Testimony of Chairman Timothy G. Massad before the U.S. House Appropriations Committee Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies
Washington, DC
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Good morning, Chairman Aderholt, Ranking Member Farr and members of the Subcommittee. I am pleased to testify before you this morning on behalf of the Commission regarding the President's request for the fiscal year (FY) 2016 budget for the Commodity Futures Trading Commission (CFTC).

The Commission has been very busy since I and two other Commissioners joined this past summer. We have worked to make sure that commercial end-users can continue to use the derivatives markets effectively and efficiently. We have continued to work to bring the over the counter swaps market out of the shadows and implement the regulatory reforms mandated by Congress. We have worked closely with our international colleagues toward harmonizing new swaps rules as much as possible. We are continuing to engage in the compliance, surveillance, and enforcement work that is necessary to prevent fraud and manipulation and enhance market integrity and transparency. And we are continuing to engage in registration of market participants and other activities to make sure these markets serve our economy. But there is much more we need to do.

Before discussing our budget request, I know I speak for all the Commissioners in first thanking our staff for their hard work and dedication. The progress we have made is a credit to their tireless efforts. I also want to thank each of my fellow commissioners for their efforts and commitment. I believe we are working together in good faith to do the best job we can in implementing the law and carrying out the Commission's responsibilities.

Our current FY 2015 budget provides an increase of $35 million over the previous year. This increase was essential to our ability to carry out our mission. We are grateful for it. We have outlined in our FY 2015 Spending Plan how we will use these resources, which will include modernizing our information technology capabilities and bolstering our staff in critical areas.

Even with this increase, however, the CFTC's budget is not at a level that is commensurate with the responsibilities Congress has assigned. The Commission's responsibilities were substantially increased by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). This gave the Commission primary responsibility for the oversight of the over-the-counter swaps market, an over $400 trillion market in the U.S., measured by notional amount.

In addition, the markets the Commission has traditionally overseen have grown in scale, technological sophistication, and complexity. The number of actively traded futures and options contracts has doubled since 2010 and increased 6 times over the last ten years. Trading is increasingly conducted in an automated, electronic fashion, and cybersecurity has become a major new threat to the integrity and smooth functioning of the critical market infrastructure that the Commission regulates. While these developments, among others, have brought new responsibilities and challenges to the Commission, its capabilities have not kept pace. Our resources continue to be stretched far too thinly over many important responsibilities.

The derivatives markets are profoundly important to a wide variety of businesses in our country. They enable businesses of all kinds to hedge commercial risk, whether it is a farmer locking in a price for his crops, a utility hedging the cost of fuel or an exporter managing foreign currency risk. Those businesses depend on the Commission to do its job efficiently and sensibly. The Commission's budget is a small, but vital, investment to make in order to make sure these markets operate with integrity and transparency.

It is also helpful to remember how excessive risk related to swaps contributed to the 2008 financial crisis, and the cost of that crisis to American families and our economy, to recognize the value of this investment. That crisis resulted in eight million jobs lost, millions of foreclosed homes, countless retirements and college educations deferred, and businesses shuttered. Indeed, the amount of taxpayer dollars that were spent just to prevent the collapse of AIG as a result of excessive swap risk was over 700 times the size of our budget. Another perspective on the size of our budget is the fact that from 2009 through 2014, the Commission collected fines and penalties of approximately twice its cumulative budgets. This year the fines and penalties collected are already over 6 times our budget.

The CFTC's Budget Request for FY 2016

The Commission requests a budget of $322 million and 895 full-time equivalents (FTE) for FY 2016. The Commission's request is an increase of $72 million and 149 FTE over the FY 2015 enacted level. This will enable us to engage in the following critical activities, among others, in support of our mission:

- Enhance our surveillance and enforcement capabilities to keep pace with our expanded oversight responsibilities and the overall growth and increasing complexity of the derivatives markets.
- Enable us to perform on a timely and thorough basis the examinations of critical market infrastructure, such as exchanges and clearinghouses, as well as intermediaries that hold billions of dollars in customer funds, to ensure that they are protecting customer interests and operating in compliance with Commission requirements.
- Enable us to review and provide timely responses to requests and concerns of derivatives market participants, including with respect to new product approvals and other innovations.
- Substantially expand our capabilities with respect to cybersecurity, which is the single most important threat to financial stability today.
- Make key investments in technology systems and resources that are vital to carry out our core mission activities.

We appreciate that this is a time of difficult budget choices. To that end, we have been and will continue to be prudent stewards of taxpayer dollars, and we are focusing our resources on the key activities that will strengthen and enhance the markets we oversee.

The 2016 Estimate Advances Key Commission Priorities

The 2016 Budget Request is focused on advancing key mission priorities. Of the requested $72 million increase, nearly $28 million is allotted for additional information technology investments that will help to modernize the Commission's capabilities. This would supplement the approximately $51 million we plan on spending on technology in FY 2015. The remaining $44 million of the increase would provide for an additional 149 FTE for related mission-activity support, specifically targeting critical areas such as surveillance, enforcement, examinations, registration, and compliance.

Surveillance

The 2016 Budget Request seeks $62.4 million for surveillance, an increase of $5.9 million and 42 FTE over the FY 2015 enacted level The Commission must enhance its surveillance capabilities to keep pace with the growth and increasing technological sophistication of the markets. Effective surveillance is essential to detect excessive risk, fraud, abusive practices, and manipulation.

The days when market surveillance could be conducted by observing traders in floor pits are long gone. Today, not only is almost all trading electronic, but in many products a majority is conducted through highly sophisticated automated trading programs. The Commission is responsible for overseeing the markets in over 40 physical commodities, as well as a wide range of financial futures and options products based on interest rates, equities, and currencies. There are over 4000 actively traded futures and options contracts, and thousands more subject to our oversight when all tenors and associated options are included. On a typical day, there may be 750,000 transactions in Treasury futures and more than 700,000 in just the E-mini S&P 500 contract, the most active equity index future. And this does not include the approximately 7 million open swaps reported to SDRs. In just a single commodity category such as crude oil, there are typically hundreds of thousands of transactions every day. Transactions are only part of the picture, however. In today's high speed markets, manipulation and fraud are often conducted using complex strategies involving bids and offers, which far outnumber consummated transactions. Each day in the Treasury futures market, for example, there can be millions of bids and offers.

Successful market surveillance activities require us to have the ability to continually receive, load, and analyze large volumes of data. This requires a massive information technology investment, sophisticated analytical tools that we develop for these unique environments, and experienced professionals who can identify potential problems and engage in further inquiry.

Moreover, the $400 trillion swaps market presents different challenges than the futures and options market with respect to surveillance. This is because there are multiple trading platforms so data must be analyzed across platforms. There is also considerable voice-driven activity and complexities to the execution and processing of trades that do not exist in the vertically integrated futures markets that require different surveillance perspectives. Aggregating data to understand participants' positions across futures and swaps markets is particularly challenging.

Whether in futures, options, or swaps, market surveillance is not simply dependent on sophisticated technological systems. We must have experienced personnel who understand the markets we oversee, who can discern anomalies and patterns and who have the experience, judgment, and skills to investigate possible infractions. There is great variation among the various products traded in our markets variation, which requires specialized knowledge: the market structure, trading patterns, and complexities of the crude oil market are quite different from that of soybeans or any other agricultural product, and each agricultural product itself has its own characteristics.

In addition to market surveillance, the Commission must oversee the risk being taken on by individual clearing firms by continually monitoring their customer and house positions and margining practices. Given the global nature of our markets, our surveillance personnel examine data from clearinghouses abroad and communicating frequently with regulators in other jurisdictions. This financial and risk surveillance function also looks through the intermediaries at large customer positions and aggregates customer data across clearinghouses. Today, for example, 36 firms hold more than $500 million each in customer funds, and 10 of these firms hold more than $10 billion each in customer funds. Failure or trouble at any one firm, particularly a larger firm, could seriously disrupt our markets. On site examinations are an important component of adequate surveillance, but they can only be conducted infrequently given the small size of our staff.

Without the requested increase in surveillance personnel and resources, the Commission will be severely limited in its ability to detect fraud and manipulation, market abuses, firms in trouble, or other improper behavior, thereby significantly increasing the potential costs and risks to our markets and our financial system generally.

Enforcement

The Commission requests approximately $70.0 million and 212 FTE for enforcement activities, an increase of $20.7 million and 48 FTE over the FY 2015 enacted level. There is nothing more important to maintaining market integrity and protecting customers than a robust enforcement program. The Commission pursues cases covering a wide variety of potential market abuses and bad behavior, ranging from traditional Ponzi schemes or precious metal scams that target retirees, to complex manipulation schemes driven by sophisticated, electronic trading strategies, to price fixing or benchmark manipulation through collusion among large traders. The markets we oversee continue to grow in size and sophistication, and our enforcement resources are increasingly stretched. For each case the Commission initiates, there are many that we cannot investigate because of resource constraints.

Some cases can require large amounts of resources due to their inherent complexities, document-intensive nature or the ability of resource-rich defendants to prolong litigation. A recent case that arose as a result of the Peregrine fraud, for example, more than two years and has required more than 4800 hours of staff time. The MF Global litigation is ongoing, more than 3 years after the firm collapsed. The LIBOR and foreign exchange benchmark cases – in which the Commission obtained an aggregate of $3.25 billion in penalties against several of the world's largest banks for colluding to fix or manipulating these benchmarks – involved intensive reconstruction of communications and trades requiring substantial document and email reviews. There will always be hard choices to be made in prioritizing matters for investigation and pursuit, but the Commission's enforcement resources today are simply not commensurate with the scale and complexity of the markets it oversees.

In particular, the Commission anticipates more time-intensive and inherently complex investigations due to innovative products and practices within the industry, including the use of automated and high frequency trading, and the global nature of the swaps marketplace. We are also experiencing an increase in international enforcement investigations in all of our markets (the most significant being the international benchmark rate rigging cases). At the same time, we must do all we can to deter unscrupulous fraudsters who target unsuspecting investors through scams, tricks and schemes.

Although the effectiveness of our enforcement efforts is best measured by the quality, breadth and effect of the cases pursued, quantitative metrics give some picture of the activity. The CFTC filed 67 new enforcement actions during fiscal year 2014. We opened more than 240 new investigations. The agency obtained $3.27 billion in sanctions, including $1.8 billion in civil monetary penalties and more than $1.4 billion in restitution and disgorgement. An increase in our enforcement efforts is a good use of taxpayer dollars, especially when considered against the cost of failing to provide adequate resources for enforcement. That cost is measured by the abusive and fraudulent behavior that goes unpunished or is caught too late. It is the loss to consumers whose customer funds are misappropriated, or to retirees whose savings are stolen through scams, or to our economy, when the efficiency and integrity of our markets is damaged by manipulation and fraudulent trading.

Examinations

The Commission requests $35.4 million and 135 FTE for examinations, an increase of $6.7 million and 21 FTE over the FY 2015 enacted level. Regular examinations, in concert with the Commission's surveillance and other activities, are a highly effective method to maintain market integrity so that American businesses can rely on these markets. This activity includes direct examinations performed by Commission staff and oversight of examinations performed by the self-regulatory organizations.

Among the most important examinations that the Commission conducts are those of clearinghouses, which have become critical single points of risk in the global financial system. Two clearinghouses under the Commission's jurisdiction have been designated as systemically important, and the Commission is responsible for twelve others. Five clearinghouses are located overseas, including some that are that are extremely important to our markets given the volume of swaps and futures cleared for U.S. persons. The Commission examines the two systemically important clearinghouses once a year; it lacks the resources to engage in more frequent or in-depth examinations or even to examine all the other major clearinghouses annually.

Although there is obviously great variation, today an annual clearinghouse examination may involve most of the time of an interdisciplinary team of eight to ten professional CFTC staff for the better part of six months. The resource requirements in terms of staff and time for a clearinghouse that has been designated as systemically important are greater because these entities must comply not only with CFTC regulations, but also with additional prudential standards.

The Commission is also responsible for examining other critical infrastructure in our financial markets, including 15 active exchanges, 22 swap execution facilities, and 4 swap data repositories. These examinations are an important investment in the safety and integrity of our financial and commodity markets.

Moreover, cybersecurity is a major risk to our financial system today, and therefore we must devote greater resources to this important challenge. We must engage in more frequent and more in-depth examinations to assess the readiness of these institutions to meet these challenges. We must also be able to respond quickly as threats arise to better understand and mitigate such threats.

We must also engage in regular examinations of clearing firms. Recent failures of a few firms, such as MF Global and Peregrine Financial, underscore the importance of such examinations. Current market conditions like low interest rates and low volatility have increased the risk profiles of many of these firms. And concentration in the industry means that today only 20 firms hold $211 billion in customer funds, or approximately 92 percent of total customer funds for the futures and cleared swaps industries. The Commission must examine whether clearing firms employ effective risk management techniques, have appropriate compliance monitoring and retain adequate levels of liquidity.

There are other entities that the Commission is responsible for examining, such as swap dealers. The recent volatility in the Swiss franc underscores the importance of examining retail foreign exchange dealers. We must be able to conduct not only annual or periodic examinations, but also other reviews triggered by unexpected incidents so that we can address the concerns of the businesses and individuals who use these markets. Without the requested level of funding, the CFTC will lack sufficient resources to conduct these examinations, which puts the markets and market participants at risk.

Registration and Compliance

The Commission requests $17.8 million and 63 FTE for registration and compliance activities, an increase of $1million and 3 FTEs over the FY 2015 level. The Commission's ability to analyze registrations in a timely and thorough manner is critical to market efficiency and confidence. The Commission's responsibilities have greatly expanded in this area, as there are over 20 SEFs and over 100 swap dealers provisionally registered. In light of the increasing globalization of the markets and changes made in Dodd-Frank, the Commission has applications for registration from 21 foreign boards of trade. The Commission is also considering applications for registration from five DCOs, and must begin to review petitions for exemption from DCO registration from several foreign clearinghouses this year. We expect to see additional applications in the future.

The Commission must also be able to respond to product and market innovation by carrying out registration reviews efficiently. A lack of adequate funding impairs the Commission's ability to attract and retain the experts who understand the markets and who are needed to review registrations and carry out compliance oversight in a timely and thoughtful manner, and can result in delay, ineffective customer protection, regulatory uncertainty, and higher legal and compliance costs for registrants– severely impacting the efficiency, integrity, and attractiveness of our markets.

Data and Technology

The 2016 Budget Request includes $108 million for the data and technology mission area, consisting of $79 million for information technology investments (*e.g.*, hardware, software, and contractor services), and approximately $29 million for staffing and other indirect costs. This is an increase of approximately $28 million from the FY 2015 level. Data and technology accounts for almost 40 percent of the agency's requested $72 million budget increase. Of the $108 million, $45 million represents amounts directly attributable to particular functional activities and $63 million is data and technology support.

The Commission's data and technology budget comprises several elements. We must expand our data operations and collections systems to meet our vastly expanded data collection responsibilities as well as the increasing technological complexity of our traditional markets. Data, and the ability to analyze and report data, are more important than ever in the derivatives markets and in CFTC's ability to oversee those markets; therefore, data understanding and ingestion is the priority for the Commission's resources. We currently receive over 300 million records per day, and our data needs (intake, storage) are increasing annually by 35 percent.

The Commission must be able to aggregate various types of data from multiple industry sources, such as DCMs, SEFs, SDRs, and DCOs across multiple markets (*e.g.*, futures, exchange-traded swaps, and off-exchange swaps). The increasing complexity, volume, and interrelations of the data set will require significantly more powerful hardware such as high performance computing systems to support business analytics.

Our infrastructure and services must also be expanded to support the growth in the agency. This includes basic computing, printing, voice, and data communications, and it requires expansion of storage, server, telecommunications, and network capacity; implementation of DHS-mandated cybersecurity measures; and a refresh of end-of-life equipment. We must also enhance our operations, platforms, and systems across all divisions. This includes legal, technology systems, and forensics support systems for enforcement as well as surveillance systems. It includes business process automation systems, public website operations, and management and administrative support systems.

Without the requested level of funds, the Commission will not have sufficient capabilities to fulfill the critical mandates of the agency, directly impacting the Commission's ability to protect market participants from fraud, manipulation, and abusive practices, and to protect the public and the U.S. economy from systemic risk.

Conclusion

The Commission is grateful to this subcommittee for the increases it has received and will continue to carry out its responsibilities as best it can with the resources it has. But with the current level of funding, the Commission cannot fulfill all of its new duties and continue to meet its traditional ones in the timely and thorough manner that the American people deserve and expect. Our responsibilities have substantially increased, and the markets we oversee are increasingly complex. Simply put, without additional resources, our markets cannot be as well supervised, participants and their customers cannot be as well protected, and market transparency and efficiency cannot be as fully achieved.

The 2016 Budget Request is designed to enable the Commission to continue making progress fulfilling its responsibilities to the American public to oversee our nation's futures, options, and swaps markets, so that we help make sure our markets continue to thrive and contribute to economic growth into the future.

I look forward to answering any questions you may have.