

**Chairman Timothy Massad, Testimony**  
**U.S. House Appropriations Committee, Subcommittee on Agriculture,**  
**Rural Development, Food and Drug Administration and Related Agencies**

Thank you Chairman Aderholt, Ranking Member Farr and members of this Subcommittee. I am pleased to testify regarding the President's fiscal year (FY) 2017 budget request for the Commodity Futures Trading Commission (CFTC).

The CFTC oversees the futures, options, and swaps markets. While most Americans do not participate in these markets directly, they are vital to our economy, affecting the prices we all pay for food, energy, and other goods and services. They do this by providing farmers, ranchers and businesses of all types with the ability to manage costs and hedge commercial risk.

For these markets to work well, sensible regulation is essential. As you know, in 2008, the absence of sensible oversight in the swaps market contributed to the intensity of the worst global financial crisis since the Great Depression. That crisis cost our economy more than 8 million jobs, wiped out the savings of millions of Americans and cost millions of families their homes.

Today, the dedicated staff and Commissioners at the CFTC are working hard to provide that oversight. I want to thank in particular our staff for their tireless efforts and commitment, as well as Commissioners Bowen and Giancarlo for the judgment and constructive approach they bring to the agency.

But sensible regulation requires adequate resources. While I appreciate the increases the agency has received in the past, I believe our budget is simply not proportionate to the responsibilities we face. The President's budget request would change that. This budget will give us the resources to keep pace with an industry that is changing and innovating at the speed of light, and that is much larger and more complex than even just a few years ago. It will enable us to address the technological transformations that are shaping our markets but also are creating new risks to financial stability—such as automated trading and cyberattacks, for example. It will ensure we can be even more responsive to the concerns of commercial end-users, who did not cause the global financial crisis yet rely on these markets to hedge commercial risk. It will allow us to meet our dramatically expanded responsibilities and continue bringing the once-opaque swaps market out of the shadows. And it will enable us to continue holding bad actors accountable, so that we protect customers and the integrity of our markets.

**The CFTC's Budget Request for Fiscal Year 2017**

To continue our progress, and to allow for the CFTC to fulfill its responsibilities to oversee these vital markets as directed by Congress, the Commission requests \$330 million and 897 full-time

equivalents (FTE). This is an increase of \$80 million and 183 FTE over the FY 2016 enacted level. It is an investment that is much needed; as it will enable this agency to engage in a number of important activities that will help ensure that U.S. derivatives markets continue to be stable, transparent, competitive and free of fraud and manipulation.

These additional resources will allow the Commission to improve surveillance capabilities to keep up with the technological sophistication of our markets today, and the extreme pace at which it is developing. This oversight will help us to detect excessive risk and prevent fraud, abusive practices and manipulation. The President's budget request will bolster the CFTC's enforcement efforts, which are so important to reining in illegal behavior. It will allow the Commission to substantially increase and improve its examinations of the critical infrastructure in our markets, such as clearinghouses, and better equip the agency to deal with the very real risk of cyberattacks. Additional resources also are essential to maintain and improve the basic information technology infrastructure and capabilities of the Commission. This includes the ability to receive, store and analyze vast new quantities of data in light of our new responsibilities and the increased use of automated trading.

The CFTC has been and will continue to be prudent stewards of taxpayer dollars. We are focusing our limited resources on a number of activities that will strengthen and enhance the markets we oversee.

### **The 2017 Estimate Advances Key Commission Priorities**

The 2017 budget request is focused on advancing key priorities related to our mission. Of the requested \$80 million increase, approximately 36 percent would be dedicated to information technology investments that will enhance all of the Commission's activities, such as market, financial and risk surveillance, data collection and analysis, and enforcement. The remaining 64 percent supports an increase in staffing and related support, with a particular focus on highly critical areas such as surveillance, enforcement and examinations.

Below is a breakdown of our request.

#### **Data and Technology**

The Commission requests \$61.1 million and 60 FTE for enterprise-wide data and technology support activities, an increase of \$17.1 million and 11 FTE above the FY 2016 enacted level. As you will hear throughout my testimony, data, and the ability to analyze and report data, are more important than ever to the CFTC's ability to oversee the markets we regulate. As a result, it is essential that the Commission expand its information technology systems.

This includes increasing our ability to receive, store, and analyze message data resulting from the growth in electronic and automated trading, as well as the vast new quantities emanating from the swaps market. The Commission currently stores more than 800 terabytes of data. We are planning to increase our storage capacity by 50 percent this year, addressing requirements for growth in our high performance analytics program and other mission activities.

The CFTC also must be able to aggregate various types of data from multiple industry sources that have grown dramatically more complex. It is important that we bolster our core infrastructure to provide flexible, reliable, scalable, and high-performance services. This includes hardware, software and other equipment, which must be expanded to support the agency's growth. And it requires enhancing communication, processing, storage, and platform infrastructure.

In addition, the Commission must safeguard the data of a wide variety of registrants and registered entities, to ensure it is maintained in a safe, secure environment, and is properly available to support the Commission's oversight and enforcement activities.

We are also working to build an efficient system to collect and analyze data from the swaps market. We have come a long way since 2008, when a lack of reporting meant neither regulators nor market participants could assess the exposures or interconnectedness of major institutions. Today, regulators have better information and market participants have greater transparency. But this is a momentous undertaking, and there is much more work to do.

There are many actions the CFTC is taking to ensure accurate and efficient data reporting. We have proposed technical specifications to standardize reporting fields, and have proposed clarifying reporting obligations, including eliminating certain unnecessary obligations, with respect to cleared swaps. We are leading international efforts on data harmonization. And we take enforcement actions to ensure reporting obligations are honored. But a lack of resources could dramatically undermine these efforts.

## **Surveillance**

The Commission requests \$62.8 million and 160 FTE for surveillance, an increase of \$25.7 million and 56 FTE over the FY 2016 enacted level. These funds will help provide an investment in technology and personnel, and further develop the Commission's automated surveillance and data visualization tools.

Last year before this Committee, I spoke of the need for more resources to improve our surveillance capabilities to address the growing complexity, volume and sophistication in our markets. Today, the situation poses an even greater challenge.

The days when the CFTC could conduct market surveillance by observing traders in floor pits are long gone. We are in an age of electronic, and mostly automated, trading, which requires an entirely new level of sophistication. In today's high-speed markets, manipulation and fraud are often conducted using complex strategies involving large numbers of bids and offers that far outnumber consummated transactions.

Moreover, the number and range of products in which we should engage in surveillance has significantly increased. Today, the CFTC oversees 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. The volume and number of contracts have grown. For example, the number of actively traded contracts on U.S. exchanges has more than tripled in the last 10 years, with a substantial increase in 2014.

To be successful in our market surveillance efforts, the Commission must have the ability to continually receive, load, and analyze large volumes of data on these transactions. This requires a massive information technology investment, sophisticated analytical tools that the Commission develops for these unique environments, and experienced professionals who can identify potential problems and engage in further inquiry.

Our expanded oversight of the swaps market presents unique challenges with respect to surveillance. For example, the types of data required by the Commission, the number of sources providing data, the complexity of the data, and the volume of the data have all expanded significantly. We must analyze this data across the multiple trading platforms that exist. There is also considerable voice-driven activity and complexity related to the execution and processing of trades, which require different surveillance perspectives. Aggregating data to understand participants' positions across futures and swaps markets, both cleared and uncleared, is particularly challenging.

The Commission also engages in surveillance to monitor risk— risk at the individual clearinghouse, clearing member and large trader levels. We must look at credit, concentration, liquidity and market risk. We monitor customer and house positions and margining practices. Commission staff must also review large customer positions being held at or managed by intermediaries. Today, there are ten clearing firms that hold more than \$10 billion in customer funds.

To give just one illustration of our challenges today, we have worked with banking and international regulators to come up with a sensible and harmonized framework for requiring margin for uncleared swaps. Now, we need to significantly enhance our surveillance of these uncleared swaps, and integrate that with existing surveillance efforts. Our goal is to obtain a

much better picture of the risks posed by large market participants to one another, and to the financial system, whether swaps are cleared or uncleared. Now that we have a sensible rule framework, lacking the resources to measure whether it is working would be a missed opportunity. It will be challenging to create and maintain this surveillance function without additional resources.

Surveillance in all of these markets does not occur with technology alone. The Commission needs experienced staff; staff who understand the markets we oversee, who can distinguish anomalies and patterns, and who have the judgment and skills to investigate possible misbehavior. Every market we oversee is different, and we must have staff with specialized knowledge of the market structure, trading patterns, and complexities of each unique market and product.

Falling short of the requested increase in surveillance would severely limit the Commission's ability to detect fraud and manipulation, market abuses, firms in trouble, or other improper behavior. The result will be increased costs and increased risks to our markets and our financial system.

## **Enforcement**

The Commission requests \$68.7 million and 212 FTE for enforcement activities, an increase of \$15.5 million and 51 FTE over the FY 2016 enacted level. There is perhaps no more important role of the CFTC than to maintain market integrity and protect consumers. To do so, a strong enforcement function is vital.

The CFTC's enforcement responsibilities are more important than ever, due to its expanded mission, market complexity, and the advent of new, complicated forms of illegal behavior, such as spoofing. The CFTC must have the necessary resources to investigate and punish abusive practices. For example, analyzing automated trading patterns requires sophisticated information technology capabilities and unique expertise. The Commission not only has insufficient resources currently, but it anticipates more time-intensive and inherently complex investigations in the future.

We have accomplished a great deal with the resources we have. The Commission is investigating more cases involving manipulation, false reporting of market information and disruptive trading practices. However, as behavior becomes more advanced, cases become more expensive. Often, these cases involve conduct spanning many years, multiple markets and products, and require forensic economic analysis of trading data. In recent years, the Commission prosecuted wrongdoers for a wide range of fraudulent schemes, including Ponzi schemes that preyed upon the retail public, precious metals speculation and commodity pools.

For example, a recent case involving alleged spoofing in connection with the May 2010 “Flash Crash” took years of intensive data analysis and other investigation. Further, the Commission often faces defendants that will spare no expense in their defense. A recent case that arose from the Peregrine fraud, for example, lasted more than two years and required more than 4,800 hours of staff time. The MF Global litigation is ongoing, more than four years after the firm collapsed. The London Interbank Offered Rate (LIBOR) and foreign exchange benchmark cases were global in nature and required intensive reconstruction of communications and trades, substantial document, email and chat room reviews, analysis of trading data and books, and outside expert analysis. The LIBOR investigation took us four years to bring the first case. Specialized experts are needed not only in benchmark cases, but also to investigate and litigate many other types of complex trading cases.

In addition to increases in complexity, the Commission also predicts a continued increase in resource-intensive, multi-jurisdictional and multi-national investigations. This is due to the global nature of the swaps marketplace where money and risk have no geographic boundaries, as well as the challenges associated with permitting compliance with foreign law in some circumstances.

While our effectiveness is best illustrated by the quality, breadth and complexity of the cases pursued, data can provide a snapshot of our accomplishments. In fiscal year 2015, the CFTC filed 69 new enforcement actions and opened more than 220 new investigations. It also obtained \$3.2 billion in sanctions, collecting over 90 percent of the sanctions imposed.

This means that over the past five years, the Commission collected fines and penalties of approximately four times its cumulative budgets. And in FY 2015 alone, the amount collected was over 12 times the enacted budget. This amount would support the Commission’s FY 2017 budget request for the next nine years.

Enforcement is not just about dollars and cents. It’s about helping investors, retirees, and others who have been victimized by wrongdoers. For example, just this past December, the Commission obtained more than \$9 million in monetary judgments against an institution for its operation of a fraudulent foreign exchange rate scheme. The scheme claimed roughly 114 victims, including several elderly victims who had invested significant portions of their life savings.

And in March of 2015, the CFTC settled charges against a number of entities for operating a fraudulent hedge fund and commodity pool, which victimized elderly persons who were deceived into participating in the scheme through their IRA accounts. To date, the CFTC has returned nearly \$4 million to those victims – and the recovery efforts continue. The Commission

also joined with the SEC and U.S. Attorney's Office for the Eastern District of Texas, which brought related civil and criminal actions.

## **Examinations**

To substantially bolster its examinations of the critical infrastructure and intermediaries in our markets, the Commission requests \$34.2 million and 128 FTE for examinations, an increase of \$3.4 million and 13 FTE over the FY 2016 enacted level. Taken in concert with other activities, regular examinations maintain market integrity so that American businesses—as well as participants from around the world—can continue to have confidence in our markets. The Commission engages in direct examinations, as well as oversight of examinations performed by 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. We lack the resources to engage in annual examinations of all clearinghouses, and to conduct a sufficient number of in-depth examinations. And yet, the number of clearinghouses, the scope and complexity of the examination issues and the importance of these examinations to overall financial stability are all increasing. Moreover, the risk of cyber-attacks is of particular concern with clearinghouses and warrants examinations specifically dedicated to that subject.

In addition to clearinghouses, we need to examine other critical infrastructure such as exchanges, swap execution facilities, and swap data repositories, as well as intermediaries such as the clearing firms that take customer money. The 10 clearing firms that each hold over \$10 billion in customer funds that I previously noted are just one example of registrants that the Commission oversees. The Commission also oversees over 100 registered swap dealers, as well as nearly 4,100 commodity trading advisors and commodity pool operators. The Commission has asked the National Futures Association (NFA) to take on greater responsibility for certain examinations, including in particular the examinations of swap dealers. However, the Commission must still oversee the NFA's activity.

For all these reasons, the Commission needs to increase its capability to conduct examinations and provide oversight. A failure to provide the requested level of funding will mean the CFTC will not have sufficient resources to do so, putting the markets and market participants at risk.

## **Registration and Compliance**

The Commission requests \$18.0 million and 62 FTE for registration and compliance activities, an increase of \$3.5 million and 10 FTE over the FY 2016 enacted level. The CFTC's ability to analyze registrations in a timely and thorough manner is critical to the stability and integrity of

the markets. The new swap regulatory framework has resulted in the permanent registrations of 18 swap execution facilities (SEFs) and five temporary registrations. There are over 100 swap dealers, plus four provisionally registered swap data repositories. However, the Commission still has a significant backlog. The Commission is dealing with applications for pending registration from 19 foreign boards of trade, as well as new derivatives clearing organizations and other applicants. We expect additional applications in FY 2017 and beyond.

And following an entity's initial registration, the CFTC keeps monitoring the entity's activities for compliance, and may provide policy direction and legal interpretative guidance when necessary.

We have again worked to delegate more responsibility to the NFA. But between the policy guidance and review work that we must do directly, as well as the oversight of our self-regulatory organizations, our resources simply are not sufficient. A lack of adequate funding impairs the Commission's ability to attract and retain the experts who understand the markets and who have the ability to review registrations and carry out compliance oversight in a timely and thoughtful manner. This results in delays, insufficient customer protection, regulatory uncertainty, and higher legal and compliance costs for registrants. All of these factors severely impact the efficiency, integrity, and attractiveness of the nation's markets.

### **Actions to Address End-User Concerns**

An increase in funding is also essential to responding to the concerns of market participants promptly and properly, in particular commercial end-users. These markets exist to enable businesses to hedge risk, and so it is vital that we are in a position to evaluate and respond to their suggestions and concerns. Since I and Commissioners Bowen and Giancarlo took office, we have taken many important actions to ensure commercial end-users can use these markets efficiently and effectively, but there is more we should consider.

For example, in mid-December, we adopted significant changes to a rule that will reduce recordkeeping obligations for commercial end-users. Now, these entities do not have to keep records of pre-trade communications or text messages, nor do they have to record oral communications related to their transactions. Further, we have simplified the requirements for keeping records of final transactions.

Also late last year, Commission staff released an important preliminary report on what is known as the "*de minimis* threshold" for swap dealing and major swap participants. An entity engaged in swap dealing at a level exceeding that threshold—which is currently \$8 billion in notional amount of swaps over the year—must register as a swap dealer. This triggers oversight by the CFTC as well as capital, margin, disclosure, recordkeeping and documentation requirements.

The rule provides that in about two years, that level will fall to \$3 billion, unless the Commission takes action.

Our staff report was written with the benefit of significant new data, thanks to the reporting efforts I described earlier. It 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. It will take us some time to consider the feedback and produce a final report, and the Commission can then decide whether to take any action.

The Commission also recently finalized a very important rule setting margin requirements for uncleared swaps. Consistent with Congressional intent, our rule does not require the collection of margin from end-users. It focuses instead on where 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. I'm pleased that the banking regulators also changed their rules, in the course of working with us, to the same standard.

In addition, just a few weeks ago, CFTC staff addressed the concerns of our community development financial institutions and small banks with under \$10 billion in assets, by making clear that these entities may choose not to clear a swap subject to the CFTC's clearing requirement, provided they comply with certain other conditions.

And 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. Our interpretation is intended to make sure commercial companies can continue to conduct their daily operations efficiently.

The Commission also 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.

These are just some of the actions we have taken to address end-user concerns. With the appropriate resources, we can do so more efficiently and thoroughly.

### **Other Agency Priorities**

Let me also briefly note two areas where additional resources will help us take necessary actions to address potential new risks in our markets. We recently unanimously approved proposals to enhance cybersecurity protections. This is critical, as the risk of cyberattacks is perhaps the greatest single threat to the orderly functioning of our markets. Our proposal seeks to make sure that the critical market infrastructure that we oversee—the exchanges, swap execution facilities,

clearinghouses and swap data repositories—engage in adequate testing of their own protections against cyberattacks and similar technological risks.

We also unanimously approved a proposal to address the increased use of automated trading in our markets. Our proposal seeks to minimize the risk that automated trading will result in disruptions in the markets by requiring adequate risk controls, testing and monitoring of algorithms, and other measures. We hope to finalize these critical rules later this year, and meeting this budget request will allow us to implement them effectively.

### **Conclusion**

Finally, let me conclude by noting again my appreciation for the increase of \$35 million we received in our fiscal year 2015 budget. This was essential to improving our ability to carry out our mission, and we used these resources wisely. In particular, we took some long overdue actions to modernize our information technology capabilities and to bolster our staff in critical areas, such as enforcement. This was effective, as evidenced by our continued progress in building a system to collect, aggregate and analyze data, as well as in our continued success in returning billions of dollars from bad actors back to U.S. taxpayers. But unfortunately, our funding level in FY 2016 remained flat, making it challenging to even maintain the additional staff the Commission added.

An increase in our budget is a wise and necessary investment for our economy. Our derivatives markets are the most robust, dynamic and innovative in the world. And that is why they have been global leaders, and have attracted global participation. But maintaining that leadership requires not only the continued ingenuity and resources of the private sector; it requires a regulatory effort that makes people from around the world want to continue to invest here. It requires a regulatory effort that is equally sophisticated and technologically competent; one that has the resources to tackle new emerging risks, and revisit existing regulations when they are outpaced by technological advancement. And it requires a regulatory effort that is capable of responding to the concerns of honest and hardworking market participants, while punishing the bad actors who might otherwise succeed in taking advantage of those very individuals.

Thank you again, Mr. Chairman. The CFTC's FY 2017 budget request is designed to enable the Commission to keep making progress toward fulfilling its responsibilities to the American public, so that we help make sure our markets continue to thrive and contribute to economic growth. I look forward to answering any questions you may have.