

**Statement of Walter L. Lukken
President and Chief Executive Officer
FIA**

Chairman Dusty Johnson, Ranking Member Yadira Caraveo, 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. FIA’s membership includes clearing firms, known in the US as futures commission merchants (FCMs), exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries. FIA’s mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct.

Prior to FIA, I served as a CFTC Commissioner for seven years and as the agency’s Acting Chair for 18 months during the financial crisis and the last reauthorization of the CFTC during the 2008 Farm Bill.

I commend the Committee for continuing your important oversight function over the CFTC and applaud you for holding this hearing to consider the reauthorization of the CFTC. FIA strongly supports the reauthorization of this important agency. Reauthorization is an exercise in good government and provides a Congressional stamp of approval on the CFTC’s important mission and legal authority. It also provides the agency, and market participants, with greater certainty about the agency’s direction and priorities.

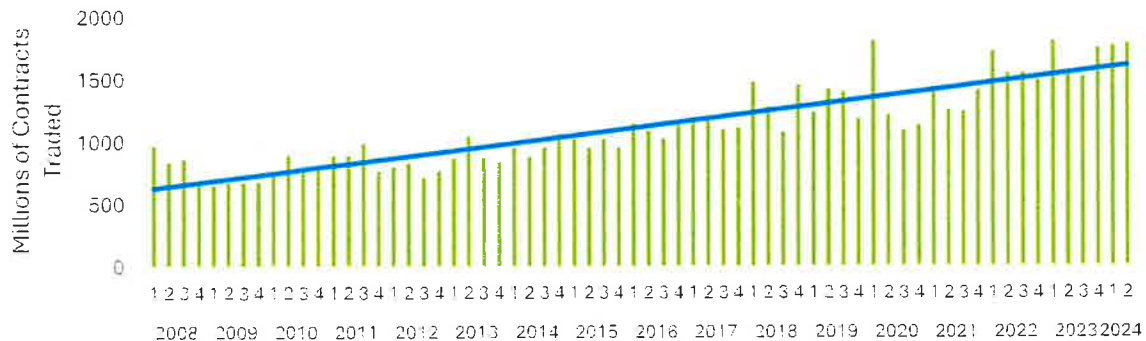
Today, I am honored to provide my counsel to this Committee once again as you deliberate CFTC reauthorization and changes to the Commodity Exchange Act (CEA).

The State of Our Markets

Our Markets Are Growing

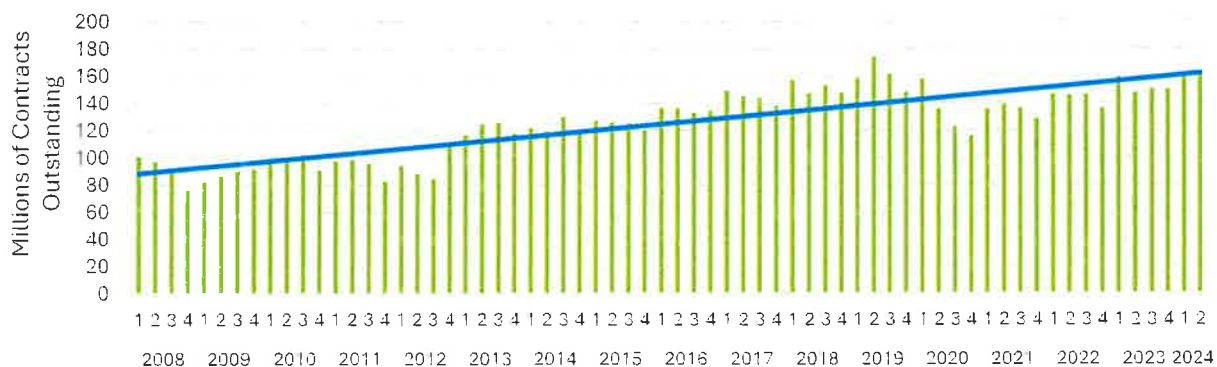
In the decade and a half since the last reauthorization in 2008, the futures and options markets have grown significantly. Total trading volume on CFTC-regulated exchanges in the US has nearly doubled from 3.4 billion futures and options contracts in 2008 to 6.6 billion in 2023. In fact, more contracts were traded on CFTC-registered exchanges in the first six months of this year than in all of 2008.

Trading volume on CFTC-regulated exchanges in the US has doubled since 2008



Open interest is another important metric for these markets because it is a general proxy for commercial hedging among participants. At the end of the second quarter of this year, open interest stands at more than 162 million futures and options contracts at the clearinghouses regulated by the CFTC, compared to 97 million at the same point of time in 2008. Strong open interest is a sign of a healthy market, so these trends are worth noting.

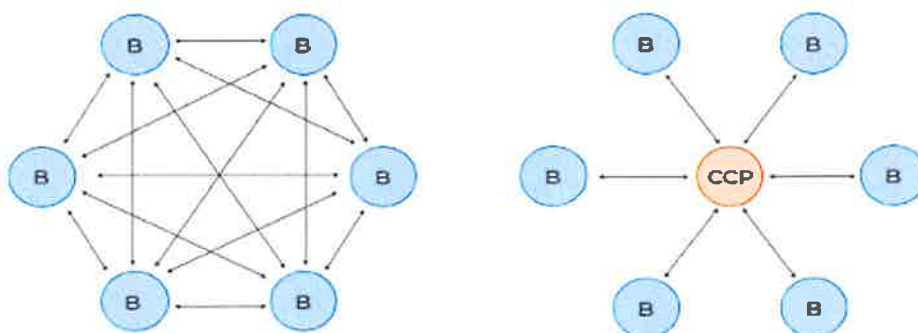
Open interest, which measures the risk transfer function of futures and options markets, is up over 67% since 2008



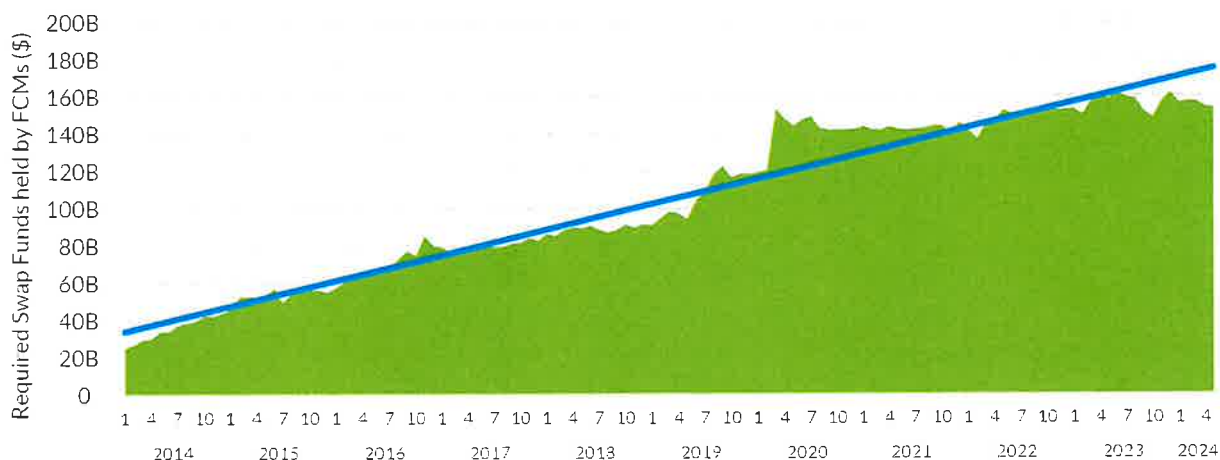
Our Markets Are Safer

After the 2008 financial crisis, regulators around the world recognized the need to move more over-the-counter derivatives into central clearing. They understood that central clearing is one of the most effective ways to make the financial system more stable and resilient. After Congress passed the Dodd-Frank Act in 2010, the CFTC implemented a new set of clearing requirements for standardized over-the-counter (OTC) interest rate and credit default swap instruments. Today, roughly 85% of the dollar denominated interest rate swap (IRS) market and roughly 60% of the credit default swap (CDS) market are cleared by central counterparties subject to CFTC oversight. That means all of those swaps are now risk-managed by FCMs and central counterparties, similar to the way futures markets have operated for decades.

Illustration of the Role played by Central Counterparties



As required by Dodd-Frank, a majority of the US OTC swaps has migrated to central clearing. Asset managers and other customers holding OTC swaps have deposited more than \$150 billion in collateral to cover the risks of these positions.



Our Markets Are Resilient

Several factors have introduced incredible volatility to global commodity markets in recent years, including the onset of COVID-19, the war in Ukraine, macroeconomic pressures including supply disruptions and inflation, and the global transition to a low-carbon economy. Effective operation through these powerful, real-world stress tests has demonstrated the resilience of our industry. Market participants have sought access to our markets to manage risk in a safe and regulated environment because of these pressures.

This Committee deserves a lot of credit for the strength of our markets. As noted above, the clearing mandates that were written into law by this Committee following the 2008 financial crisis have expanded the important role of FCMs and CCPs in reducing systemic risk in our markets. By working in partnership with the National Futures Association (NFA), the CFTC, and the broader industry over the last several decades, the cleared derivatives markets have remained robust and resilient despite the extreme market volatility and record trading volumes. And, importantly, end-users in the real economy never lost their ability to access these markets to manage risk and discover prices.

Our Markets Are Global

Just as producers need access to global markets to sell their physical commodities, they too need access to global derivatives markets to hedge risk in times of uncertainty. Knowing they can rely on well-regulated futures and options markets provides American farmers the protection from price volatility 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 US 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 both agricultural producers and consumers here in the US¹.

¹ In 2021 FIA took an in-depth look at cross-border flows and we determined that roughly 25% of the trading in CME's equity index futures and options came from outside the US. The ratio was 26% in energy, 30% in agriculture, and 45% in metals. The same held true for ICE Futures US. Approximately 34% of the volume in its agricultural contracts originated from outside the US.

Dating back to my time as a CFTC Commissioner and Acting Chair, and even prior, the derivatives markets have been global. Execution, clearing and settlement often take place in different countries and across different time zones and continents. And, since the last reauthorization, our markets have become even more global in nature. Market participants benefit from the global nature of our markets. The more participants, the stronger the market for those seeking to hedge risks.

FIA appreciates that Members of this Committee, including Ranking Member David Scott and Representative Austin Scott, among others, have worked over the years to engage policymakers in other jurisdictions to ensure a level playing field, reduce market fragmentation and improve collaboration between the CFTC and its international counterparts.

Our Markets Are Innovative

One of the most noteworthy provisions in the Commodity Exchange Act mandates the CFTC to promote fair competition and responsible innovation. There are very few other parts of the federal government with such an explicit mandate. I think this has benefited the CFTC throughout its history and something to keep in mind as you consider reauthorization.

The US derivatives markets are nimble, allowing growth and innovation. This is evidenced by the pace of new and novel contracts being listed on our markets today. There are futures contracts based on battery metals such as lithium and cobalt - crucial components for the electric vehicle industry. There are futures on bitcoin and ether, the two most heavily traded crypto currencies. There are the so-called "ultra" Treasury bond and note futures, which have given asset managers and other institutional investors more ways to hedge their interest rate risks.

Another example is the expanded range of crude oil futures. In 2008, the US was a net importer of crude oil. Today we are a net exporter, thanks to gains in the productivity of the US oil industry. The futures industry has responded by developing new futures contracts based on prices at the export terminals along the Gulf Coast. Those contracts are expressly designed to help companies hedge price risks on international flows of oil.

The biofuels market offers another example. According to the US Department of Agriculture (USDA), approximately 20% to 25% of all soybean oil produced in the US is sold to refineries and converted into renewable diesel. Companies throughout the supply chain use the well-established futures based on soybean oil and heating oil to hedge the risks in this new and rapidly growing alternative to fossil fuels.

These are just a few examples of the agility, market responsiveness and innovative spirit that has long characterized the US futures industry and will continue to characterize the industry for years to come.

Priorities for Committee Oversight of CFTC

This committee plays a crucial role in the oversight of the CFTC as novel and emerging trends present themselves. As the agency's authorizing body, this committee can provide guidance and Congressional intent to the agency's rulemaking authority as it considers these evolving trends. I want to highlight some of the topics worthy of your attention.

Evolving Market Structures

Historically, the regulation of the futures markets, as directed by the Commodity Exchange Act, has been by functional registration category. The statute, and its implementing regulations, require market participants who take on certain responsibilities to register in various categories.

Exchanges that bring together buyers and sellers and self-regulate their markets are required to register as designated contract markets (DCMs). Clearinghouses, with their obligations to protect the financial integrity of the system, are required to register as designated clearing organizations (DCOs). Clearing members, those firms that guarantee and safeguard customer funds and serve as their agents, are required to register as futures commission merchants (FCMs).

Given these targeted responsibilities, these registrants have historically been housed in independent legal entities. Increasingly, however, we are seeing more exchanges and clearinghouses that are embedding an FCM within their legal structure.

CFTC Chairman Rostin Behnam has recognized this trend and has indicated his desire to address this issue by rulemaking this fall. He testified before this Committee in March,² highlighting that “we are seeing a shift to structures, driven by technology, that combine or compress what have historically been unique and separate activities into a single or fewer entities. This compression raises many important questions including those regarding conflicts of interest within vertically integrated structures.”

FIA has a long history of supporting innovation in the derivatives industry. FIA also strongly believes in the fundamental regulatory principle: same business, same risks, same rules.

In our May 2022 comment letter³ about the FTX US Derivatives application before the CFTC, which sought to combine several market functions into a single entity, we identified fundamental principles of the derivatives regulatory oversight structure that they could not adequately address. These include principles of segregation of customer funds, conflicts of interest of those entrusted with market operations and customer funds, financial resourcing and capitalization of market operators, appropriately planned and sized default resources, and safeguards of key market operations.

FIA has strong concerns that collapsing the existing multi-tiered ecosystem—with its inherent checks and balances and customer protections—could undo the strong foundation of the listed derivatives markets and, ultimately, put customers at risk. We want to make sure end-users, including those in the agricultural and energy sectors, will continue to have the same protections as customers are guaranteed today.

FIA welcomes Chair Behnam’s desire to establish a strong regulatory regime to cover conflicts originating from affiliated entities serving multiple functions within these vertically integrated structures.

Emerging Technology and Artificial Intelligence (AI)

The Commission’s principles-based regulatory framework and flexible approach to regulation has a proven track record when it comes to protecting customers, promoting innovation and preserving market integrity. Regulators and policymakers are rightfully exploring potential uses and risks of emerging technology, such as AI in the derivatives markets that the CFTC regulates and beyond.

² <https://agriculture.house.gov/calendar/eventsingle.aspx?EventID=7732>

³ <https://www.fia.org/sites/default/files/2022-05/FIA%20FTX%20Request%20for%20Amended%20DCO%20Registration%20Order%205.11.22.pdf>

In January 2024, the CFTC Divisions of Market Oversight, Clearing and Risk, Market Participants, and Data and the Office of Technology Innovation issued a request for comment (RFC) to better inform them about AI.

FIA believes⁴ the existing statute and CFTC rules and guidance provide the controls and oversight needed for the Commission to promote and protect the integrity and resilience of our markets. FIA urges the CFTC to take a "technology-neutral" approach and focus on achieving regulatory outcomes, rather than attempting to regulate the technology itself, moving forward.

US Bank Capital Proposals

On July 27, 2023, the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation - together, the US bank regulators – proposed the Basel III endgame capital framework and, separately, the Federal Reserve requested comment on a proposal that would make significant adjustments to the calculation of the global systemically important bank holding companies surcharge. These proposed rules⁵ represent a comprehensive rewrite of the regulatory capital standards for the biggest US banks.

While outside the jurisdiction of the CFTC, these rules will harm the CFTC-regulated derivatives markets and the end-users that rely on them. FIA contributed to a report and a set of recommendations⁶ adopted by the CFTC Global Markets Advisory Committee (GMAC) at a recent June 2024 meeting.

The report highlights excerpts from the formal comment letters filed by the users of derivatives markets noting concerns about the proposals, including agriculture, energy, insurance, pension funds and others.

We also commend CFTC Chairman Rostin Behnam for his comments in public testimony before this Committee in March 2024, emphasizing the need to “create incentives” for clearing and committing to working with his prudential regulators to ensure new bank capital rules are not “creating unnecessary barriers to clearing and clearing services for end users.”

Treasury Clearing

In December 2023, the Securities Exchange Commission (SEC) adopted final rules that will require most market participants to clear US Treasury (UST) repo and cash security transactions in the secondary market. While these transactions are not futures contracts, our industry and its participants utilize treasury securities and repo contracts every day in the collateralization, settlement and cash management of futures positions. Our industry is also exploring whether it can take a more direct role in the clearing of these products given the similarities to the futures and swaps markets.

The SEC’s clearing mandate may seem familiar to committee members who were involved in the Dodd Frank Act that mandated the clearing of OTC derivatives after the financial crisis. Both efforts aimed to move these bilateral, trillion-dollar markets to a client, all-to-all cleared market. In other words, the futures market model. That our markets act as the model for reform demonstrates the importance of our efficient, transparent business practices as an industry.

⁴ <https://www.fia.org/sites/default/files/2024-04/FIA-FIA%20PTG-CME-ICE%20Response%20to%20CFTC%20AI%20RFC%204.24.pdf>

⁵ <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm>

⁶ <https://www.cftc.gov/PressRoom/PressReleases/8918-24>

The incumbent, DTCC's FICC, has made the most progress to date, having filed several rules with the SEC to build the framework for its clearing model with more rules to come in the fall. CME and ICE also have publicly announced an interest in providing cash treasury clearing.

FIA finds this competition healthy because it will sharpen the discussions with the end users in mind. We believe we have the expertise and experience to offer in how "done away" client clearing models will work, given their similarity to the agency give-up clearing model of the futures markets.

There are challenges ahead that may require this Committee's attention. The CFTC and SEC will need to work together to ensure that the Treasury clearing mandate does not conflict with CFTC regulations. Both agencies are working collaboratively to address these concerns.

The second issue is the timeline. Several workstreams need to be addressed before the first deadlines come into place, including capital, accounting, cross-margining, risk and credit controls and netting. Implementing this mandate before June 2026 will be a heavy lift, especially considering the importance of the Treasury and repo markets to the funding of the government and financial markets. Regulators will need to be flexible and aligned with industry to ensure realistic timetables.

Our industry will keep this committee abreast as this critical rulemaking is implemented.

FIA Views on CFTC Reauthorization

Overall

As noted earlier in my testimony, our markets have demonstrated incredible resilience given the onset of COVID-19, the war in Ukraine, weather and energy disruptions in the US and abroad, and the commodity market volatility associated with these events. Throughout all these events, the US regulatory framework has proved itself as a source of strength for our markets, and the global clearing system has worked as intended, minimizing the counterparty risk that we witnessed during the crisis of 2008.

As a result, FIA does not believe a broad CFTC reauthorization bill is needed now. Rather, a bill that provides a Congressional stamp of approval on this agency's important mission and legal authority, and that acknowledges the CFTC's proven track record through a period where we have seen record market volatility, is the best approach.

Customer Protection

FIA joins the NFA in supporting legislative clarification to resolve legal uncertainty in FCM 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.

Expanding Access to Educational Resources for Small and Mid-Size Farmers

Today's farmers and ranchers are incredibly savvy businesspeople. They want to offset their risk where possible. But they have a lot on their plates. And that's before the food reaches our plates.

FIA supports efforts to expand educational resources about the opportunities and risks of risk management tools like futures and other cleared derivatives. It would go a long way to helping the 2% that feed the 98% - particularly for the small and midsize farmers, producers and end-users.

During a March 2023 full committee hearing titled “Rising Risks: Managing Volatility in Global Commodity Derivatives Markets,” FIA’s board chair, Alicia Crighton, received a question from Representative Jasmine Crockett about a USDA report from October 2020 that raised concerns about a low percentage of farmers using futures or options to hedge price risk.

FIA took interest in this report and encourages this Committee to consider whether opportunities exist – perhaps through CFTC reauthorization or another vehicle - to expand the manner in which the CFTC might leverage funding through the CFTC Office of Customer Education and Outreach (OCEO) to partner with not-for-profits, private sector educational initiatives or other government entities, like the USDA. Educational resources should be used to highlight both the opportunities and the risks of risk management tools like futures and options.

We believe this may address the concerns raised by Representative Crockett and provide additional resources to farmers during a time when they have experienced, and continue to experience, considerable volatility in their markets.

Modernizing the CFTC

The last CFTC reauthorization was enacted the same year Apple launched its App Store. The technological advancements by market participants have been incredible since that time.

According to former Chairman of the CFTC Christopher Giancarlo, “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.”⁷

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, 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.

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 reforms to the CEA that strengthen our markets.

⁷ <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo70>