

**SUBMITTED WRITTEN TESTIMONY OF
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BEFORE THE
U.S. HOUSE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON AGRICULTURE, RURAL DEVELOPMENT AND RELATED
AGENCIES**

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Thank you, Chairman Aderholt, Ranking Member Bishop and Members of the Subcommittee for the opportunity to testify before you today on the Commodity Futures Trading Commission (“Commission” or “CFTC”) FY 2019 Budget Request.

For more than a century, U.S. businesses have relied on the derivatives markets to hedge their cost of production. These markets have allowed farmers and ranchers to hedge their costs of production and delivery price so that Americans can always find plenty of food on grocery store shelves. The derivatives markets influence the price and availability of heating in American homes, the energy used in factories, the interest rates borrowers pay on home mortgages and the returns workers earn on their retirement savings. More than 90 percent of *Fortune* 500 companies use derivatives to manage commercial or market risk in their worldwide business operations. In short, derivatives serve the needs of society to help moderate price, supply and other commercial risks to free up capital for economic growth, job creation and prosperity.

The FY 2019 budget submitted by the Commission reflects the true needs of a policy setting and civil law enforcement agency that has the duty to ensure the derivatives markets operate effectively. At a time in history when the nature of our financial markets are rapidly transforming, as digital technologies are having an increasing impact on everything in the early Twenty-First Century from information transfer to retail shopping to personal communications, this budget will provide the Commission with the resources it needs to put in place and oversee responsible regulations that allow for innovation and enable our markets to remain competitive and safe at home and abroad.

Just as the Industrial Revolution changed the world within years and decades, the current technological revolution is now changing our world every day, with time compressing years into days, and days into minutes. Therefore, we must reset our own thinking and shape an appropriate regulatory response.

In order for the CFTC to fulfill its duty to oversee these vital derivatives markets in FY 2019, the Commission is requesting \$281.5 million and 716 full-time equivalents (FTE.) This is an increase of \$31.5 million and 46 FTE over the resources provided under the *Further Extension of Continuing Appropriations Act, 2018*, P.L. 115-123, and is the same level of funding that the Commission requested in FY 2018.

When I appeared before this subcommittee last year, I spoke about my approach to budgeting. In the private sector, we would never simply take last year's budget number and add a percentage increase. Rather, each dollar requested had to serve a purpose. So, when I sat down with our leadership team, my budget baseline was zero. I pledged to carry out the Agency's mission to foster open, transparent, competitive and financially sound markets, free from fraud and manipulation, in a way that best fosters broad-based economic growth and prosperity while respecting the American taxpayer through careful management of our agency resources.

The Commission's budget request for FY 2019 reflects and builds on the efforts from 2018. I believed then and I believe now that \$281.5 million is the level of funding necessary to fulfill our statutory mission.

21ST CENTURY TECHNOLOGY

Technology is impacting trading, markets and the entire financial landscape with far ranging implications for capital formation and risk transfer. These technologies include machine learning and artificial intelligence, algorithm-based trading, data analytics, "smart"

contracts valuing themselves and calculating payments in real-time and distributed ledger technologies, which over time may come to challenge traditional market infrastructure.

It is no surprise that these technologies are having an equally transformative impact on U.S. derivatives markets. One thing is certain: ignoring these changes in the market would be a disaster. They will not go away. Nor is it a responsible regulatory strategy. As the axiom of Moore's Law¹ states, technological power doubles about every 18 months. We must not respond in a reactive way; chase to catch up with technology. We must be proactive with a regulatory and statutory framework that is ahead of the curve, prevents and punishes fraud and criminality, gives clarity and coherence to this dark and often inaccessible technology, and anticipates the evolution of virtual currencies. The same technology can give us advantages in market regulation. Our task, as market regulators, is to set and enforce rules that foster innovation while promoting market integrity and confidence.

We are at the juncture of changing times and the American public deserves a well-equipped regulator overseeing these vital markets

AGENCY REFORM AND THE KISS PROJECT

Since I became Chairman, I have made efforts to normalize operations and practices, and found opportunities to reinvest and maximize current resources. That means a return to greater care and precision in rule drafting; more thorough econometric analysis; and a reduced docket of new rules and regulations to be absorbed by market participants. The CFTC has embraced the Administration's directive that each federal agency minimizes the costs borne by their regulation. The KISS initiative I launched last March included a review of rules and processes, and the invitation for public comment to collect ideas on how we can be a more effective regulator. The effort has produced a tiered list of significant efforts² the Commission is undertaking that will lessen regulatory burden. Recently, we released³

¹ *Moore's Law and the Future of Information Technology*, Reviewed, Tyler Wells Lynch , September 03, 2013

² Remarks of CFTC Chief of Staff Michael Gill at the National Press Club, CFTC Kiss Policy Forum, Washington, D.C. February 12, 2018

³ Giancarlo: We're Making Government Function More Efficiently for Taxpayers and Market Participants, February 15, 2018

notification on the proposed replacement for the complex and confusing lettering for defined terms with a simple alphabetical list. The replacement will remove unnecessary complexity from our rules and should help to make regulatory compliance less burdensome.

Internally, I have embraced the Administration's Reform Plan concept and have implemented in-depth organizational reviews to ensure that as an agency, we are staffed and providing the most effective services to the American tax-payer. This is an on-going effort but it has already borne results. We are now leveraging knowledge gained from enforcement actions and surveillance efforts to enable the provision of more efficient, and timely consumer education materials to the public. The Primer on Virtual Currency, Bitcoin webpage, and podcasts are just a few of the initiatives resulting from these efforts.

ECONOMIC MODELING AND ECONOMETRIC CAPABILITIES

The budget request, if met, would boost the CFTC's analytical expertise and monitoring of systemic risk in the derivatives markets, especially with central counterparty clearinghouses. These investments include the expansion of sophisticated econometric and quantitative analysis devoted to risk modeling, stress tests, and other stability-related evaluations necessary for market oversight. Furthermore, such analysis conducted by the CFTC will aid in rulemaking, policy development, and enhance the Commission's ability to provide high-quality cost benefit considerations for decision-making.

INCREASED EXAMINATIONS OF CLEARINGHOUSES

The Commission expects the number of designated clearing organizations (DCOs) to continue to increase in FY 2019, with many expanding their business to other jurisdictions around the world. As the number of DCOs increase, the complexity of the oversight program will increase. It is imperative that the Commission strengthen its examinations capability to enable it to keep pace with the growth in the amount and value of swaps cleared by DCOs pursuant to global regulatory reform implementation. As the size and scope of DCOs increase, so too has the complexity of the counterparty risk management oversight programs and liquidity

risk management procedures of the DCOs under CFTC regulation here and abroad. In addition, funding will also enable the Commission to enhance its financial analysis tools used to aggregate and evaluate risk across all DCOs.

CYBER SECURITY

Cyber security is critically important to protecting infrastructure and financial markets around the world. I feel strongly that it is the most important single issue facing our markets today in terms of market integrity and financial stability.

As market leaders and regulators, we must take every step possible to thwart cyber-attacks on the world's financial markets. The cyber threat must take priority, which is why we will devote more resources to cybersecurity in FY 2019. Threats and attacks occur on DCOs regularly. Vulnerabilities are continually discovered that require the Commission to analyze the vulnerability, understand the root cause of the vulnerability, and to engage in discussions with the DCOs as to how they are protecting the organization, and the marketplace, against the vulnerability. It is through the examination of systems safeguards that the Commission helps to ensure the DCOs are prioritizing cyber security activities. With this budget request, the CFTC will be able to address some of the needs to support these unplanned occurrences.

As an agency, the Commission is faced with growing pressure to protect terabytes of data, and maintain compliance with FISMA and OMB mandates. Protecting our information comes with a price. Some of the additional funding requested will also allow us to make internal cyber security improvements including implementation of additional cyber security sensors and defenses to further protect the market data we collect on a daily basis.

FINANCIAL TECHNOLOGY

The requested budget will also allow the Commission to also address market-enhancing innovation through financial technology (FinTech). FinTech comprises a range of technology in

the financial services sector and includes innovations in retail banking, investment, and virtual currencies like bitcoin.

LabCFTC is the focal point of the CFTC's efforts to facilitate market-enhancing innovation and fair competition for the benefit of the American public. It also helps to ensure that we can keep pace with changes in our markets, and proactively identify emerging regulatory opportunities, challenges, and risks. We have situated LabCFTC within the CFTC's Office of the General Counsel. It allows LabCFTC to leverage the expertise of the CFTC's legal team to manage the interface between technological innovation, regulatory modernization, and existing rules and regulations.

LabCFTC has hosted innovators across the nation, ranging from startups to established financial institutions to leading technology companies. These outreach efforts are designed to make the CFTC more accessible to FinTech innovators, and to serve as a platform for informing the Commission's understanding of emerging technologies. The information gathered in these meetings also provides important insights to CFTC staff on market innovations that may influence policy development. In fact, through its engagement with—and study of—innovative technologies, LabCFTC was recently able to recommend new virtual currency surveillance tools to our Enforcement division. Our Enforcement team has been able to avail itself of this new technology, and is now able to enhance certain surveillance and enforcement activities. This important development helps underscore the value of LabCFTC, and its effort to ensure that we are prepared to be a 21st century digital regulator.

In addition to LabCFTC's efforts undertaken domestically, the Commission has been proactive in working with international regulators on FinTech applications to harmonize approaches and to share best practices. Last month the CFTC and the UK's Financial Conduct Authority (FCA) signed an arrangement that commits the regulators to collaborating and supporting innovative firms through each other's financial technology (FinTech) initiatives – LabCFTC and FCA Innovate. This is the first FinTech innovation arrangement for the CFTC with a non-US counterpart. We believe that by collaborating with the best-in-class FCA FinTech

team, the CFTC can contribute to the growing awareness of the critical role of regulators in 21st century digital markets.

OVERSIGHT OF VIRTUAL CURRENCIES

In FY 2018, the exchanges self-certified several new contracts for futures products for virtual currencies. These innovations impact the regulatory landscape and with this budget request, the Commission will invest more in new technologies and tools that support important surveillance and enforcement efforts.

Under the CEA and Commission regulations and related guidance, exchanges have the responsibility to ensure that their Bitcoin futures products and their cash-settlement process are not readily susceptible to manipulation, and DCOs have the responsibility of risk management to ensure that the products are sufficiently margined. The CFTC has the authority to ensure compliance with both. In addition, the CFTC has legal authority over virtual currency derivatives in support of anti-fraud and manipulation including enforcement authority in the underlying markets.

The CFTC has been in close communication with the SEC with respect to policy and jurisdictional considerations, and in connection with our recent enforcement cases. We have also been working with the U.S. Treasury and the FSOC. In addition, we have been in communication with our foreign counterparts through bilateral discussions and the International Organization of Securities Commissions.

In the past several weeks the CFTC has filed a series of civil enforcement actions against perpetrators of fraud and market abuse involving virtual currency. These actions and others to follow confirm that the CFTC, working closely with the Security and Exchange Commission (SEC) and other fellow financial enforcement agencies, will aggressively prosecute those who engage in fraud and manipulation of US markets for virtual currency.

ENFORCEMENT

The day after the White House announced its intention to nominate me as CFTC Chairman, I spoke to hundreds of industry executives at the annual Futures Industry Conference.⁴ I issued a warning to those who may seek to cheat or manipulate America's derivatives markets. I said, "There will be no pause, no let up and no reduction in our duty to enforce the law and punish wrongdoing in our derivatives markets. The American people are counting on us." I am committed to punishing bad actors in the marketplace and to do so with swift justice to stop their bad actions. Through robust enforcement of our laws and regulation, we will continue to send a clear signal to the marketplace about our seriousness in punishing bad behavior and compensating victims.

In the fiscal year that ended September 30, 2017, the CFTC brought 49 enforcement-related actions, which included significant actions to root out manipulation and spoofing and to protect retail investors from fraud. The CFTC also pursued significant and complex litigation, including cases charging manipulation, spoofing, and unlawful use of customer funds.

One-third of the way through FY 2018, the Commission has filed 11 manipulative conduct cases. The most manipulation cases the CFTC has ever filed in a single year is 12, which the CFTC filed in FY 2017. Below is a chart that shows the numbers over the past several years.

⁴ Remarks of Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference, Mar. 15, 2017, at: <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20>

CFTC Enforcement Actions Manipulation, Attempted Manipulation, Spoofing, and/or Manipulative or Deceptive Device	
FY 2018 (through 2/13/18)	11
FY 2017	12
FY 2016	4
FY 2015	11
FY 2014	6
FY 2013	5
FY 2012	2
FY 2011	4
Total	55

But it is not just about the numbers; it is about making our markets safer and removing bad actors from the marketplace. We believe that to adequately deter future misconduct, we must prosecute not just the companies responsible, but also the individuals involved in the wrongdoing. We also believe that, to maximize deterrence, we must work with our criminal law enforcement partners to ensure that wrongdoers face not just civil liability, but also the prospect of criminal prosecution and time in jail.

In the January 2018, the CFTC filed manipulation and spoofing cases against six individuals in coordination with the Department of Justice and the FBI, which brought criminal charges against the same individuals. This constitutes the largest coordinated prosecution with the criminal authorities in the history of the CFTC. These prosecutions were equally significant

for DOJ: In a press statement, the Assistant Attorney General characterized it as “the largest futures market criminal enforcement action in Department history.”

Complementing its enforcement efforts, the CFTC has also strengthened its Whistleblower Program, and provided whistleblowers additional incentives to report wrongdoing to the CFTC. In May 2017, to further protect whistleblowers, the CFTC added protections prohibiting employers from retaliating against whistleblowers and from taking steps that would impede would-be whistleblowers from communicating with the CFTC about possible misconduct. In the near future, the CFTC also anticipates issuing its largest ever whistleblower awards. These incentives are working. In FY 2017, the Commission received a record number of whistleblower reports—nearly twice as many as in any other year, and FY 2018 is on track to receive nearly twice as many as in FY 2017.

The Commission takes its enforcement efforts very seriously and prides itself on being a premier Federal civil enforcement agency dedicated to deterring and preventing manipulation and other disruptions of market integrity.

Full funding of our budget request will allow us to continue to carry out our mission in the area of enforcement.

CONCLUSION

Thank you again for this opportunity to appear before the subcommittee regarding the CFTC’s FY 2019 budget request. As I said earlier, we meet at a time in history when a familiar world is disappearing and a new one emerging.

Like millions of Americans, I have been impressed with the new movie about Winston Churchill, “Darkest Hour.” I am reminded of an insightful quote from Winston Churchill, “We shall not fail or falter; we shall not weaken or tire... Give us the tools, and we will finish the job.”

We need the tools to do our job of protecting the markets that Americans rely on each day. With the proper balance of sound policy, regulatory oversight, and private sector

innovation, new technologies and global trading will allow American markets to evolve in responsible ways, and continue to grow our economy and increase prosperity.

I look forward to answering your questions.

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