Testimony of Chairman Timothy G. Massad
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Thank you, Chairman Conaway, Ranking Member Peterson, and members of the Committee. I'm very pleased to be back testifying on behalf of the Commodity Futures Trading Commission (CFTC). I appreciate the opportunity to discuss the progress and priorities of the agency.

As you know, the CFTC oversees the futures, options, and swaps markets. While they, and the agency, are not well-known to most Americans, the importance of these markets to American businesses, families and the American economy cannot be overstated.

The derivatives markets allow farmers to lock in a price for their crops, utilities to manage the cost of fuel, and businesses of all types and sizes to hedge commercial risk. And as a result, they shape the prices we all pay for food, energy and a host of other goods and services.

At the CFTC, our job is to ensure these markets are working properly, by helping to deter and prevent fraud and manipulation. We strive to create a regulatory framework that promotes transparency, competition and innovation. This benefits everyone – from the agriculture community to business owners and investors saving for retirement. And we try our best to do this in a way that does not impose undue burdens on those end-users who rely on these markets as an important component of their business.

Since I last testified before this Committee, the CFTC has made considerable progress in a number of areas. The Commission has written, and is working to enforce, most

of the rules required by the Dodd-Frank Act, which was enacted in the aftermath of the worst financial crisis since the Great Depression. We are also focused on fine-tuning our rules, so they do not improperly burden commercial end-users. This work adds to our traditional responsibilities of surveillance, compliance, and enforcement for the futures and options markets. And we have been addressing new developments and challenges in our markets, particularly those created by technological development.

Today, I would like to highlight some of our accomplishments over the past year and also lay out a number of key priorities for the months ahead.

Before I begin, I want to thank our staff for their tireless work on behalf of our mission. I know I speak for my fellow Commissioners Bowen and Giancarlo when I say that the effort, dedication and expertise of the CFTC staff are the reasons we've made such strides this year.

I would also like to thank Commissioners Bowen and Giancarlo for their dedication. Each brings experience, judgment, and an important perspective to the work of the Commission. We have developed a productive working relationship that is grounded in good faith and mutual respect. I appreciate their willingness to collaborate and work together constructively.

Recent Accomplishments

The CFTC has taken many actions during the past year to help make sure our financial markets continue to be the best in the world. There are several I'd like to talk about today.

Margin for Uncleared Swaps. One of our more recent actions was the Commission's approval of a final rule setting margin requirements for uncleared swaps.

Our margin rule is one of the most significant elements of swaps market regulation set forth in the Dodd-Frank Act. There will always be a large part of the market that is not cleared – many swaps are not suitable for central clearing and our clearinghouses will be stronger if we exercise care in what is required to be cleared. And in the absence of clearing, margin requirements protect against excessive risk buildup in the system.

I think the rule we have adopted is strong and sensible. Consistent with Congressional intent, our rule does not require the collection of margin from end-users. It focuses instead on where some of the greatest risk exists– between large financial institutions, where the default of one entity would lead to further defaults by its counterparties, given the interconnectedness of our financial system. It requires swap dealers and major swap participants to post and collect margin with financial entities with whom they have significant exposures. It requires initial margin, which is designed to protect against potential future loss on a default, as well as variation margin, which serves as mark-to-market protection.

We also worked very hard to harmonize our rule with those concurrently issued by the prudential regulators, as well as with international standards. Shortly after I took office, I committed to doing all we could to achieve such harmonization. There were many differences 18 months ago. Today, I believe we have succeeded.

To determine how our rule should apply to inter-affiliate transactions, we worked to strike the proper balance between benefits and costs.

It was important that we mandate appropriate protections to help ensure the safety and soundness of swap dealers. So, we require full variation margin be exchanged for all inter-affiliate swaps. We did not require initial margin for all such swaps, however, which is one point of difference with the prudential regulators. Instead, to prevent evasion of collection requirements in certain cases, we require initial margin, and we require posting of initial margin to insured depository institutions that are swap dealers. We also require that inter-affiliate swaps be subject to a centralized risk management program appropriate to monitor and to manage these risks.

We have also been working to address new and emerging threats to the financial system.

Cybersecurity. Cyberattacks are perhaps the number one risk to financial stability that we face today. This past year, the Commission unanimously took action to enhance cybersecurity protection in our markets. We proposed rules designed to make sure that the private companies that run the core infrastructure under our jurisdiction—exchanges, clearinghouses, swap execution facilities and swap data repositories – are doing adequate evaluation of cybersecurity risks and testing of their own cybersecurity and operational risk protections. They address concerns related to information security, physical security, business continuity and disaster recovery. The proposals set principles-based testing standards, which are deeply rooted in industry best practices.

The proposals identify five types of testing as critical to a sound system safeguard program: vulnerability testing, penetration testing, controls testing, security incident response plan testing and enterprise-wide assessment of technology risk. Such efforts

are vital to mitigate risk and preserve the ability to detect, contain, respond to, and recover from a cyberattack or other type of operational problem.

Before adopting final rules, we will carefully consider any feedback we may receive. We hope to finalize these important rules before the end of this year.

Internal Cybersecurity. I would note, that in addition to guarding against technological threats among the entities we regulate, we continue to be vigilant regarding our own cybersecurity. A draft report set to be released by the Office of Management and Budget in March underscores our commitment, and our success. The draft report grades federal agencies in meeting cybersecurity performance goals, and I'm pleased to report that of all small agencies reporting, it ranks the CFTC among the top five, receiving a compliance score of over 90 percent.

We continue to do all we can to build and enhance our systems with our limited resources. For example, we are participating in the Department of Homeland Security's Continuous Diagnostic Mitigation Program, we have increased advanced malware defenses and we are implementing new data loss prevention technology this year.

Proposed Rule on Automated Trading. Let me turn to another area where we are responding to technological change. Last November, the Commission unanimously proposed rules to address the increased use of automated trading. Today, almost all trading in our markets is electronic, and approximately 70 percent of trading in the futures market is automated.

Automated trading has brought many benefits to market participants – such as more efficient execution, lower spreads and greater transparency. But its extensive use also raises important policy and supervisory questions and concerns.

Our proposed rule focuses on minimizing the potential for disruptions or other operational problems that can be caused by automated trading. These could occur from fat fingers, untested algorithms or in other ways. Our proposal builds upon the steps we and the exchanges have already taken on this front. It relies on a principles-based approach that codifies many industry best practices.

Our proposal requires pre-trade risk controls such as message throttles and maximum order size limits, and other measures such as "kill switches," which facilitate emergency intervention in the case of malfunctioning algorithms. But it does not prescribe the parameters or limits of such controls, because we believe market participants are the ones who should determine those specifics. Our proposal sets general requirements pertaining to the design, testing and supervision of automated trading systems, but again it leaves the details of those to market participants.

We have proposed requirements at the exchange level as well as at the clearing member and trading firm levels. This, too, is a best practice suggested by many firms. We have proposed requiring proprietary traders who access the market directly and who are using automated trading to register with the CFTC. And we have included measures to limit the practice of self-trading.

We hope to finalize this rule in 2016 as well.

Continuing to Support Commercial End-Users

Let me turn now to some concerns of commercial end-users. Since I took office, I have made it my priority to do all we can to ensure commercial end-users can use these markets efficiently and effectively. I know Commissioners Bowen and Giancarlo share that view. Commercial end users did not cause the financial crisis, and were not the focus of Congressional reforms. So, as we take the necessary steps to create sensible regulation of these markets, we must make sure end users do not face undue burdens.

Over the past year, the Commission has taken many actions to address the needs and concerns of commercial end-users.

Simplifying Recordkeeping Requirements. In mid-December, we adopted significant changes to a rule that will reduce recordkeeping obligations for commercial end-users. This final rule, unanimously approved by the Commission, amends recordkeeping requirements set forth under Commission Regulation 1.35. This regulation, first implemented in 1948, requires various types of market participants to keep written and oral records of their commodity interest and related cash or forward transactions. It is very important to our efforts to ensure our markets are strong, transparent, and operate free of fraud and manipulation.

We revised the rule so that members of exchanges and swap execution facilities not registered with the Commission, such as end-users, do not have to keep pre-trade communications or text messages. Further, we have simplified the requirements for keeping records of final transactions. The amended rule also states that commodity trading advisors do not have to record oral communications regarding their transactions.

The rule strikes an appropriate balance between the costs of recordkeeping and the benefits to market oversight. It reduces the burden on businesses, farmers and ranchers that depend on the derivatives markets, and will ensure that they are able to continue using these markets effectively and efficiently. Our final rule reflects the input we have received by many commercial businesses and other market participants.

Volumetric Optionality. In addition to our recent action with respect to trade options, the Commission also clarified when certain agreements that include volumetric optionality provisions are forward contracts, rather than swaps. These types of contracts are widely used by a variety of end-users, including electric and natural gas utilities. By clarifying how these agreements will be treated, the interpretation is intended to make sure commercial companies can continue to conduct their daily operations efficiently.

Relief for Small Banks and CDFIs. A few weeks ago, CFTC staff addressed the concerns of our community development financial institutions ("CDFI") and small banks with under $10 billion in assets. Staff's action made clear that these entities may choose not to clear a swap subject to the CFTC's clearing requirement, provided that they elect the end-user exception and comply with certain other conditions.

These actions complement a number of steps we took earlier to address end-user concerns.

Public Utility Companies. For example, the Commission amended its swap dealer rules so that local, publicly-owned utility companies can continue to effectively hedge their risks in the energy swaps market. These companies, which keep the lights on in many homes across the country, must access these markets efficiently in order to provide reliable, cost-effective service to their customers.

Customer Protection/Margin Collection. The Commission also unanimously adopted a change to the "residual interest" rule. This is an important aspect of our customer-protection related rules, designed to help prevent future insolvencies like the failure of MF Global – and to protect customers in the event it does happen. To address a concern of many in the agricultural community and many smaller customers regarding the posting of collateral for their trades, we removed a provision that would have automatically changed the deadline for futures commission merchants to post "residual interest," which, in turn, can affect when customers must post collateral.

We also expect to have a roundtable soon on the issue of how this rule is working in practice. We'll have more to say about that in the near future.

Reporting Requirements for Contracts in Illiquid Markets. Finally, CFTC staff also granted relief from the real-time reporting requirements for certain less liquid, long-dated swap contracts. Staff agreed to permit slightly delayed reporting so that the reporting requirements do not make it more difficult to hedge.

These are just some of the actions we have taken to make sure these markets work for commercial end-users. And during my tenure, I intend to continue to remain focused on their concerns.

Improving Data Reporting

The CFTC is also taking important steps to ensure that the swap data we receive is accurate, consistent and useful.

Reporting of swaps transaction data was a key goal of the reforms agreed to by the leaders of the G-20 nations, and one of the most important components of the Dodd-Frank Act. We have come a long way since the fall of 2008, when a lack of reporting meant neither regulators nor market participants could assess the exposures or interconnectedness of major institutions. The reforms we have implemented have given better information to regulators and greater transparency to market participants.

But building an efficient system to collect and analyze data from this market is an enormous undertaking, and there is more work to do. Currently, for example, there is considerable variation in how different participants report the same fields to SDRs, and in how the SDRs themselves transmit information to the CFTC. When the rules were first written, we purposely didn't prescribe exactly how each field should be reported – for a number of reasons. First, when the agency issued the reporting rules, we didn't yet have any data to inform our views. And second, we expected the industry to develop standardized terms. That, unfortunately, did not happen.

So in December, CFTC staff requested public comment on technical specifications for the reporting of 120 priority data elements. We are seeking public input on this, which culminated months of work to identify priority areas where standardization or clarification is needed.

In addition, last year we proposed clarifying reporting obligations with respect to cleared swaps. This will ensure that as swaps are cleared, there is a simple, consistent process for reporting them. The proposal will help ensure that there are not multiple records of a swap that can lead to erroneous double counting, and that accurate valuations of swaps are provided on an ongoing basis. It will eliminate unnecessary reporting requirements, reduce reporting costs and improve data quality. And it will enhance the Commission's ability to trace swaps from execution through clearing.

We are also leading international efforts on data harmonization. And finally, we will continue to take enforcement actions to ensure that participants honor their reporting obligations.

De Minimis Threshold. Despite the need for more progress on data reporting, it's important to acknowledge how far we've already come. An important example of this is the preliminary report CFTC staff recently released on what is known as the "*de minimis* threshold" for swap dealing and major swap participants.

The *de minimis* limit was set by the CFTC and the Securities and Exchange Commission's joint rule defining swap dealers. If an entity engaged in swap dealing exceeds that threshold –which is currently $8 billion dollars in notional amount of swaps over the year – it must register as a swap dealer, in which case capital and margin requirements as well as disclosure, recordkeeping and other requirements apply. The rule also provides that at the end of 2017, that level will fall to $3 billion, unless the Commission takes action.

When our two agencies wrote the "*de minimis* exception" we did it with limited data.

But we now have a wealth of information that we can use to inform a discussion about what is the appropriate level at which to set the *de minimis* threshold. In November 2015, our staff issued a preliminary report that aims to start that conversation, by taking a fresh look at the issue. The staff's preliminary report does not make a recommendation as to what the level should be. It instead explores the issues, and invites public comment on the data, the methodology and the issues discussed.

The comment period on this study recently closed. We will now begin the process of carefully studying the feedback we've received, producing a final report, and making a decision on what, if any, action to take.

Priorities for the Months Ahead

The year ahead will also be marked by continued progress at the CFTC. Moving forward, an important part of our agenda will be to finalize the various proposals I have noted—in particular, cybersecurity and automated trading.

In addition, we will be taking action on a number of priorities that are important to this Committee.

Trade Options. Continuing with our effort to address end-user concerns, I plan to soon ask the Commission to adopt proposed rule changes related to trade options, which are a type of commodity options. This proposal would eliminate the obligations of commercial participants to report trade options to swap data repositories. It would include eliminating the requirement to file "form TO."

I strongly support finalizing this proposal. Trade options products are commonly used by commercial participants, and this relief will help them continue to do so efficiently. Many of the comments we received on the proposal were supportive, and several asked us to consider further eliminating some requirements on commercial participants. While I cannot speak for my fellow Commissioners, I am optimistic that we can be responsive to some of those requests, and hope this can be completed in the near future.

Related to trade options, we have also heard comments regarding peaking supply and capacity contracts. There has been some concern over the appropriate treatment of these products, which many end-users rely on to ensure they have the appropriate supply of commodities needed to run a business, manufacture a product, or generate electricity. I have asked CFTC staff to look at this. And while again, I cannot speak for my fellow Commissioners, I would support the Commission providing guidance or otherwise addressing this issue.

Continued Focus on Clearinghouse Resiliency. We will remain keenly focused on preventing excessive risk and promoting stability in the financial system. A primary focus here will be clearinghouse strength and resiliency generally. As you know, clearinghouses play a critical role in the global financial system – one which has only become more prominent since the enactment of Dodd-Frank. We have taken many actions already to address resiliency, but there is much more to do. There are considerable efforts going on domestically and internationally to look at a range of issues to make sure clearinghouses are strong and safe. This includes, in particular, stress-testing standards for CCPs, and recovery and resolution planning.

We are also chairing the international working group that is looking at a variety of issues, including stress-testing, margin methodologies, and capital and recovery planning. It also includes an examination of interdependencies among global clearinghouses. It's very important to do this in a manner that supports the liquidity of these markets.

On the subject of clearinghouses, let me note that last week, the Commission announced the approval of the registration of Eurex Clearing as a clearinghouse. Eurex Clearing is one of the largest clearinghouses in Europe, and we are pleased they

have registered with the CFTC. This is an important step forward to enhance global clearing and harmonization of derivatives rules.

In addition, we are continuing to work with the European Commission (EC) on the issue of "equivalence," so that European firms can continue to do business with our clearinghouses. I have always believed there is an ample basis for the European Commission to declare us equivalent.

It is important that a determination of equivalence happen soon, particularly because the European clearing mandate is scheduled to take effect in a few months, and it's vital that we avoid market disruption. I know my counterpart on the EC, Commissioner Jonathan Hill, shares that concern and wants to bring this to closure. So I'm hopeful they will act and a determination will be issued soon.

Cross-Border Margin Rule. Soon, I will ask the Commission to adopt the staff recommendation on the cross-border application of our new rules on margin for uncleared swaps. In June of last year, the Commission unanimously approved a proposal on this issue, an important component of our margin rule. It addresses risk that could be created outside our borders, but still could jeopardize our financial stability and our economy.

I believe our final rule will draw a reasonable line that makes clear when we should take offshore risk into account. As with our broader margin rule, our proposal also recognizes the importance of harmonizing rules with other jurisdictions.

Revised Capital Rule. In addition, the staff is working on updating our proposed rules related to capital requirements for swap dealers and major swap participants. As with the margin rules, we're working with our fellow regulators—in this case the

prudential regulators as well as the SEC—to harmonize these standards as much as possible.

Improving SEF Trading. Further, we will continue to focus on improving swaps trading.

Over the past two years, we have implemented a new framework for trading on regulated platforms. This is bringing greater transparency, better price information and greater integrity to the process. In fact, a recent paper put out by the Bank of England confirms that the improvements in transparency caused by trading on SEFs has led to lower costs and increased liquidity.

I'm very pleased that just a couple of weeks ago, the Commission announced permanent registration status for 18 swap execution facilities (SEFs) Indeed, the volume of SEF trading is growing. But there is more to do to fine tune our rules to improve SEF trading. Our goal is not just to implement the trading mandate in the law and achieves the basic goals of transparency, fairness and integrity in trading – but strive to create conditions in which participants want to trade on SEFs.

Over the past several months, we have taken action to ensure more flexibility regarding acceptable modes of execution. We have improved SEF confirmation practices and confirmation data reporting. We have clarified SEF capital requirements. We provided relief related to executing block trades and correcting erroneous trades. And we've issued no-action relief to provide market participants additional time to adapt to procedures for executing package transactions.

This spring, I will ask the Commission to consider changes to our rules to enhance trading and participation. I expect this will include formalizing a number of the "no

action" letters and guidance staff issued over the past 18 months through rulemaking proposals.

We will also consider some additional changes, such as the "made available to trade" – or MAT – determination process. This identifies products that must be traded on SEFs. Some market participants have suggested that the Commission play a larger role in this process, and we are considering it.

Finally, we will be looking at ways to harmonize our rules further with those of other countries. In particular, we are working with the European Commission, European Securities and Markets Authority and the Financial Conduct Authority regarding differences between our rules and European rules.

Europe's rules are still evolving, and have not yet been implemented. But I am hopeful that as their rules take shape, and as we look for ways to fine tune ours, we can work together to ensure greater harmonization.

Position Limits. In addition, the Commission continues to work on finalizing important rules related to position limits.

I know there is great interest in these rules – and some concern. None of us currently on the Commission were in office when these rules were proposed, and therefore we are taking time to listen to end users and other market participants and consider the proposals very carefully. This is particularly the case regarding concerns about bona fide hedging. We understand the significance of these rules to the ability of commercial end-users to continue to use the markets efficiently for risk management and price discovery.

We recently proposed to modify the aggregation provisions of the rules. These changes are designed to streamline the process for waiving aggregation requirements when one entity does not control another's trading, even if they are under common ownership.

We are also considering the possibility of further modifications, which would have the exchanges play a greater role in granting exemptions for non-enumerated hedges. We have discussed this at our advisory committee meetings and we are continuing to study it. We're also continuing to gather information on deliverable supply estimates so that limits are set appropriately.

Working to Implement New Congressional Changes. In addition, we have begun working to implement recently-enacted congressional changes related to indemnification and to "centralized treasury units" or CTUs. As you know, the law ensures that an end-user company that uses a CTU to streamline and manage all its derivatives activity would continue to be exempt from margin and clearing requirements that are designed for financial institutions. Congress also removed the requirement that other regulators seeking access to Swap Data Repositories (SDR) provide a written indemnification agreement to the SDR. And CFTC staff are working to incorporate these changes so as to facilitate data sharing. Moreover, we will continue to work with Congress on a CFTC reauthorization measure.

Enforcement

Finally, robust enforcement is vital to maintaining the integrity of our markets. It has been, and will remain, a priority.

Our enforcement division has continued to do an excellent job protecting customers, preventing fraud and manipulation – and holding entities accountable for

misbehavior. In the past year, we have brought or resolved actions related to integrity of benchmarks. We're working to identify new and improper behavior – such as spoofing – and have brought cases against bad actors for their attempts to manipulate the markets. We've confronted scams that target retirees, Ponzi schemes that target investors, illegal precious metals transactions, and fought for consumers whose customer funds were misappropriated.

Over the past fiscal year, the CFTC's total monetary sanctions topped more than $3.2 billion dollars. That number is more than 12 times the CFTC's budget for fiscal year 2015. And over the past five years, the Commission collected fines and penalties of approximately four times its cumulative budgets. We will continue to focus on robust enforcement.

Resources

Finally, let me just say that with the many things on our agenda, our desire to be responsive to the concerns of lawmakers, end-users and other market participants, is seriously impaired by our current level of resources at the CFTC.

We are very grateful for the increases we have previously received. Our fiscal year 2015 budget provided us an increase of $35 million over the previous year. This was essential to improving our ability to carry out our mission. We have used these resources judiciously to support a number of activities, including modernizing our information technology capabilities and bolstering our staff in critical areas.

But as you know, our responsibilities were greatly expanded after the crisis, and our markets have grown enormously in size, importance and technological complexity. Our budget is not commensurate with the scope of our responsibilities. As a result, it

has become increasingly challenging to carry out our duties at our current funding level.

For example, without sufficient funding, the CFTC cannot modernize its information technology and data collection systems sufficiently to keep up with the markets, nor hire the personnel necessary meet its responsibilities in a timely manner. As a result, the Commission will be less proactive, less flexible, and less responsive than we need to be. It hurts our ability to fine-tune rules appropriately, and it impacts our ability to perform our surveillance and enforcement duties in a thorough and efficient manner. This can have consequences for businesses, consumers and the broader economy.

Conclusion

Thank you again for inviting me today. Let me close by saying that I believe the United States has the best financial markets in the world. They are the strongest, most dynamic, most innovative, and most competitive — in large part because they have the integrity and transparency that attracts participants.

The CFTC is committed to working with you and doing all we can to further enhance those qualities. Thank you for your assistance in this work. I look forward to your questions.