.S. Department of the Treasury, April 2018, https://home.treasury.gov/sites/default/files/2018-04/20180423%20Regulatory%20Reform%20Report_0.pdf
[10] Joint Trades Final Stages of Initial Margin Phase-In Comment Letter, September 2018, https://www.isda.org/2018/09/26/joint-trades-final-stages-of-initial-margin-phase-in-comment-letter/
[11] ISDA letter to U.S. Regulators on $50 IM Threshold and Documentation Requirement, June 2019, https://www.isda.org/a/UO6ME/Letter-to-US-Regulators-BCBS_IOSCOstatement_20190603_FINAL.pdf

On March 5, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) issued a statement noting that counterparty relationships with exposures below the IM exchange threshold are not required to meet documentation, custodial or operational requirements.[12]

It is important national regulators provide certainty that documentation and custodial requirements will not initially apply for those relationships below the $50 million IM exchange threshold. By adopting a risk-based approach, it will enable the industry to focus its efforts on ensuring larger firms that are likely to post IM are ready to comply. It will also ensure smaller, non-systemically important entities that are not required to post IM are not burdened with unnecessary operational costs.

We agree with a recommendation made by CFTC Chairman J. Christopher Giancarlo in a letter to Federal Reserve Board Vice Chairman Randal K. Quarles for U.S. regulators to issue guidance that unambiguously provides relief for counterparty relationships that do not exceed the $50 million IM exchange threshold under U.S. requirements.[13]

- Inter-affiliate Margin for Non-cleared Derivatives

Inter-affiliate trades enable firms to centralize their risk management activities. For example, a European entity might prefer to enter into a swap with a local, European-based subsidiary of a U.S. financial institution. That U.S. institution might choose to consolidate its exposure within a centralized, global risk management function. The subsidiary would therefore enter into an offsetting transaction with that risk management unit. That internal, offsetting trade is known as an inter-affiliate or internal risk management transaction.

Critically, inter-affiliate transactions do not raise systemic risk concerns because they do not create additional counterparty exposure outside of the corporate group and do not increase interconnectedness between third parties. Instead, inter-affiliate transactions allow firms to manage their risk in a centralized way that ultimately limits overall credit exposure to third parties.

Requiring the exchange and segregation of IM for inter-affiliate transactions diverts capital away from more efficient uses in the market, and makes it more difficult for firms to manage their risks. At year-end 2018, the top 20 derivatives dealers had posted approximately $39.4 billion in inter-affiliate IM – capital that cannot be deployed in more productive ways.

While the CFTC has provided an exemption for inter-affiliate swaps from IM requirements,[14] the U.S. prudential regulators have not. This disparate treatment creates a competitive disadvantage for those entities subject to inter-affiliate requirements under U.S. prudential rules.

[12] BCBS/IOSCO statement on the final implementation phases of the margin requirements for non-centrally cleared derivatives, March 2019, https://www.bis.org/press/p190305a.htm
[13] Letter from CFC Chairman J. Christopher Giancarlo to Federal Reserve Board Vice Chairman Randal K. Quarles, May 2019, https://www.cftc.gov/PressRoom/PressReleases/7922-19
[14] Regulators in other key jurisdictions such as the EU, Japan and Singapore have also provided an exemption for inter-affiliate trades. The exemption for intergroup trades in the European Union is currently scheduled to expire 2020

In both margin issues, we understand regulatory fixes are under consideration by prudential regulators, but we would urge the Committee to continue monitoring these important issues until they are resolved.

- Legacy Trades

It is also important that legacy swaps are not brought into the scope of margin, clearing and other regulatory requirements simply because of contractual changes resulting from benchmark reform or Brexit. Legacy trades are currently exempt from these requirements (if executed before the implementation date), but a contractual change – such as an adjustment to incorporate robust fallbacks based on risk-free rates – could change that.

On March 5, BCBS/IOSCO stated that amendments to legacy derivatives contracts pursued solely for the purpose of addressing interest rate benchmark reforms do not require the application of the margin requirements.[15] We urge U.S. regulators to provide clarity on this point. The industry faces enough of a challenge to prepare for phase five of the initial margin requirements without bringing legacy swaps into scope too.

SA-CCR

In December 2018, the U.S. banking agencies – the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation – proposed the new standardized approach for counterparty credit risk (SA-CCR). This will change the method by which banks are required to calculate their counterparty credit risk exposure for all derivatives transactions.

ISDA is concerned that the current proposal is more conservative than global standards set by the BCBS and, in particular, does not reflect the underlying risk in commodity derivatives. If implemented as currently proposed, it would create an unlevel playing field for U.S. banks and commercial end users that rely on commodity derivatives for hedging purposes.

ISDA has conducted a comprehensive quantitative impact study (QIS) and found that the current proposed SA-CCR rules would lead to a 70% increase in risk-weighted assets (RWAs) for commodity derivatives when compared with the current approach.[16] This jump is largely due to the calibration of supervisory factors, which are meant to reflect the volatilities of the transaction type. The supervisory factors for oil and gas contracts under the U.S. proposal exceed those set by the BCBS, which results in a 37% increase in RWAs for oil and gas when compared with the Basel standard.

In order to avoid penalizing U.S. banks and imposing higher transaction costs on commercial end users, U.S. banking agencies should adopt supervisory factors for commodities that address the actual risk of the contracts and, at a minimum, do not exceed the BCBS standards.

[15] BCBS/IOSCO statement on the final implementation phases of the margin requirements for non-centrally cleared derivatives, March 2019, https://www.bis.org/press/p190305a.htm

[16] Industry Response to the Standardized Approach for Counterparty Credit Risk (SA-CCR), March 2019, https://www.isda.org/2019/03/18/industry-response-to-standardized-approach-for-counterparty-credit-risk-sa-ccr/

ISDA is also concerned about the potential cost implications for commercial end users, which rely on commodity derivatives for hedging purposes. The QIS showed that RWAs would increase by 50% for transactions with commercial end users.

Any requirements that constrain the use of derivatives may affect the ability of commercial end users to hedge their funding, currency, commercial and day-to-day risks, which would weaken their balance sheets and make them less attractive from an investment perspective. ISDA has recommended removing application of the overly conservative alpha factor from transactions with commercial end users.

It is important these issues are addressed to prevent disrupting financing and hedging for users of commodity derivatives markets. Although bank capital rules do not necessarily fall under this Committee's jurisdiction, the rule may have a significant adverse impact on the market participants and financial products that do. As a result, it is appropriate for the Committee to continue to monitor these important rule-makings. We thank the Chairman for his letter to U.S. banking agencies on SA-CCR and inter-affiliate margin.

SEF Rules

The SEF rules are another example of where certain regulatory modifications are appropriate. To this end, we commend CFTC Chairman Giancarlo for engaging with all market participants to review SEF practices, and proposing reforms intended to better align the rules with Dodd-Frank provisions and encourage more trading on SEFs.

The CFTC issued proposed changes to its SEF framework at the end of last year,[17] which included flexibility in the method of execution and the potential elimination of the 'made available to trade' determination (a process for determining which products should be subject to mandatory SEF trading).

Irrespective of that proposal, we believe regulators should remain focused on addressing key issues raised by market participants over the years and codify the existing no-action relief to provide greater certainty. Current no-action relief exists for certain types of package transactions and block trade requirements, among other provisions. Providing a permanent solution for these issues would simplify compliance efforts.

With respect to specific regulatory reforms, the CFTC should prioritize allowing SEFs to use a range of execution methods and to provide a clear process for determining which contracts should be subject to mandatory trading on SEFs. Consultation on this process should consider views from all market participants.

CCP Best Practices

As the volume of cleared derivatives has grown, central counterparties (CCPs) have become increasingly systemically important. However, two CCPs have experienced member defaults over the past five years that have exceeded the defaulting member's contribution to default resources and required the use of mutualized resources in the default fund, spreading losses to

[17] Swap Execution Facilities and Trade Execution Requirement 83 FR 61946, November 2018, https://www.cftc.gov/sites/default/files/2018-11/federalregister110518b.pdf

other CCP participants. These defaults have highlighted weaknesses in some CCP risk management practices, and emphasized the importance of consistent best practices.

In response, ISDA has analyzed current practice and published a set of recommendations. These include:

- Risk controls and margin requirement that adapt to concentration, liquidity, member credit quality and wrong-way risk in a member's portfolio
- Effective and transparent default management processes; and
- Robust membership criteria and greater assurances of continued adherence to them.

Importantly, these practices will ensure that, outside of an extreme stress event, the default of a member will not propagate to other members or the wider financial system.

We believe this Committee should continue to remind regulatory bodies that there is no more important duty than the oversight of CCPs to ensure best practices are met.

Treatment of Margin under the SLR

The clearing of derivatives is a central objective of the Dodd-Frank Act, but the supplementary leverage ratio (SLR) in its current form acts to disincentivize clearing. This is because the current rules do not take the exposure-reducing effects of initial margin into account.

The failure of the SLR to recognize the risk-mitigating benefits of collateral significantly impacts the economics of client clearing. While the impact on capital is modest relative to overall bank capital, it significantly increases the amount needed to support client clearing activities. Some banks have opted to scale back or withdraw from the client clearing business as a result, which runs counter to the objectives of Dodd-Frank to encourage central clearing.

The BCBS announced on June 20 that it had agreed a targeted and limited revision of the leverage ratio to allow margin received from a client to offset the exposure amounts of client-cleared derivatives.[18] We encourage the Committee to closely monitor how U.S. regulators approach this issue. It is vital that derivatives users are able to access clearing services cost-effectively.

Reporting

The regulatory reporting framework is another example of where unnecessary complexities and duplications are creating excessive operational burdens and costs for derivatives users.

The CFTC has published amendments to the Part 49 rules governing swap data repositories and data reporting requirements. It is also expected to issue amendments to its Part 43 and Part 45 trade reporting rules, which provide important transparency on derivatives activity to the public and to the CFTC. We appreciate the CFTC's work to adopt the standard 'critical data elements' recommended by the Committee on Payments and Market Infrastructures (CPMI) and IOSCO and to address ambiguity that impairs the quality of the resulting data.

[18] Basel Committee discusses policy and supervisory initiatives and approves implementation reports, June 2019, https://www.bis.org/press/p190620.htm

However, ISDA remains concerned that the trade reporting requirements may still be overly complex, requiring data that is subjective and not easily accessible to firms, thereby reducing the quality and consistency of the information. A streamlined set of data fields that aligns with the information confirmed between the parties for the derivatives transaction will ultimately be more reliable and more useful.

Globally, the fact that 21 FSB jurisdictions have put reporting rules in place is a huge achievement. However, each requires similar data to be reported in a different way. Operational differences and, in some cases, privacy rules prevent unfettered sharing of data between regulators. Firms are required to meet idiosyncratic reporting formats and data fields in each jurisdiction.

This imposes a significant compliance burden on end users and is self-defeating – it makes it all but impossible for global regulators to quickly and accurately aggregate exposures across derivatives instruments. ISDA welcomes the work in this area by the CFTC, the CPMI and IOSCO, as multilateral coordination is critical. However, the pace of reform has been slow and incremental.

Regulatory Fragmentation

Another key challenge relates to cross-border trading and the fragmentation of liquidity. Derivatives markets are global, which gives companies the ability to efficiently and cost-effectively manage their exposures. For cross-border markets to function effectively, market participants need consistency in rule sets where possible and a robust cross-border framework that recognizes overseas rules that are comparable in outcomes.

This was understood by the Group-of-20 (G-20) back in 2009, when it agreed a set of commitments that paved the way for Dodd-Frank. In particular, it stressed that the reforms should be implemented in a way that ensures a level playing field and avoids fragmentation of markets, protectionism and regulatory arbitrage.[19]

Unfortunately, the rules have often differed in scope, substance and timing when implemented across jurisdictions. Derivatives market participants are living with the huge cost and regulatory compliance challenges of complying with multiple rule sets.

ISDA has documented numerous examples of fragmentation in different parts of the regulatory framework, explaining how rules differ from jurisdiction to jurisdiction. As mentioned above, the most widely acknowledged example of regulatory fragmentation is in the regulatory reporting space, with 21 FSB jurisdictions requiring common data to be reported in different formats. ISDA has also documented the inconsistencies that exist in

[19] "We are committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage." G-20 Leaders Statement: The Pittsburgh Summit, September 2009, http://www.g20.utoronto.ca/2009/2009communique0925.html

margin requirements[20] and trading venues.[21] Both papers provide clear examples of regulatory driven market fragmentation.

Unfortunately, the CFTC took an extraterritorial approach in its 2013 cross-border guidance.[22] While section 2(i) of the CEA stipulates that the swaps provisions of Dodd-Frank should only apply to activities outside the U.S. that have a "direct and significant connection" with U.S. commerce, the CFTC took a much broader view and applied its rules to entities in other countries. The expansive extraterritorial reach of the CFTC and the rule-by-rule reviews mean the process by which market participants have be able to rely on deference or substituted compliance is limited and slow in coming.

These factors have resulted in an overlapping and duplicative regulatory structure that has led to inefficiencies, complexity and higher costs for derivatives users. Ultimately, it contributes to market fragmentation and increased risk.

- Cross-border Regulations

In order to resolve inconsistencies between global rule sets, it is imperative that the process for substituted compliance and equivalence determinations is robust and efficient. Regulatory tools already exist to provide for substituted compliance, but the decisions in practice have been slow to arrive and are often made on a granular, rule-by-rule basis.

As an alternative, ISDA has proposed a risk-based framework for the evaluation and recognition of the comparability of derivatives regulatory regimes in foreign jurisdictions. This approach strikes an appropriate balance by focusing on risk and its cross-border implications. ISDA has further developed this concept in a paper that addresses regulatory driven market fragmentation.[23]

A process should also be agreed internationally that would enable national regulators to implement equivalence and substituted compliance determinations in a predictable, consistent and timely manner.

Rather than attempting the impossible task of aligning each and every regulatory requirement across jurisdictions, this approach would allow substituted compliance determinations to be based on broad outcomes. It would reduce the chances of lengthy negotiations that could ultimately lead to reduced liquidity and fragmentation.

We welcome the CFTC's commitment to recalibrate its cross-border regulatory framework.[24] This is particularly timely given the significant progress other jurisdictions have made in

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[20] Implementation of Margin Requirements and Market Fragmentation, June 2019, https://www.isda.org/a/XvkME/Implementation-of-Margin-Requirements-and-Market-Fragmentation.pdf
[21] A Practical Guide to Navigating Derivatives Trading on U.S./EU Recognized Trading Venues, April 2018, https://www.isda.org/a/COmEE/A-Practical-Guide-to-Navigating-Derivatives-Trading-on-US-EU-Recognized-Trading-Venues.pdf
[22] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, July 2013, https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf
[23] Regulatory Driven Market Fragmentation, January 2019, https://www.isda.org/a/wpgME/Regulatory-Driven-Market-Fragmentation-January-2019-1.pdf
[24] Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation, October 2018, https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118.pdf

implementing the G-20 reforms. The CFTC should assess the laws of foreign jurisdictions based on a common set of principles, with an understanding that each jurisdiction may have implemented the G-20 derivatives reforms from slightly different perspectives.

Not all regulatory outcomes have been inconsistent, however. The Principles for Financial Market Infrastructures (PFMIs), developed by CPMI and IOSCO, are a great example of principles that have resulted in relative regulatory consistency. We believe the PFMIs could be a model for improving consistency in the application of financial rules, setting a standard for a more transparent, timely, outcomes-based approach.

Regulators across the globe need a better process to resolve the rule differences and focus on meeting outcomes. We encourage the CFTC to undertake a reform of the extraterritorial application of its guidance to respect the work achieved in other jurisdictions and to focus more on substituted compliance.

- Brexit

Brexit could become another key source of market fragmentation.

The terms and timing of the UK's exit from the European Union remain uncertain, but ISDA will do its part to identify the issues and mitigate the impact on the derivatives market to the greatest extent possible.

A key concern is the risk of fragmentation and disruption should a 'hard Brexit' occur on October 31 – that is, the UK leaves the EU in a disorderly way, without an exit deal and without a transition period. In that instance, a top priority will be to ensure continuity of clearing and trading between cross-border counterparties.

To that end, ISDA welcomes the joint announcement by the CFTC and UK regulators in February to grant the necessary approvals and no-action relief once Brexit occurs to allow trading and clearing activity to continue.[25]

This follows in the footsteps of a temporary equivalence determination for UK CCPs by the European Commission last December, in the run-up to the March 29 deadline.[26]

These announcements will go some way to reducing market disruption and ensuring derivatives markets are able to function smoothly. A loss of recognition for UK CCPs would have created huge operational challenges, as thousands of contracts would have had to be relocated to alternative CCPs, giving rise to increased systemic risk, significant costs and distorted competition in global derivatives markets.[27]

[25] Joint Statement by UK and U.S. Authorities on Continuity of Derivatives Trading and Clearing Post-Brexit, February 2019, https://www.cftc.gov/PressRoom/PressReleases/7876-19
[26] European Commission implements 'no-deal' Contingency Action Plan in specific sectors, December 2019, http://europa.eu/rapid/press-release_IP-18-6851_en.htm
[27] The Impact of Brexit on OTC Derivatives: Other 'Cliff Edge' Effects Under EU Law in a 'No Deal' Scenario, October 2018, https://www.isda.org/2018/10/09/cliff-edge-effects-under-eu-law-in-a-no-deal-brexit-scenario/

ISDA also welcomes the joint European Commission and CFTC statement on EMIR 2.2 in March.[28] We strongly encourage regulators to rely on enhanced supervisory cooperation and coordination when it comes to the supervision of third-country CCPs, and to defer to national authorities wherever possible.

- CFTC-SEC Rules

Global regulatory harmonization should be an objective of regulators everywhere to avoid duplications, inconsistencies and fragmentation. This is especially true in the U.S., where oversight of the market is bifurcated between the CFTC and SEC. ISDA appreciates the continued efforts of the agencies to harmonize their rule sets, and hopes they will continue to work together as the SEC finalizes its rules and the CFTC revises its existing framework.

Where inconsistencies and duplication continue to exist, we believe the issues could be addressed by adopting a 'safe harbor' approach that recognizes compliance with the other agency's rule sets. Such an approach should aim to streamline requirements and ensure customers can benefit from access to capital providers, both foreign and domestic.

The SEC's recent adoption of final rules on capital requirements for security based swap dealers and margin for non-cleared security based swap transactions is a good example of convergence between the two agencies.[29] Under the rules, dual registrants that deal predominantly in swaps and do not have significant amounts of security based swaps can choose to comply with the capital, margin, and segregation requirements of the CFTC rather than the SEC requirements.

Solutions

The implementation of Dodd-Frank and the G-20 commitments more broadly has been one of the most seismic transformations in the history of the derivatives market. ISDA has been at the forefront of this transformation, working to develop globally consistent solutions to common industry implementation challenges.

Industry Solutions for Margin

Where possible, ISDA has worked with members to develop global solutions for margin that ensure consistency in how firms apply the rules. To mitigate the potential for disputes over margin calculations, we released the ISDA Standard Initial Margin Model (ISDA SIMM) in 2016. Use of a single model helps with operational use, model approval, legal documentation, economical running costs, transparency and infrastructure development by users, regulators, vendors and middleware providers.

More recently, as the IM regulatory framework extends to smaller entities, we developed ISDA Create – IM,[30] a powerful digital platform that allows the negotiation and execution of

[28] Joint European Commission and CFTC Statement on EMIR 2.2, March 2019, https://www.cftc.gov/PressRoom/SpeechesTestimony/jointeuropeanandcftcstatement031319
[29] SEC Adopts Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Amends the Capital and Segregation Requirements for Broker-Dealers, June 2019, https://www.sec.gov/news/press-release/2019-105
[30] ISDA and Linklaters Launch Full Version of ISDA Cerate – IM, January 2019, https://www.isda.org/2019/01/31/isda-and-linklaters-launch-full-version-of-isda-create-im/

IM documents with multiple parties simultaneously. This will help smaller, resource-constrained firms to comply with global margin requirements.

Digital Solutions

ISDA is playing its part in supporting financial institutions as they look to harness the potential of new technologies to drive efficiencies and reduce costs.

The derivatives market has developed over time in a bespoke and bilateral way, without standard conventions for how trade events and processes are represented. Each participant has developed its own unique representations. The lack of firm foundations has limited the ability to apply automated solutions across the industry in a scalable way.

In response, ISDA has developed the Common Domain Model (ISDA CDM), a digital blueprint for how derivatives are traded and managed across the trade lifecycle. We launched the full version of the ISDA CDM for interest rate and credit derivatives earlier this year,[31] and are currently working to extend this to other asset classes.

Creating a standard representation for events and products that can be used by all participants, infrastructures, platforms and regulators will enable firms to develop automated solutions that can be interoperable and scalable in a way that has never been done before.

The ISDA CDM is already being tested in a number of environments. Last month, ISDA announced the deployment of the model to support the UK Financial Conduct Authority, the Bank of England and participating financial institutions in testing phase two of the digital regulatory reporting pilot,[32] a UK initiative to explore the use of technology to help firms meet their regulatory reporting requirements and to improve the quality of information reported.

Benchmarks

ISDA's work in supporting the industry through major changes extends beyond the G-20 commitments. When considering the global challenges facing the derivatives industry, there are none more global or more challenging than benchmark reform. With an estimated $370 trillion in notional exposure to key interbank offered rates (IBORs) across financial markets, this is an issue that affects all aspects of the economy, from Wall Street to Main Street.

ISDA has been working on this on multiple fronts, but has played a leading role in an industry effort to develop robust, consistent fallback language for derivatives contracts. The aim is to enable contracts referencing LIBOR and other IBORs to trade with the minimum possible disruption after a discontinuation of the underlying benchmark.

Last year, ISDA consulted on technical adjustments that would apply to the fallback rate in the event certain IBORs are permanently discontinued.[33] The aim of the adjustments is to

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[31] ISDA Publishes CDM 2.0 for Deployment and Opens Access to Entire Market, March 2019, https://www.isda.org/2019/03/20/isda-publishes-cdm-2-0-for-deployment-and-opens-access-to-entire-market/
[32] ISDA CDM Deployed to Help Deliver UK Digital Regulatory Reporting Pilot, May 2019, https://www.isda.org/2019/05/21/isda-cdm-deployed-to-help-deliver-uk-digital-regulatory-reporting-pilot/
[33] Interbank Offered Rate Fallbacks for 2006 ISDA Definitions, July 2018, https://www.isda.org/2018/07/12/interbank-offered-rate-ibor-fallbacks-for-2006-isda-definitions/

ensure the contracts function as closely as possible to the counterparties' original intentions after a fallback kicks in, resulting in a rate that is predictable, transparent and fair.

The market reached a clear consensus on the preferred methodologies for those benchmarks covered by that consultation,[34] and ISDA is currently running a further consultation on additional benchmarks, including U.S. dollar LIBOR, CDOR and HIBOR.[35]

Simultaneously, ISDA launched an additional consultation on pre-cessation issues. That consultation asks market participants for their views on the issues that would emerge following an announcement that LIBOR is no longer representative, and whether and how ISDA documentation should address it.

ISDA is also working to further flesh out the parameters and mechanics of the term and spread adjustments, and we plan to have new fallback language in place for certain IBORs at the start of 2020.

The ISDA SIMM, ISDA Create – IM, the ISDA CDM and the benchmark fallbacks are good examples of global solutions that enable changes in regulation and market structure to be implemented as consistently as possible.

As the industry continues to evolve, ISDA looks forward to developing further solutions and advancing existing ones to make sure market participants have the tools they need to deal with the challenges they face.

Conclusion

Significant progress has been made in implementing post-crisis derivatives reforms, and the financial system is much stronger and more transparent as a result. ISDA and its members have worked hard to implement the requirements, and have developed a number of industry solutions to help facilitate consistent compliance with the rules.

However, some parts of the regulatory framework could be further refined to improve efficiency and reduce unnecessary costs and duplication. In line with the G-20, we believe focus should be given to eliminating market fragmentation, which can "impair financial stability by reducing market liquidity and trapping scarce resources. It can drag efficiency and economic growth."[36] That ultimately has an effect on U.S. companies, retailers and households.

ISDA looks forward to working with this Committee, as well as U.S. and foreign regulators, to develop solutions to address these important issues.

[34] ISDA Publishes Final Results of Benchmark Fallbacks Consultation, December 2018, https://www.isda.org/2018/12/20/isda-publishes-final-results-of-benchmark-fallback-consultation/
[35] ISDA Benchmark Fallbacks Consultations, May 2019, https://www.isda.org/2019/05/16/may-2019-benchmark-fallbacks-consultations/
[36] Speech by Ryozo Himino, Vice minister for international affairs, Financial Services Agency, Japan, at the 2018 ISDA Annual Japan Conference, October 26, 2018, Tokyo, https://www.fsa.go.jp/common/conference/danwa/20181026.pdf

MANAGED FUNDS ASSOCIATION

WRITTEN STATEMENT

OF

RICHARD H. BAKER
PRESIDENT AND CHIEF EXECUTIVE OFFICER
MANAGED FUNDS ASSOCIATION

For the Hearing on
The State of the Derivatives Market and Perspectives for CFTC Reauthorization

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BEFORE THE

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

JUNE 25, 2019

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WRITTEN STATEMENT OF MANAGED FUNDS ASSOCIATION

The State of the Derivatives Market and Perspectives for CFTC Reauthorization

Chairman Roberts, Ranking Member Stabenow, Managed Funds Association ("**MFA**") greatly appreciates the opportunity to share its views on the state of the derivatives market and perspectives for the CFTC Reauthorization. MFA represents the world's largest alternative investment funds and is the primary advocate for sound business practices for hedge funds, funds of funds, managed futures funds, and service providers. MFA's members manage a substantial portion of the approximately $3 trillion invested in hedge funds around the world. Our members serve pensions, university endowments, and charities, among others.

MFA's members are a valuable component of the capital markets. They provide liquidity and price discovery to capital markets, capital to companies seeking to grow or improve their businesses, and important investment options to investors seeking to increase portfolio returns with less risk, such as pension funds trying to meet their future obligations to plan beneficiaries. Our members' skills help their customers plan for retirement, honor pension obligations, and fund scholarships, among other important goals.

MFA members are also highly sophisticated investors who participate in the commodities and derivatives markets as commodity pool operators ("**CPOs**") and/or commodity trading advisors ("**CTAs**"). MFA has consistently supported the reforms to the over-the-counter ("**OTC**") derivatives markets contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**") that mitigate systemic risk, increase transparency, and promote an open, competitive, and level playing field. We welcomed the U.S. market's transition to central clearing for liquid, standardized swaps that occurred over the course of 2013. We believe that liquid, safe, and efficient derivatives markets facilitate investment to the benefit of everyone in the marketplace, including corporate treasurers, farmers, and ranchers who need to protect themselves against swings in crop prices, and pensioners who seek reliable returns on their retirement investments.

MFA has welcomed the many opportunities to be a constructive partner to this Committee. In that spirit, and in support of the broader policy and regulatory authorities in the United States, we offer some recommendations with respect to CFTC Reauthorization and the state of the derivatives market, as follows:

(1) Amend the Commodity Exchange Act ("**CEA**") to adopt "Dodd-Frank-like" protections for confidential, sensitive intellectual property, and to enhance data protection at regulators through the Protection of Source Code Act;

(2) Ensure accessibility and affordability of customer clearing;

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(3) Encourage CFTC to adopt regulatory refinements to the swaps trading framework;

(4) Encourage CFTC to implement measures relating to initial margin requirements for uncleared derivatives;

(5) Encourage a harmonized U.S. approach to regulation of commodity pool operators and investment advisers.

ENHANCING DATA PROTECTION

For several years now, MFA has engaged with policymakers and regulators, including the CFTC and Securities and Exchange Commission ("**SEC**"), on the issue of data security and treatment of confidential information. MFA and its members have significant concerns about information security at regulatory agencies. Information security vulnerabilities at a regulator jeopardize not only market participants and their investors, but also the U.S. economy through the loss of domestic trade secrets and confidence in the integrity of the regulatory framework. This month, the CFTC Office of Inspector General issued a report highlighting the vulnerability of the CFTC's Integrated Surveillance System to hacking, which reinforces this concern.

Over the last several years, due to both statutory mandates and regulatory discretion, agencies have expanded the scope and breadth of the types of information that they request of registrants. These agencies, however, have generally continued to rely on the same frameworks for information collection and protection. Thus, we were especially pleased with the announcement earlier this year of CFTC Commissioner Dawn Stump's data protection initiative. That initiative aims to ensure that the CFTC only collects data required for its regulatory responsibilities, removes duplicative reporting streams, explores alternative mechanisms for accessing sensitive information, enhances internal controls for interacting with data, examines response procedures to cyber incidents, and updates data retention best practices.

MFA believes that the Committee should include in the CFTC Reauthorization two legislative solutions with respect to enhancing data privacy, protection, and collection.

First, the Committee should adopt "Dodd-Frank-like" protections for confidential and sensitive intellectual property of asset managers. The Dodd-Frank Act specifically amended the Investment Advisers Act of 1940 to protect the confidentiality of reports (*i.e.,* systemic risk reports, such as Form PF) that the SEC requires for SEC-registered investment advisers, but no corresponding amendments were made to the CEA for CFTC reports (*i.e.,* Forms CPO-PQR and CTA-PR). The current inconsistency between the confidentiality protections afforded to reports by investment advisers as opposed to reports by CPOs and CTAs exposes CPOs and CTAs to greater risk of public disclosure

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of their confidential and proprietary data than investment advisers. The Committee should amend section 8 of the CEA consistent with section 404 of the Dodd-Frank Act to ensure that consistent confidentiality protections would extend to the reports, documents, records and sensitive and proprietary information of CPOs and CTAs.

Second, the Committee should amend the CEA, by including Senator David Perdue's the "Protection of Source Code Act," introduced in the 115th Congress, which would require the CFTC to issue a subpoena before compelling a person to "produce or furnish source code, including algorithmic trading source code or similar intellectual property that forms the basis for design of the source code." Senator Perdue also introduced a measure that would apply parallel requirements to the SEC under the securities laws. MFA believes that legislation such as the Protection of Source Code Act and companion House legislation introduced in the 115th Congress would be an important and constructive step for implementing and ensuring that regulators have a robust process in place when it comes to determining the necessity of highly sensitive, confidential information. Significantly, the legislative measure does not impede regulators from seeking the information they need, it only ensures that regulators have a process in place before seeking certain types of information, balancing the needs of regulators and registrants.

ENSURING THE ACCESSIBILITY AND AFFORDABILITY OF CUSTOMER CLEARING

MFA has long championed the post-crisis reform efforts of Congress. Specifically, MFA strongly supports the effort to reduce risk in the derivatives markets by transitioning standardized and liquid OTC derivative contracts into central clearing. MFA believes that central clearing has greatly benefited the derivatives markets by reducing systemic, counterparty, and operational risk, and has resulted in a well-functioning and safer system where counterparties face a well-regulated CCP. As such, MFA is opposed to efforts and policies that would weaken or undermine the clearing mandate of the Dodd-Frank Act. In this regard, we raise to the Committee's attention our concerns with the leverage ratio rules ("**Leverage Ratio**") of the Basel Committee on Banking Supervision ("**BCBS**" or "**Basel Committee**"), which threaten the ongoing success and benefits of central clearing. Without revision, these rules threaten the affordability and accessibility of customer clearing.

The current Leverage Ratio disincentivizes derivatives clearing because it does not provide an offset for customer "initial margin" ("**IM**"). That unfavorable treatment limits the ability of customers to use centrally cleared derivatives and could limit the ability of end-users to hedge their risks. MFA was gratified, therefore, by the announcement last week that the Basel Committee has called for an offset for IM in the Leverage Ratio for customer-cleared derivatives. If the Basel Committee's forthcoming published standards are consistent with the announcement, we would join CFTC Chairman J. Christopher Giancarlo in his call to U.S. prudential regulators to implement expeditiously the revised leverage ratio in their respective rules.

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Customers have been key to the success of central clearing in the United States and across the globe. While some clearing of swaps between dealers existed prior to enactment of the Dodd-Frank Act, artificial barriers to entry prevented customers from similarly participating in the cleared swaps market. Implementation of the central clearing requirement eliminated many of those artificial barriers and resulted in substantial customer clearing.

At present, swaps customers exclusively access CCPs indirectly through clearing members (typically banks), rather than becoming direct members of CCPs, for a variety of reasons, both financial and operational. Swaps customers must post IM, which is the customer's money, and CFTC rules require clearing members to hold customer funds from the clearing member's own assets (*i.e.*, "segregate" the IM).

Unfortunately, the current BCBS Leverage Ratio rules fail to provide an offset that recognizes the exposure-reducing effect of customers' segregated IM. According to the BCBS, the reason for the lack of an offset for customer IM that is held by the clearing member and not segregated is that it not only offsets exposures, but also can be used by the clearing member for further leverage. In the U.S., segregation rules severely restrict the ability of IM to be held in anything other than extremely low-risk and extremely liquid assets, assuring that it is always available to absorb losses ahead of the bank. Moreover, the substantial majority of segregated IM is posted to the CCP, and therefore, is entirely outside the control of the clearing member.

The failure of the Leverage Ratio to recognize the purpose of segregated IM discourages the use of cleared derivatives by customers. The lack of offset will result in clearing members incurring large Leverage Ratio exposures, which will likely raise prices for customer clearing significantly. As the CFTC stated in its recent letter to the U.S. prudential regulators, "[f]ailing to reduce a clearing member's exposure by the segregated client margin it holds results in an inflated measure of the clearing member's exposure for a cleared trade."

In addition, the Leverage Ratio's current overstatement of a clearing member's actual economic exposure in a cleared derivative transaction has disincentivized banking organizations from providing clearing services to many customers. The Leverage Ratio is estimated to increase significantly the cost of using cleared derivatives. As a result, MFA members expect reduced access to clearing services and higher prices for such access without an appropriate revision to the Leverage Ratio. This substantial cost increase may cause other customers to reduce their hedging activities to levels that are inadequate to manage their risk, which could result in price increases and volatility for food, gasoline, and other consumer goods.

In MFA's view, prudential requirements that inflate the economic risk of derivatives, particularly the Leverage Ratio, impose artificial barriers for clients to access cleared derivatives and work at cross-purposes with mandates to clear. We support Senator Perdue's efforts to address the adverse impact of the current formulation of the U.S. supplementary leverage ratio on customer clearing, and for co-sponsoring in the last Congress S. 3682 to require the appropriate Federal banking agencies to recognize the

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exposure-reducing nature of client margin for cleared derivatives.

Therefore, to ensure the continued affordability and robustness of customer clearing in this country, we encourage the Committee to support the CFTC in urging U.S. prudential regulatory authorities to implement a similar offset for U.S. clearing members to the announced BCBS revision to the Leverage Ratio. To avoid competitive disadvantage to U.S. banks, U.S. prudential regulators should act promptly.

ENCOURAGE CFTC TO ADOPT REGULATORY REFINEMENTS TO THE SWAPS TRADING FRAMEWORK

MFA's members have a strong interest in open, fair, competitive, transparent and liquid markets. In general, the CFTC's swaps trading regime has been beneficial for investors as it has helped develop vibrant markets for the trading of liquid, standardized, cleared swaps on swap execution facilities ("**SEFs**") and designed contract markets ("**DCMs**"). MFA and its members have petitioned the CFTC to adopt regulatory refinements to the current swaps trading framework, and are not in support of the comprehensive reforms proposed by the CFTC in November of 2018.[1] To promote the continued growth of vibrant U.S. SEF markets, and the Dodd-Frank Act goal of pre-trade price transparency to increase price competition and liquidity, and lower transaction costs, MFA recommends that the Committee encourage the CFTC to adopt regulatory refinements to the swaps trading framework, as discussed below.

Trade Execution Requirement. The CFTC should maintain the current "made available to trade" process independent from its clearing determination as not all swaps subject to the CFTC's clearing requirement are suitable for mandatory execution on SEFs. The CFTC should modify the current "made available to trade" process by (i)

[1] *See* MFA Petition for Rulemaking to Amend Certain CFTC Regulations in Parts 1 (General Regulations under the Commodity Exchange Act), 39 (Derivatives Clearing Organizations, Subpart B – Compliance with Core Principles) and 43 (Real-Time Public Reporting), submitted to Mr. Christopher Kirkpatrick, Secretary of the Commission, on October 22, 2015 ("**MFA SEF Petition**"), available at: https://www.managedfunds.org/wp-content/uploads/2015/10/CFTC-Petition-for-SEF-Rules-Amendments-MFA-Final-Letter-with-Appendix-A-Oct-22-2015.pdf; MFA Position Paper: Why Eliminating Post-Trade Name Disclosure Will Improve the Swaps Market, dated March 31, 2015, cited in fn. 9 at p. 61572 of the Name Give-Up Comment Request, available at: https://www.managedfunds.org/wp-content/uploads/2015/04/MFA-Position-Paper-on-Post-Trade-Name-Disclosure-Final.pdf; MFA letter in response to the CFTC's Proposed Rule, "Swap Execution Facilities and Trade Execution Requirement" (RIN 3038-AE25), submitted to Christopher Kirkpatrick, Secretary of the Commission, on March 15, 2019, available at: https://www.managedfunds.org/wp-content/uploads/2019/03/MFA-Comment-Letter-on-CFTC-SEF-Proposed-Rule-Final.pdf; *and* MFA letter in response to the CFTC's Request for Comment, "Post-Trade Name Give-Up on Swap Execution Facilities" (RIN 3038-AE79), submitted to Christopher Kirkpatrick, Secretary of the Commission, on March 15, 2019, available at: https://www.managedfunds.org/wp-content/uploads/2019/03/MFA-Letter-on-CFTC-Comment-Request-on-Post-Trade-Name-Give-up-on-SEFs-Final.pdf.

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eliminating the self-certification process and providing the CFTC with a more defined role, and (ii) providing market participants with an opportunity to participate in the process, such as through industry advisory committees and the public comment process.

Methods of Execution. Currently, for swaps that are subject to the trade execution requirement, a SEF must offer an Order Book or a "Request for Quote" system that requires transmission of requests to a minimum of three other market participants ("**RFQ-to-3**"). The CFTC should ensure a baseline level of pre-trade transparency and multiple-to-multiple execution on SEFs by retaining RFQ-to-3 to preserve the documented benefits of greater transparency, liquidity, and competition.

Impartial Access Requirements. MFA recommends that the CFTC codify its existing SEF impartial access guidance to ensure there is an open, competitive, and level playing field. Otherwise, MFA is concerned that a SEF may impose access limitations on buy-side firms either (i) directly by prohibiting buy-side firms from joining the venue or (ii) indirectly through activities-based criteria. Such barriers to access suppress natural market evolution, limit market competition and innovation and restrict the ability of buy-side firms to access specific liquidity pools and trading protocols.

Pre-Execution Communications and Block Trades. MFA recommends that the CFTC retain the current block trade exceptions, which allow block trades to be negotiated away from a SEF, provide an appropriate degree of execution flexibility and permit clients to continue to engage in bilateral conversations to obtain market color.

Straight-Through-Processing Requirements. MFA recommends that the CFTC codify existing CFTC staff guidance and no-action relief setting forth the current straight-through-processing ("**STP**") standards in order to provide market participants with clearing certainty immediately following execution. These standards require that SEF-executed cleared trades be submitted to the derivatives clearing organization within ten minutes; prohibit breakage agreements; and establish void *ab initio* for trades that are rejected from clearing for non-credit reasons in order to provide certainty and market-wide consistency.

Prohibit Post-Trade Name Give-Up. The CFTC should prohibit post-trade name disclosure (or "**name give-up**") by SEFs for swaps that are executed anonymously and intended to be cleared in order to provide an open, competitive, and level playing field for all market participants. A prohibition of name give-up would strengthen the CFTC's swaps trading regime by furthering the CEA's policy goals of promoting SEF trading of cleared swaps and enhancing price transparency and competition on SEFs. It is therefore critical that the CFTC issue a formal rule proposal addressing the practice of name give-up prior to finalizing its other SEF amendments.

By focusing on more targeted reforms, such as improvements to the trade execution requirement and codifying existing impartial access and STP requirements, the CFTC would address critical process flaws and enhance and preserve key aspects of the current framework that are working well for investors. Thus, MFA respectfully urges the Committee to encourage the CFTC to adopt our recommended regulatory refinements to the swaps trading framework.

IMPLEMENTATION OF INITIAL MARGIN REQUIREMENTS UNDER THE UNCLEARED MARGIN RULES

The implementation of the final phases of the IM requirements under the uncleared margin rules ("**UMR**") adopted by the CFTC and other U.S. regulators has presented a myriad of challenges for buy-side firms. We are concerned that outstanding issues might result in prohibitive price increases and decreases in liquidity. MFA has recommendations for various short-term and long-term measures that are necessary to provide certainty and clarity for market participants.

While our members support incentives for central clearing of standardized OTC derivatives, we recognize that market participants have an ongoing need to be able to enter into bespoke and customized derivatives contracts that cannot be easily cleared by a CCP (so-called "uncleared derivatives"). MFA supports requiring buy-side firms to collateralize these uncleared derivatives through the posting of margin. Many MFA members already post IM for their uncleared derivatives, but currently, most do not collect IM from their swap dealer counterparties. Under UMR, buy-side firms will be required to receive regulatory IM from their swap dealers and segregate it with a third-party custodian bank.

For the last several years, MFA has engaged with U.S. and international regulatory bodies on implementation of UMR. Our primary concern with UMR implementation is maintaining reasonable costs and sufficient market liquidity for this important part of the swaps market. If the cost of trading uncleared derivatives is disproportionately increased by UMR implementation, it could reduce liquidity and adversely impact market participants' ability to invest and properly hedge their portfolios using these instruments. Moreover, for products where no central clearing offering is available and/or where central clearing is not appropriate, calibrating UMR to incentivize such clearing is unrealistic, and accordingly, may need to be revisited. UMR should be designed to properly mitigate the risks associated with uncleared derivatives, not to penalize market participants for using uncleared derivatives to meet their trading needs for prudent risk management, including entering into customized transactions where warranted.

On March 5, 2019, BCBS and IOSCO[2] issued a public statement that the BCBS-IOSCO international margin framework does not specify documentation, custodial or operational requirements if the bilateral IM amount does not exceed the framework's 50 million US$/Euro IM threshold. Although the BCBS-IOSCO Guidance is a good first step in providing needed clarity to market participants, MFA urges the Committee to

[2] Available at: https://www.bis.org/press/p190305a.htm (the "**BCBS-IOSCO Guidance**").

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encourage the CFTC to coordinate with the U.S. prudential regulators and other regulators to adopt expressly the BCBS-IOSCO Guidance this summer.

Although the UMR does not require an in-scope entity to post regulatory IM until its bilateral IM amount in a counterparty relationship exceeds $50 million, the requested guidance would, nonetheless, help clarify the obligations of market participants and manage and prioritize their resources. MFA believes the issuance of the requested guidance this summer is critical to ease resource burdens and avoid trading disruptions for swaps market participants in the final phases, especially for the relatively large influx of newly in-scope entities, including many MFA members, on the September 1, 2020 implementation date for Phase 5.

MFA also urges the Committee to encourage the CFTC to coordinate with the U.S. prudential regulators and other regulators to provide a forbearance period of six months after a Phase 5 entity's counterparty relationship that was initially below the $50 million regulatory IM exchange threshold later exceeds such exchange threshold. Such forbearance is necessary to allow the Phase 5 entity to put the necessary bilateral collateral documentation and trilateral custodial arrangements in place to both post and receive regulatory IM and avoid trading disruptions. A reasonable forbearance period would help to alleviate the complexities, compliance expenses, and resource constraints facing Phase 5 entities, including with respect to separately managed accounts and associated risks.

In addition to these near-term measures, MFA urges the Committee to encourage the CFTC to coordinate with the U.S. prudential regulators and other regulators through the BCBS-IOSCO Working Group on Margining Requirements ("**WGMR**") to implement broader regulatory solutions that would involve targeted recalibration of UMR IM requirements. MFA recommends that the CFTC and other WGMR members consider:

- Excluding physically settled foreign exchange swaps and forwards in calculations of aggregate average notional amount thresholds for determining whether counterparties are in-scope of the UMR IM requirements. This recalibration is logical and would smooth implementation by avoiding the inclusion of products that should not otherwise be affected by the rules into the process.

- Adopting another phase-in threshold between 750 billion US$/Euro and 8 billion US$/Euro; specifically, MFA recommended a Phase 5.a. threshold of 100 billion US$/Euro in 2020, with 8 billion US$/Euro pushed back to 2021 as Phase 5.b. A more gradual and orderly staging would ensure that there is market infrastructure in place to support the final stages of IM phase-in and avoid market disruption. Such a further phase-in would also be preferable to a blanket delay of Phase 5, which would simply defer the cliff-edge effect of the threshold dropping from 750 billion US$/Euro to 8 billion US$/Euro without further facilitating the industry's transition.

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- Enhancing the use and risk-sensitivity of approved IM models, including the ISDA SIMM™, by:
    - o Exempting Phase 4-5 non-dealer counterparties from prudential-style governance of IM models designed for bank capital standards;
    - o Enhancing portfolio margining in IM models;
    - o Accelerating regulatory approvals of business-specific IM models to avoid model herding to a single standard IM model; and
    - o Authorizing opt-in margining of non-regulated products to enhance portfolio offsets in IM models.
- Requiring robust data security protections by third-party software vendors that provide functionality for regulatory IM calculations, reconciliation, and margin workflows.

We respectfully urge the Committee to encourage the CFTC to coordinate with other regulators and the WGMR to implement our requested regulatory measures as soon as possible to avoid significant swaps market disruption.

A HARMONIZED U.S. APPROACH TO REGULATION

MFA supports the harmonization efforts that CFTC Commissioner Brian Quintenz and SEC Commissioner Hester Peirce have undertaken to enhance regulatory efficiency and effectiveness between the SEC and CFTC. To support this initiative and the goals of the CFTC, SEC, and Treasury that relate to promoting coordination, harmonization, and efficiency across regulators, MFA developed a proposal for a harmonized approach to CFTC and SEC regulation of firms that are registered with both the CFTC as CPOs or CTAs and with the SEC as investment advisers ("**dual registrants**").[3] We have urged the CFTC and SEC to enhance coordination and efficiency in the regulation of dual registrants, and we believe that this Committee has an important oversight role to play in ensuring that regulators take a more harmonized or coordinated approach to regulation of dual registrants.

Dual registrants are subject to a wide range of related, but not identical, requirements arising from CFTC, SEC, and National Futures Association ("**NFA**") rules.

[3] *See* letter from the Honorable Richard H. Baker, President and CEO, MFA, and Jennifer W. Han, Associate General Counsel, MFA, to the Honorable Jay Clayton, Chairman, SEC, and the Honorable Christopher Giancarlo, Chairman, CFTC, dated November 15, 2018, on "A Proposal for a Harmonized Primary Regulator Approach to SEC and CFTC Regulation of Dual Registrants", available at: https://www.managedfunds.org/wp-content/uploads/2018/11/MFA-Proposal-for-Dual-Registrants.final_.11.15.18.pdf.

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These requirements include systemic risk reporting, examinations, advertising, marketing, sales practice and promotional materials, recordkeeping, privacy policies, information security and cybersecurity, self-assessment, business continuity and disaster recovery planning, ethics, and registration forms.

Under our proposed CFTC-SEC approach to harmonized regulation, currently dual registrants would continue to be registered with, and subject to oversight by, both agencies. All trading activities in the futures and swaps market would continue to be governed by CFTC rules and all securities market activities would continue to be subject to SEC rules. However, through an exemptive-relief safe harbor, each agency would provide substituted compliance for CPO/CTA and adviser regulations, whereby a registrant would be able to satisfy its compliance obligations with one agency by complying with the other agency's rules that serve the same purpose. A dual registrant would determine which agency's rules it would need to comply with based upon an assets under management test. For example, if a majority of a registrant's exposure was from derivatives overseen by the CFTC, it would comply with the CFTC and NFA regulations, and would be granted substituted compliance by the SEC for certain investment adviser regulations.

MFA believes that a harmonized approach to CFTC-SEC regulation of dual registrants could significantly enhance regulatory efficiency and effectiveness, and reduce regulatory burdens by streamlining systemic risk reporting and implementing joint or coordinated exams of dual registrants. These aspects to dual regulation create the greatest additional ongoing cost and burden. A harmonized approach would also provide clear and quantifiable benefits to the CFTC and SEC, registrants and the investing public, as well as conserve valuable government resources, reduce waste, promote good governance, and greatly enhance regulatory efficiency and effectiveness.

Separately, to assist regulators with streamlining and rationalizing systemic risk reporting, MFA also submitted to the CFTC and SEC detailed comments and suggestions for revising Form PF, a joint systemic risk report.[4] MFA supports the CFTC and SEC's role in overseeing systemic risk consistent with the Dodd-Frank Act, which requires the SEC, the CFTC, in consultation with the Financial Stability Oversight Committee ("**FSOC**") to work together in developing a systemic risk report for private funds.[5] Nevertheless, we had envisioned a single form to be used by both the SEC and CFTC, rather than three similar but separate forms: joint SEC-CFTC Form PF, CFTC Form CPO-PQR, and CFTC Form CTA-PR. MFA's recommendation for a single, harmonized systemic risk report and proposed revisions would improve the accuracy and relevancy of

[4] *See* letter from the Honorable Richard H. Baker, President and CEO, MFA, and Jennifer W. Han, Associate General Counsel, MFA, to the Honorable Christopher Giancarlo, Chairman, CFTC, dated October 9, 2019, on "A Streamlined Form PF: Reducing Regulatory Burdens", available at: https://www.managedfunds.org/wp-content/uploads/2018/10/MFA.CFTC-Form-PF.final-w.-attachment.10.9.18-1.pdf.

[5] See Section 404 of the Dodd-Frank Act, Pub. L 111-203, 124 Stat. 1376 (2010), available at: https://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

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information about the industry, individual managers and pools/funds; and allow regulators to more effectively assess systemic risk across commodity pools and investment funds, and minimize the significant regulatory costs imposed on operators and advisers of private pools/funds.

MFA continues to engage with CFTC and SEC staffs to discuss an optimal framework for a harmonized approach to CFTC and SEC regulation of dual registrants. MFA has recommended that the CFTC and SEC prioritize adopting a harmonized approach to the regulation of dual registrants that would decrease duplicative regulation, allow for substituted compliance, joint, or coordinated exams, and permit the submission of a single systemic risk report to the CFTC, SEC, and NFA.

We respectfully urge that the Committee exercise its oversight role in ensuring that regulators take a more harmonized or coordinated approach to regulation of dual registrants.

CONCLUSION

On behalf of MFA, I greatly appreciate the ability to share our recommendations regarding CFTC Reauthorization and the state of the derivatives market. MFA members value liquid, safe, and efficient derivatives markets and effective oversight of these markets and market participants. As such, MFA believes that the Committee should include in the CFTC Reauthorization legislative solutions with respect to enhancing data privacy, protection, and collection.

In addition, to strengthen the U.S. derivatives markets and financial system, we respectfully urge Congress and the Committee, through their oversight powers, to encourage the CFTC to: ensure the accessibility and affordability of customer clearing; adopt regulatory refinements to the swaps trading framework; coordinate with other regulators and the WGMR to implement regulatory measures as soon as possible to avoid significant swaps market disruption; and work with the SEC to adopt a more harmonized or coordinated approach to regulation of dual registrants.

MFA is committed to working with Members and staff of Congress, the Committee, and regulators to address these issues towards the goal of strengthening our nation's economy.

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CHURCH ALLIANCE

Acting on Behalf of Church Benefits Programs

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June 24, 2019

The Honorable Pat Roberts
Chairman
Senate Committee on Agriculture,
Nutrition & Forestry
328A Russell Senate Office Building
Washington, DC 20510

The Honorable Debbie Stabenow
Ranking Member
Senate Committee on Agriculture,
Nutrition & Forestry
328A Russell Senate Office Building
Washington, DC 20510

Dear Chairman Roberts and Ranking Member Stabenow:

The Church Alliance is pleased to submit the following statement for the record of the Senate Committee on Agriculture, Nutrition, and Forestry's June 25, 2019 hearing on *The State of the Derivatives Market and Perspectives for CFTC Reauthorization*. We urge you to advance CFTC reauthorization legislation that expands the church plan exemption from the commodity pool operator ("CPO") and commodity trading advisor ("CTA") rules under the Commodity Exchange Act ("CEA") to include church plan-related accounts. As explained below, this clarification is important to respect Constitutional considerations and to help safeguard the financial security of America's religious communities.

ABOUT THE CHURCH ALLIANCE AND CHURCH BENEFIT PLANS

The Church Alliance is a coalition of chief executive officers of thirty-seven (37) denominational benefit programs covering mainline and evangelical Protestant, Catholic, and Jewish faith traditions. Church Alliance members provide retirement and welfare benefits to approximately one million clergy (including ministers, priests, rabbis, and other spiritual leaders), lay workers, and their family members, serving over 155,000 churches, synagogues, and affiliated organizations.

By way of background, denominational benefit plans are typically maintained by a separately incorporated church benefit organization (often called a pension board or benefit board) designated as the entity that sponsors or administers and maintains the benefit programs for eligible employees within the denomination. These benefit plans are generally multiple-employer in nature and cover thousands of church and synagogue employers throughout the country, many of which are located in rural communities. These programs often also cover foreign mission organizations and their missionaries. Church benefit organizations thus typically provide retirement and welfare benefits to thousands (or, in the case of the larger denominations, tens of thousands) of clergy and lay workers at multiple locations. Retirement benefits may be provided through a defined contribution (typically 403(b)(9)) plan, a defined benefit plan or both. Having a centralized program sponsored by one organization serving multiple church employers helps ensure continuity and consistency of employee benefits for the many clergy who move from one church or church-related organization to another to fulfill the ministry of a denomination.

THE DISPARATE TREATMENT OF CHURCH PLAN COMMODITIES TRANSACTIONS

To manage plan assets for long-term stability and growth, church benefits boards often engage investment managers or advisers that carry out commodities transactions for the purposes of diversification and hedging. To prevent excessive government entanglement in religion, CFTC Rule 4.5(a)(4)(v) excludes church plans from the CPO definition and thus relaxes the CPO and CTA registration obligations that would otherwise apply to these activities.

However, the Rule 4.5(a)(4)(v) exemption does not apply in circumstances where church plan assets are comingled for investment purposes with other church funds (such as from a church endowment), as permitted by tax and securities laws. These comingled accounts ("church plan-related accounts") can be tremendously beneficial for investment management purposes, providing efficiencies and economies of scale for church plans and their beneficiaries, as well as for the missions of the comingled church endowments. The CPO definition's disparate treatment between church plan assets and church plan-related accounts undermines these advantages by subjecting the latter to compliance obligations that are uniquely burdensome in the church plan context, as detailed below.

THE SOUND POLICY RATIONALE FOR EXTENDING THE CHURCH PLAN EXEMPTION TO CHURCH PLAN-RELATED ACCOUNTS

There is no sound policy or other justification for the higher regulatory burden imposed on church plan-related accounts under the CFTC's rules. Conversely, there are several important reasons to extend the church plan exemption to church plan-related accounts:

1. Preventing Entanglement of Government and Religion

The history of the Rule 4.5(a)(4)(v) exemption indicates that the CFTC followed the drafters of the Employee Retirement Income Security Act ("ERISA") in exempting church plans to avoid excessive government entanglement in religion in contravention of the Constitution. The Commission's notice of proposed rulemaking cited congressional proceedings on ERISA in which "Congress recognized that there were serious Constitutional objections to subjecting the churches, through their plans, to the examination of books and records and possible levy on church property to satisfy plan liabilities. As a consequence, 'church plans' were excluded from the purview of ERISA."[1] The CFTC followed this logic in creating the Rule 4.5(a)(4)(v) exemption, which relieves church plans from certain CPO and CTA obligations that might otherwise burden the free exercise of religion.

These considerations apply with equal force to church plan-related accounts, which are church-established and church-owned investment vehicles maintained for the mission purposes and benefit of a church. The religious purposes of these accounts, and theologically-based polity decisions by churches to manage them through their benefit boards, raise the same Constitutional issue of government entanglement with religion that applies to church plans themselves. There is no indication that the CFTC or any other government entity disputed this essential equivalence. Rather, the church plan-related account omission appears to have been the result of an unintended omission that should be clarified to fulfill the congressional motivation and Constitutional justification for the church plan exemption.

2. Following the Long-Standing Approach of the Securities Laws

In contrast to the CEA and its implementing regulations, the securities laws have long contained exemptions that cover church plans and church plan-related accounts. For example, Section 3(c)(14) of the Investment Company

[1] 65 Fed. Reg. 10939, 10941 (Mar. 1, 2000) (citation omitted).

Act of 1940, as amended; Section 3(a)(13) of the Securities Act of 1933, as amended; and Section 508(f) of the National Securities Markets Improvement Act of 1996, as amended, all specifically exempt church plans and church plan-related accounts from requirements to register or report as investment companies, register securities held, or disclose information about the securities they hold. This approach follows from the Constitutional concerns outlined above and confirms that addressing these concerns requires exemption relief for church plans and church plan-related accounts alike. Moreover, harmonization between the commodities laws and securities laws is intuitive, reasonable, and would significantly reduce needless complexity and compliance burdens on the religious community.

3. Preserving and Growing Church Plan Resources for Beneficiaries

As a final point, it is important to consider the real-world impact of the CFTC's current policy on church benefit plans and the individuals they serve. Church plans operate on a not-for-profit basis for the benefit of their clergy and lay worker beneficiaries. Absent an exemption, church plan-related accounts are subject to the CFTC registration requirements applicable to CPOs and CTAs. CPOs are subject to several additional requirements concerning each pool they operate; they must prepare and distribute disclosure documents, periodic account statements, and audited financial reports. In addition, CPOs are required to maintain records regarding each pool's participants, transactions, and operations, as well as transactions related to the CPO and its principals. These requirements are costly and burdensome and, unfortunately, every dollar that goes toward compliance expenses for church plans is a dollar that does not go toward providing much-needed retirement and welfare benefits for beneficiaries – most of whom are individuals of modest means who have devoted their lives to ministry and service. The CFTC's current policy has also led church plans to restrict or reconsider their managing church plan-related accounts, which prevents plans from realizing the advantages of these arrangements in terms of improved returns for beneficiaries.

Extending the church plan exemption to church plan-related accounts would allow church benefit boards to maximize the resources they devote to beneficiaries, rather than to compliance requirements that other federal financial regulators do not impose. An expanded exemption would also strengthen church plan financial performance by allowing church benefit boards to access the full range of commodities investments that provide diversification, opportunities to hedge, and returns. The ultimate benefit would be to the clergy and church lay worker participants in these plans and to the communities they support across the country.

THE URGENT NEED FOR LEGISLATIVE CLARIFICATION

Recognizing the policy justifications set forth above, Congress has advanced legislative clarifications of the CPO definition on a bipartisan, bicameral basis in recent years. In 2015, a church plan CPO fix was included as a result of a unanimous vote on a bipartisan amendment during the House Agriculture Committee's markup of its CFTC Reauthorization bill (H.R. 2289). The bill was later passed in the House. The CFTC Reauthorization bill (H.R. 238) was reintroduced and passed by the House in early 2017; the bill again included the church plan CPO fix language. In 2016, the Senate Agriculture Committee marked up its version of a CFTC Reauthorization bill, which also included the church plan CPO fix. CFTC staff, during meetings with Church Alliance representatives, has expressed no opposition to legislative clarification of the CPO and CTA provisions; in fact, they have expressed agreement with the policy justifications for such legislation. In the current session of Congress, Committee members Senator Amy Klobuchar (D-MN) and Senator David Perdue (R-GA) have introduced standalone legislation (S. 552) to expand the church plan exemption from the CPO requirements to church plan-related accounts. The long history of bipartisan, bicameral congressional support for this issue provides additional validation of the policy rationale described above.

Conclusion

In closing, the Church Alliance greatly appreciates the opportunity to submit this statement for the record. We urge the Committee to advance a CFTC reauthorization bill or other legislation that clarifies the treatment of church plan-related accounts for CPO and CTA purposes. We stand ready to assist your efforts moving forward and would be pleased to answer any questions about the intersection between church benefits plans and commodities transactions, or other matters relating to church benefit plans. Thank you for your consideration.

Sincerely,

James F. Sanft
Chair of the Church Alliance

QUESTIONS AND ANSWERS

JUNE 25, 2019

Senate Committee on Agriculture, Nutrition & Forestry
Hearing on the State of the Derivatives Market and Perspectives for CFTC Reauthorization
June 25, 2019
Questions for the Record
Mr. Joe Barker

Senator Amy Klobuchar

1. Farmers who rely on futures markets for hedging purposes have needs that are different from those of Wall Street Traders. As Congress works to reauthorize the Commodity Futures Trading Commission, what are the distinct needs of farmers—as end users of futures products—that deserve particular attention from this Committee?

   Answer: Since the original purpose of futures markets is to facilitate the transfer of risk, all end-users, hedgers and farmers need markets that promote fair price discovery and provide liquidity. Farmers in particular need to continue to have direct access to the futures and options markets so that they can effectively manage the price risks that exist as part of their daily business activities. As part of this liquidity need, it is important that we continue to have a diverse group of financially strong futures commission merchants (FCMs) that will service individual producers and the agricultural industry that supports these farmers.

   Risk management execution fees and costs are typically included in the price of each cash trade along the supply chain. Because the farmer is the ultimate price taker, they bear the cost of every transaction along the way of taking their production to market. This is why we believe that a financial transaction tax on commodity futures and options transactions is not in the best interest of farmers.

   In addition, farmers and other hedgers need a definition of a bona fide hedge to clearly include common practices such as anticipatory hedging and cross hedging. These practices are commonly used by farmers to help them lock in operating margins when those opportunities appear.

Senate Committee on Agriculture, Nutrition & Forestry
Hearing on the State of the Derivatives Market and Perspectives for CFTC Reauthorization
June 25, 2019
Questions for the Record
The Honorable Walter Lukken

Chairman Pat Roberts

1. Mr. Lukken, I understand that cybersecurity is one of the biggest concerns of market participants. As you noted in your testimony, in early June of this year the CFTC's Office of Inspector General released a report highlighting "numerous weaknesses" in the Commission's Information Technology system. Such a report may cause concerns considering the security breaches at the SEC in 2016 that led to unauthorized access of nonpublic information. In addition to increased funding for the CFTC, what other options should legislators consider to ensure that confidential proprietary market information, which has been disclosed to regulators, remains secure?

Private sector businesses and service providers are dedicating more time and resources on cybersecurity. It only makes sense that regulatory agencies, including the CFTC, that collect sensitive market data do the same, particularly given the sensitivity of the data collected and the potential for unauthorized access. FIA supports Congress providing guidance and directing the CFTC to review existing data collection methods and practices. This includes reviewing whether there is duplicative or unnecessary collection of data taking place and how data collected by the agency is being retained. As Thomas Sexton of the National Futures Association (NFA) noted in his testimony, "Not holding unnecessary data in the first place is the best mitigation of risk." FIA could not agree more. Further, we support congressional efforts to ensure that data housed by the CFTC is encrypted, confidential, and in line with industry best practices.

FIA strongly supports CFTC Commissioner Dawn Stump's leadership on the Data Protection Initiative, announced in March 2019[1]. In addition, FIA believes that highly sensitive source code data developed by firms to run their trading systems deserves the same protections under the law as any other form of intellectual property.

Senator Amy Klobuchar

1. Under current law, "church plan" benefit programs are exempt from the "commodity pool operator" and "commodity trading adviser" rules under the Commodities Exchange Act. I introduced a bill to extend this exemption to church plan-related accounts, such as endowments or foundations of churches and church-controlled nonprofits. How would making this change help church plans better access commodity futures markets to provide diversification and risk mitigation for their participants?

[1] https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement071219

The legislation you introduced, along with Senator David Perdue (R-GA), would extend exemptions from the "commodity pool operator" and "commodity trading adviser" rules under the Commodities Exchange Act to endowments or foundations of churches and church-controlled non-profits. This would allow less burdensome access to commodity futures markets for churches and church-controlled non-profits to provide diversification and risk mitigation tools for benefit plan participants.

Senate Committee on Agriculture, Nutrition & Forestry
Hearing on the State of the Derivatives Market and Perspectives for CFTC Reauthorization
June 25, 2019
Questions for the Record
Mr. Thomas Sexton

Chairman Pat Roberts

1. Mr. Sexton, as the Self-Regulatory Organization through a statutory relationship with the CFTC, in this post-crisis environment, is there anything that Congress can or should do to improve upon that relationship? Alternatively, is it necessary to make any modification to the Commodity Exchange Act relating to the oversight of swap dealers?

NFA Response:
Strengthening Customer Protections in FCM Bankruptcy Proceedings
NFA firmly believes that customer protection issues should be front and center as Congress works to reauthorize the CFTC. The last few reauthorization bills voted out of this Committee and the House Agriculture Committee have included a key customer protection provision relating to FCM bankruptcies, which we continue to strongly support. This provision would strengthen customer protections and provide customers with priority in the event of an FCM bankruptcy. We urge this Committee to include this key statutory change in any future reauthorization bill.

Over 30 years ago the CFTC adopted rules regarding FCM bankruptcies. Among other things, those rules provided that if there was a shortfall in customer segregated funds, the term "customer funds" would include all assets of the FCM until customers had been made whole. Several years ago, a district court decision in the Griffin Trading bankruptcy cast doubt on the validity of the CFTC's rule. Although that decision was subsequently vacated, a cloud of doubt continues to linger over the validity of the CFTC's rule. Congress should remove that doubt and ensure that customers have priority if there is a shortfall in segregated funds, and can do so by amending Section 20 of the Commodity Exchange Act. Section 20 gives the CFTC authority to adopt regulations regarding commodity brokers that are debtors under Chapter 7 of Title 11 of the United States Code. We suggest that Congress amend Section 20 to clarify that the CFTC has the authority to adopt the rule that it did. We believe there is a broad base of industry support for this approach, and we would be happy to work with Congress on specific proposed language.

Cybersecurity and Data
NFA supports providing the CFTC with the resources, authority and direction to review and enhance its data collection methods, practices, and security given the sensitivity of the data collected and the potential for unauthorized access. This

includes reviewing whether there is duplicative or unnecessary collection of data taking place and how data collected by the agency is being retained and secured.