U.S. COMMODITY FUTURES TRADING COMMISSION
ENSURING THE INTEGRITY OF THE FUTURES & OPTIONS MARKETS

SPEECHES & TESTIMONY

Testimony of Mark P. Wetjen Acting Chairman, Commodity Futures Trading Commission Before the U.S. Senate Appropriations Subcommittee on Financial Services And General Government

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Good morning, Chairman Udall, Ranking Member Johanns and members of the Subcommittee. Thank you for inviting me to today's hearing on the President's Fiscal Year 2015 funding request and budget justification for the Commodity Futures Trading Commission (Commission or CFTC).

During the last two years, despite significant budgetary constraints, the CFTC has made important progress in fulfilling its mission. As you know, under the Commodity Exchange Act, the Commission has oversight responsibilities for the derivatives markets, which include futures, options, cash, and swaps. Each of these markets is significant. Collectively, they have taken on particular importance to the U.S. economy in recent decades and, as a consequence, have grown substantially in size, measuring hundreds of trillions of dollars in notional value. Their operation and integrity are critical to the effective functioning of the U.S. and global economies.

At their core, the derivatives markets exist to help farmers, producers, small businesses, manufacturers and lenders focus on what they do best: providing goods and services and allocating capital to reduce risk and meet Main Street demand. Well-regulated derivatives markets facilitate job creation and the growth of the economy by providing a means for managing and assuming prices risks and broadly disseminating, and discovering, pricing information.

Stated more simply, through the derivatives marketplace, a farmer can lock in a price for his crop; a small business can lock in an interest rate that would otherwise fluctuate, perhaps raising its costs; a global manufacturer can lock in a currency value, allowing it to better plan and grow its global business; and a lender can manage its assets and balance sheet to ensure it can continue lending, fueling the economy in the process.

Essentially, these complex markets facilitate the assumption and distribution of risk throughout the financial system. Well-working derivatives markets are key to supporting a strong, growing economy by enabling the efficient transfer of risk, and therefore the efficient production of goods and services. Accordingly, it is critical that these markets are subject to appropriate governmental oversight.

Mr. Chairman, Ranking Member, and Committee members, I do not intend the testimony that follows to sound alarmist, or to overstate the case for additional resources, but I do want to be sure that Congress, and this committee in particular, have a clear picture of the potential risks posed by the continued state of funding for the agency. When not overseen properly, the derivatives markets may experience irregularities or failures of firms intermediating in them – events that can severely and negatively impact the economy as a whole and cause dramatic losses for individual participants. The stakes, therefore, are high.

The CFT C's Responsibilities Have Grown Substantially in Recent Years

The unfortunate reality is that, at current funding levels, the Commission is unable to adequately fulfill the mission given to it by Congress: to prevent disruptions to market integrity, protect customer assets, monitor and reduce the build-up of systemic risk, and ensure to the greatest extent possible that the derivatives markets are free of fraud and manipulation.

Recent increases in the agency's funding have been essential and appreciated. They have not, however, kept pace with the growth of the Commission's responsibilities, including those given to it under Dodd-Frank.

Various statistics have been used to measure this increase in responsibilities. One often-cited measure is the increase in the gross notional size of the marketplace now under the Commission's oversight. Other measures, though, are equally and perhaps more

illustrative.

Trading Volume Has Increased

For instance, the trading volume of CFTC-regulated futures and options contracts was 3,060 million contracts in 2010 and rose to 3,477 million in 2013. Similarly, the volume of interest rate swap trading activity by the 15 largest dealers averaged 249,564 swap events each in 2010, and by 2012, averaged 332,484 each (according to the International Swaps and Derivatives Association ("ISDA") data). Those transactions, moreover, can be executed in significantly more trading venues, and types of trading venues, both here and abroad. In addition, the complexity of the markets – its products and sophistication of the market tools, such as automated-trading techniques – has increased greatly over the years.

Clearing Houses Manage More Risk

The notional value of derivatives centrally cleared by clearing houses was $124 trillion in 2010 (according to ISDA data), and is now approximately $223 trillion (according to CFTC data from swap data repositories ("SDRs")). That is nearly a 100 percent increase. The expanded use of clearinghouses is significant in this context because, among other things, it means that the Commission must ensure through appropriate oversight that these entities continue to properly manage the various types of risks that are incident to a market structure dependent on central clearing. A clearinghouse's failure to adhere to rigorous risk management practices established by the Commission's regulations, now more than ever, could have significant economic consequences. The Commission directly oversees fifteen registered clearinghouses and two of them, Chicago Mercantile Exchange, Inc., and ICE Clear Credit LLC, have been designated as systemically important by the Financial Stability Oversight Council.

Clearing Houses and Intermediaries Manage More Customer Funds

The amount of customer funds held by clearinghouses and futures commission merchants (FCMs) was $177 billion in 2010 and is now over $218 billion, another substantial increase. These are customer funds in the form of cash and securities deposited at firms to be used for margin payments made by the end-users of the markets, like farmers, to support their trading activities. Again, Commission rules are designed to ensure customer funds are safely kept by these market intermediaries, and a failure to provide the proper level of oversight increases the risk of certain practices by firms, including operational risks or fraud. In fact, recent events in the FCM community led to the temporary or permanent loss of more than a billion dollars of customer funds.

Substantially Larger Number of Firms Now Registered with the CFTC

The total number of registrants and registered entities overseen directly or indirectly by the Commission, depending on the measure, has increased by at least 40 percent in the last four years. This includes 102 swap dealers and two major swap participants (MSPs).

In addition, the CFTC oversees more than 4,000 advisers and operators of managed funds, some of which have significant outward exposures in and across multiple markets. It is conceivable that the failure of some of these funds could have spill-over effects on the financial system. In all cases, investors in these funds are entitled to know their money is being appropriately held and invested.

Additionally, the Commission directly or indirectly supervises another approximately 64,000 registrants, mostly associated persons that solicit or accept customer orders or participate in certain managed funds, or that invest customer funds through discretionary accounts. Although it leverages the resources of the self-regulatory organizations ("SROs"), the Commission itself must oversee these registrants in certain areas and provide guidance and interpretations to the SROs. The Commission does so with a total staff of only 648 employees currently onboard – about 1 percent of the number of registrants under its purview. Separately, the Commission must oversee more than three dozen registered entities, including clearinghouses and trading venues, each of which is subject to a complex set of regulatory requirements newly established or modified by the Dodd-Frank Act and designed to mitigate systemic risk.

By almost any measure, in fact, the portfolio of entities that the Commission is charged with overseeing has expanded dramatically in size and risk over the last half decade. The intermediaries in the derivatives markets are by and large well-run firms that perform important services in the markets and for their customers. Nevertheless, collectively, these firms can potentially pose risks – in some cases significant risks – to the financial system

and the broader economy. Accordingly, those relying upon these firms and the public deserve assurance that such firms are supervised by an agency capable of meaningful oversight.

The CFTC Has Made Important Progress But Has Been Significantly Constrained

For much of FY 2013, the CFTC operated under continuing resolutions, which extended the FY 2012 appropriation of $205 million. These appropriations, however, were subject to sequestration. Effectively, our operating budget for FY 2013 was $195 million. Thus, the FY 2014 appropriation of $215 million was a modest budgetary increase for the Commission, lifting the agency's appropriations above the sequestration level of $195 million that has posed significant challenges for the agency's orderly operation. As directed by Congress, the agency has submitted a FY 2014 Spend Plan outlining its allocation of current resources, which reflects an increased emphasis on examinations and technology-related staff.

Even with these significant budget constraints, the dedicated staff of the Commission were able to complete the majority of new rulemakings required by the Dodd-Frank Act – about 50 rulemakings in all. This was in addition to the Commission's ongoing work overseeing the futures exchange and options markets. These regulatory efforts resulted in greater transparency, which is critical to reducing systemic risk and lowering costs to end-users, while improving efficiency and supporting competition.

With regard to technology, we made progress in a variety of areas. We improved the quality of data reported to swap data repositories and have laid groundwork to receive, analyze and promulgate new datasets from SROs related to new authorities. We upgraded data analytics platforms to keep up with market growth. Financial risk surveillance tools were enhanced to support monitoring and stress testing related to new authorities. The Commission has prototyped a high-performance computing platform that dramatically reduces data analytics computation times and an on-line portal for regulatory business transactions to improve staff and industry productivity. The Commission has implemented enhanced position limit monitoring and is ready to implement pre-trade and heightened account ownership and control surveillance. Finally, the Commission has ensured that foundational server, storage, networking, and workstation technology are refreshed on a cost-effective cycle and that technology investments have cybersecurity and business continuity built-in.

In its role as a law enforcement agency, the Commission's enforcement arm protects market participants and other members of the public from fraud, manipulation and other abusive practices in the futures, options, cash, and swaps markets, and prosecutes those who engage in such conduct. As of May 1, 2014, the Commission filed 31 enforcement actions in FY 2014 and also obtained orders imposing more than $2.2 billion in sanctions. By way of comparison, in FY 2013, the Commission filed 82 enforcement actions, and obtained orders imposing more than $1.7 billion in sanctions.

With the bulk of rulemaking behind us, the necessary focus must be examinations, market supervision and enforcement. Simply stated, this requires appropriate staffing and technological resources sufficiently robust to oversee what are highly advanced, complex global markets, and be able to take effective and timely enforcement action.

The FY 2015 Request Prioritizes Examinations, Technology, Market Integrity, and Enforcement

The President's FY 2015 budget request reflects these priorities and highlights both the importance of the Commission's mission and the potential effects of continuing to operate under difficult budgetary constraints.

The request is a significant step towards the longer-term funding level that is necessary to fully and responsibly fulfill the agency's core mission: protecting the safety and integrity of the derivatives markets. It recognizes the immediate need for an appropriation of $280 million and approximately 920 staff years (FTEs) for the agency, an increase of $65 million and 253 FTEs over the FY 2014 levels, heavily weighted towards examinations, surveillance, and technology functions.

In this regard, the request balances the need for more technological tools to monitor the markets, detect fraud and manipulation, and identify risk and compliance issues, with the need for staff with the requisite expertise to analyze the data collected through technology and determine how to use the results of that analysis to fulfill the Commission's mission as the regulator of the derivatives markets. Both are essential to carrying out the agency's

mandate. Technology, after all, is an important means for the agency to effectively carry out critical oversight work; it is not an end in itself.

In light of technological developments in the markets today, the agency has committed to an increased focus on technology. The FY 2015 budget request includes a $15 million increase in technology funding above the FY 2014 appropriation, or about a 42 percent increase, solely for IT investments.

In my remaining testimony, I will review three of the primary mission priorities for FY 2015.

Examinations

The President's request would provide $38 million and 158 FTEs for examinations, which also covers the compliance activities of the Commission. As compared to FY 2014, this request is an increase of $15 million and 63 FTEs.

I noted earlier that the Commission has seen substantial growth in, among other things, trading volumes, customer funds held by intermediaries in the derivatives markets, and margin and risk held by clearinghouses. Examinations and regulatory compliance oversight are perhaps the best deterrents to fraud and improper or insufficient risk management and, as such, remain essential to compliance with the Commission's customer protection and risk management rules.

The Commission has a direct examinations program for clearinghouses and designated contract markets, and it will soon directly examine swap execution facilities and SDRs. However, the agency does not at this time have the resources to place full-time staff on site at these registered entities, even systemically-important clearing organizations, unlike a number of other financial regulators that have on-the-ground staff at the significant firms they oversee. The Divisions of Market Oversight and Clearing and Risk collectively have a total of 47 examinations positions in FY 2014 to monitor, review, and report on some of the most complex financial market operations in the world.

The Commission today performs only high-level, limited-scope reviews of the nearly 100 FCMs holding over $218 billion in customer funds and 102 swap dealers. In fact, the Commission currently has a staff of only 38 to examine these firms, and to review and analyze, among other things, over 1,200 financial filings and over 2,400 regulatory notices each year. This staff level is less than the number the Commission had in 2010, yet the number of firms requiring its attention has almost doubled, and there has been a noted increase in the complexity and risk profile of the firms. Additionally, although it has begun legal compliance oversight of swap dealers and MSPs, the Commission has been able to allocate only 13 FTEs for this purpose. This number is insufficient to perform the necessary level of oversight of the newly registered swap dealer entities.

In FY 2014, the Commission overall will have a mere 95 staff positions dedicated to examinations of the thousands of different registrants that should be subject to thorough oversight and examinations. The reality is that the agency has fallen far short of performance goals for its examinations activities, and it will continue to do so in the absence of additional funding from Congress. For example, as detailed in the Annual Performance Review for FY 2013, the Commission failed to meet performance targets for system safeguard examinations and for conducting direct examinations of FCM and non-FCM intermediaries. The President's budget request appropriately calls on Congress to bolster the examinations function at the agency, and it would protect the public, and money deposited by customers, by enhancing the examinations program staff by more than 66 percent in FY 2015.

Moreover, if Congress fully funds the President's request, the Commission can move toward annual reviews of all significant clearinghouses and trading platforms and perform more effective monitoring of market participants and intermediaries. Partially funding the request will mean accepting potentially avoidable risk in the derivatives markets as the Commission is forced to forego more in-depth financial, operational and risk reviews of the firms within its jurisdiction. Thus, the Commission would be reactive, rather than proactive in regard to firm or industry risk issues.

Technology and Market Integrity

The FY 2015 request also supports a substantial increase in technology investments relative to FY 2014, roughly a 42 percent increase. The $50 million investment in technology will provide millions of dollars for new and sophisticated analytical systems that will, in part, assist the Commission in its efforts to ensure market integrity. As global markets have moved almost entirely to electronic systems, the Commission must invest in

technology required to collect and analyze market data, and to handle the unprecedented volumes of transaction-level data provided by financial markets.

The President's FY 2015 budget request supports, in addition, 103 data-analytics and surveillance-related positions in the Division of Market Oversight alone, an increase of more than 98 percent over the FY 2014 staffing levels. Market surveillance is a core Commission mission, and it is an area that depends heavily on technology. As trading across the world has moved almost entirely to electronic systems, the Commission must make the technology investments required to collect and make sense of market data and handle the unprecedented volumes of transaction-level data provided by financial markets.

Effective market surveillance, though, equally depends on the Commission's ability to hire and retain experienced market professionals who can analyze extremely complex and voluminous data from multiple trading markets and develop sophisticated analytics and models to respond to and identify trading activity that warrants investigation. The FY 2015 investment in high-performance hardware and software therefore must be paired with investments in personnel that can employ technology investments effectively.

Accordingly, to make use of existing and new IT investments, the FY 2015 request would provide funding for 193 FTEs, an increase of 74 FTEs over FY 2014. These new staff positions are necessary for the Commission to receive, analyze, and effectively surveil the markets it oversees. These new positions, together with the technology investments included in the FY 2015 request, will enable the Commission to make market surveillance a core component of our mission.

The CFTC has invested appropriated funds in FY 2013 and FY 2014 in technology to make important progress. We have the groundwork in place to receive and effectively analyze swaps transaction data submitted to repositories and SROs related to new authorities. The FY 2015 request would provide funding to continue and increase the pace of progress in the areas noted above and also support the additional examination, enforcement, and economic and legal staff. Effective use of technology is essential to our mission to ensure market integrity, promote transparency, and effectively surveil market participants.

Enforcement

The President's FY 2015 request would provide $62 million and 200 FTEs for enforcement, an increase of $16 million and 51 FTEs over FY 2014. The simple fact is that, without a robust, effective enforcement program, the Commission cannot fulfill its mandate to ensure a fair playing field. From FY 2011 to date, the Commission has filed 314 enforcement actions and also obtained orders imposing more than $5.4 billion in sanctions.

The cases the agency pursues range from sophisticated manipulative and disruptive trading schemes in markets the Commission regulates, including financial instruments, oil, gas, precious metals and agricultural products, to quick strike actions against Ponzi schemes that victimize investors. The agency also is engaged in complex litigations related to issues of financial market integrity and customer protection. By way of example, in FY 2013, the CFTC filed and settled charges against three financial institutions for engaging in manipulation, attempted manipulation and false reporting of LIBOR and other benchmark interest rates.

Such investigations continue to be a significant and important part of the Division of Enforcement's docket. Preventing manipulation is critical to the Commission's mission to help protect taxpayers and the markets, but manipulation investigations, in particular, strain resources and time. And once a case is filed, the priority must shift to the litigation. In addition to requiring significant time and resources at the Commission, litigation requires additional resources, such as the retention of costly expert witnesses.

In 2002, when the Commission was responsible for the futures and options markets alone, the Division of Enforcement had approximately 154 people. Today, the agency's responsibilities have substantially increased. The CFTC now also has anti-fraud and anti-manipulation authority over the vast swaps market and the host of new market participants the agency now oversees. In addition, the agency is now responsible for pursuing cases under our enhanced Dodd-Frank authority that prohibits the reckless use of manipulative or deceptive schemes. Notwithstanding these additional responsibilities, however, total enforcement staff has shrunk – there are currently only 147 members of the enforcement staff. The President's budget request would bring this number to 200. More cops on the

beat means the public is better assured that the rules of the road are being followed.

In addition to the need for additional enforcement staff and resources, the CFTC also believes technology investments will make our enforcement staff more efficient. For instance, the FY 2015 request would support developing and enhancing forensic analysis and case management capabilities to assist in the development of analytical evidence for enforcement cases. In FY 2013 and FY 2014, appropriated funds invested in information technology have enabled the Commission to continue enhancing enforcement and litigation automation services, including a major upgrade to the document and digital evidence review platform that will enable staff to keep pace with the exploding volume of data required to successfully conduct enforcement actions.

A full increase for enforcement means that the agency can pursue more investigations and better protect the public and the markets. A less than full increase means that the CFTC will continue to face difficult choices about how to use its limited enforcement resources. At this point, it is not clear that the agency could maintain the current volume and types of cases, as well as ensure timely responses to market events.

Other FY 2015 Priorities: International Policy Coordination & Economic and Legal Analysis

The global nature of the derivatives markets makes it imperative that the United States consult and coordinate with international authorities. For example, the Commission recently announced significant progress towards harmonizing a regulatory framework for CFTC-regulated SEFs and EU-regulated multilateral trading facilities (MTFs). The Commission is working internationally to promote robust and consistent standards, to avoid or minimize potentially conflicting or duplicative requirements, and to engage in cooperative supervision, wherever possible.

Over the past two years, the CFTC, SEC, European Commission, European Securities and Markets Authority, and other market regulators from around the globe have been meeting regularly to discuss and resolve issues with the goal of harmonizing financial reform. The Commission also participates in numerous international working groups regarding derivatives. The Commission's international efforts directly support global consistency in the oversight of the derivatives markets. In addition, the Commission anticipates a significant need for ongoing international policy coordination related to both market participants and infrastructure in the swaps markets. The Commission also anticipates a need for ongoing international work and coordination in the development of data and reporting standards under Dodd-Frank rules. Dodd- Frank further provided a framework for foreign trading platforms to seek registration as foreign boards of trade, and 24 applications have been submitted so far.

Full funding for international policy means the Commission will be able to maintain our coordination efforts with financial regulators and market participants from around the globe. If available funding is decreased, we will be less able to engage in cooperative work with our international counterparts, respond to requests, and provide staffing for various standard-setting projects. The President's FY 2015 request would enable the Commission to sustain its efforts, providing $4.2 million and 15 FTEs that would be dedicated to international policy.

In addition, for FY 2015, the President's budget would support $24 million and 92 FTEs to invest in robust economic analysis teams and Commission-wide legal analysis. Compared to the FY 2014 Spending Plan, this request is an increase of $4 million and 18 FTEs. Both of these teams support all of the Commission's divisions.

The CFTC's economists analyze innovations in trading technology, developments in trading instruments and market structure, and interactions among various market participants in the futures and swaps markets. Economics staff with particular expertise and experience provides leverage to dedicated staff in other divisions to anticipate and address significant regulatory, surveillance, clearing, and enforcement challenges. Economic analysis plays an integral role in the development, implementation, and review of financial regulations to ensure that the regulations are economically sound and subjected to a careful consideration of potential costs and benefits. Economic analysis also is critical to the public transparency initiatives of the Commission, such as the Weekly Swaps Report. Moving into FY 2015, the CFTC's economists will be working to integrate large quantities of swaps market data with data from designated contract markets and swap execution facilities, and large swaps and futures position data to provide a more comprehensive view of the derivatives markets.

The legal analysis team provides interpretations of Commission statutory and regulatory authority and, where appropriate, provides exemptive, interpretive, and no-action letters to CFTC registrants and market participants. In FY 2013, the Commission experienced a significant increase in the number and complexity of requests from market participants for written interpretations and no-action letters, and this trend is expected to increase into FY 2015.

A full increase for the economics and legal analysis mission means the Commission will be able to support each of the CFTC's divisions with economic and legal analysis. Funding short of this full increase or flat funding means an increasingly strained ability to integrate and analyze vast amounts of data the Commission is receiving on the derivatives markets, thus impacting our ability to study and detect problems that could be detrimental to the economy. Flat funding also means the Commission's legal analysis team will continue to be constrained in supporting front- line examinations, adding to the delays in responding to market participants and processing applications, and hampering the team's ability to support enforcement efforts.

Conclusion

Effective oversight of the futures and swaps markets requires additional resources for the Commission. This means investing in both personnel and information technology. We need staff to analyze the vast amounts of data we are receiving on the swaps and futures markets. We need staff to regularly examine firms, clearinghouses, trade repositories, and trading platforms. We need staff to bring enforcement actions against perpetrators of fraud and manipulation. The agency's ability to appropriately oversee the marketplace hinges on securing additional resources.

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

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