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Chairman Scott, Ranking Member Scott, members of the subcommittee, thank you for the opportunity to testify here today. I am President of National Futures Association. For those new to the subcommittee, NFA is the industrywide self-regulatory organization for the derivatives industry. Our membership includes Swap Dealers, Futures Commission Merchants (FCM), Commodity Pool Operators (CPO), Commodity Trading Advisors (CTA), Introducing Brokers and all of the Associated Persons in the futures industry. NFA's responsibilities include registration of all industry professionals on behalf of the CFTC, passing rules to ensure fair dealing with customers, monitoring Members for compliance with those rules and taking enforcement actions against those Members that violate our rules.

In a nutshell, our job is to help the CFTC. For example, besides the registration process, NFA also reviews all CPO and CTA disclosure documents, CPO annual pool financial statements, and all of the policies and procedures that Swap Dealers are required to file with the CFTC. In addition, we immediately notify the CFTC if any of our exams uncover emergency situations and coordinate our responses with the Commission. We also meet regularly with the Division of Enforcement to avoid duplication of effort and also with the Division of Swaps and Intermediary Oversight on our exam process and rule development issues. More recently, at Chairman Massad's request, we have discussed other ways in which the Commission can take advantage of the regulatory resources of NFA and the CME. The Commission faces a huge job and we will continue to help in any way we can.

Reauthorization is always an important process for the industry as a whole and for NFA in particular. That's never been more true than it is today. NFA was pleased that key customer protections we supported were included in last year's bill, and I would like to address those provisions and reiterate why we support them. Let me begin, though, by discussing some of the challenges NFA has had to meet as a result of Dodd-Frank and other changes in the industry.

In some ways, NFA today is a very different organization than it was just a few short years ago. The most obvious change at NFA is size. Four years ago we had a staff of 300; today we have a staff of 480. Four years ago we operated on a budget of $42 million; this year our budget was over $80 million and we project another significant budget increase next year. We have always recognized that increased spending on regulation is not a virtue in and of itself. However, our Board was convinced that changes in the industry and in the scope of NFA's responsibilities made these increases essential. There are three main forces driving these changes at NFA, two of them related to Dodd-Frank.

Swap Dealer Membership

Dodd-Frank required certain Swap Dealers to register with the CFTC, and the CFTC required them to become Members of NFA. We have over 100 Swap Dealer Members, the vast majority of whom are either large U.S. banks or financial institutions, foreign banks or affiliates of one of those groups. Over the last several years we have built our Swaps Compliance Department from scratch. We began by building our senior management team and were lucky enough to recruit a team of six talented, experienced and dedicated individuals who have a total of over 100 years of experience in the swaps area. We have continued to build our staff and now have almost 100 individuals working exclusively on swaps compliance issues. We have reviewed hundreds of thousands of pages of policies and procedures that Swap Dealers were required to file with the CFTC, have begun the development of NFA's internal risk management guidelines to monitor Swap Dealer Members and developed examination modules for all of the rules adopted by the CFTC. This year we began conducting on-site examinations of Swap Dealer Members.

Much has been done in this area but much more work remains. We are working with the CFTC and other regulators to maximize our coordination and minimize duplication of effort. We are also working with the Commission to sort out the extent of NFA's responsibilities to monitor foreign firms that the CFTC has allowed to comply with comparable rules from their home jurisdiction. In this area, again, our primary goal is to limit wasting resources by duplicating the work of other regulators.

Swap Execution Facilities

Dodd-Frank also allowed for the creation of Swap Execution Facilities, electronic trading platforms for swaps. These SEFs have their own self-regulatory responsibilities to conduct surveillance of their markets. Of the 22 registered SEFs, 16 have contracted with NFA to perform certain surveillance functions on their behalf. As a result, NFA has tripled the size of our Market Regulation Department. We began our work in this area by developing a comprehensive set of the data elements NFA would need to receive from SEFs to perform our responsibilities. In doing so, we consulted extensively with both the industry and the CFTC. The result of those deliberations was a document listing the 150 data elements SEFs must provide to NFA. When SEF

trading was launched on October 2, 2013, we were ready. The CFTC adopted our data elements as the industry standard, and with the CFTC we have begun discussions with international regulators to ensure uniform international standards.

Changes in Rules and Regulatory Practices

The third force driving change at NFA has nothing to do with Dodd-Frank. Following the failures of two FCMs, MF Global and Peregrine, a special committee of NFA's public directors commissioned an independent review of NFA's examination procedures. The study was conducted by a team from the Berkeley Research Group that included former SEC personnel who conducted that regulator's review of the SEC's practices after the Madoff fraud. The report stated that NFA's exams of Peregrine were conducted in a competent manner but also included a number of recommendations designed to improve the operations of NFA's regulatory examinations. The recommendations included areas such as hiring, training, supervision, risk management and continuing education. All of the committee's recommendations have been implemented and they have certainly made NFA a better regulator. Those changes come with a price tag, however, and we have increased the size of NFA's Futures Compliance Department by 33% since MF Global and Peregrine.

Improving examination procedures and increasing the size of the staff were helpful but they were not enough to accomplish the changes that we felt had to be made. Our Board also approved a wide range of new rules designed to prevent future FCM failures. Most importantly, rule changes adopted by NFA and CME now provide for the daily confirmation of balances for segregated customer funds held in over 2,000 accounts. We compare the confirmation from the depository with the daily information we receive from FCMs and immediately note and follow up on any material discrepancies. This rule change, and others I've described in previous testimony, mark a huge step in the protection of customer funds.

As I mentioned earlier, NFA was pleased that key customer protections we supported were included in the reauthorization bill approved by this subcommittee last year. There were several provisions of that bill that were of particular importance to NFA, and I would like to briefly restate our support for those measures.

- Strengthening Customer Protections in FCM Bankruptcy Proceedings

Over 30 years ago the CFTC adopted rules regarding FCM bankruptcies. Among other things, those rules provided that if there was a shortfall in customer segregated funds, the term "customer funds" would include all assets of the FCM until customers had been made whole. Several years ago, a district court decision cast doubt on the validity of the CFTC's rule. That decision was subsequently vacated but a cloud of doubt lingers on. This committee attempted to remove that doubt in last year's bill by proposing to amend the Act to clarify the CFTC's authority to adopt the rule that it did. I believe there is a broad base of industry support for that approach, and we urge you to include that provision in any reauthorization bill that moves this year.

- Codification of Customer Protection Rules

As I mentioned earlier, NFA, CME and other self-regulatory organizations adopted a number of very effective customer protection rules in the wake of MF Global and Peregrine. Two of the most significant rules involved the daily confirmation of customer segregated fund balances and additional requirements any time an FCM withdraws more than 25% of its own funds from segregated accounts. Last year's bill ensured that those protections could not be peeled back by requiring SROs to maintain those rules. We fully support that concept and, again, hope that this year's reauthorization bill contains similar provisions.

- Changes to the De Minimis Level for Swap Dealer Registration

The current de minimis level of swap dealing that triggers swap dealer registration is $8 billion, but under the current structure that level will automatically be reduced to $3 billion without any affirmative rule making by the CFTC. The time may well come when it is appropriate to adjust the threshold up or down, but the consequences of doing so could be very significant for both market participants and regulators, including NFA. A change of that magnitude should not happen by default. Last year's bill provided that the de minimis level could only be changed by the CFTC taking the affirmative step of amending its rules. We continue to support that provision and urge its inclusion in this year's bill.

Before I close let me also mention one issue that is of critical importance to all of us—Congress, regulators, market participants and the general public—cyber security. At NFA we need both an internal and an external focus on this important issue. Internally, we continue to do everything we can to protect the confidentiality of all of the data we hold, including all of the registration data we hold on behalf of the CFTC. Our security measures are constantly reviewed by our own staff, by the CFTC and by consultants we hire to try to penetrate our defenses. We believe that our security measures reflect the state of the art, but we take no particular comfort in that. We recognize that the risk of penetration will always be present no matter how extensive our defenses. Therefore, we are implementing countermeasures like enhanced monitoring and encryption across our systems to further protect our data in the event of a breach.

Our external focus is on providing our Members with the guidance they need to ensure that their security measures satisfy their regulatory responsibilities. Our Members range in size from huge multinational corporations with ultra sophisticated defenses to one person shops. We are working with the CFTC and the industry to develop guidance that would provide meaningful protections and be flexible enough to apply to all of our Members.

Mr. Chairman, I recognize both how difficult and how important the reauthorization process is for the derivatives industry and all of the end users that depend on these markets for their hedging needs. I agree with Chairman Massad that we must always be sensitive to the costs imposed by regulation. This is particularly true as the number of FCMs continues to dwindle, concentrating more risk in fewer FCMs and limiting the FCMs that serve agricultural end users. We look forward to working with the subcommittee to strike the difficult balance that must be achieved and will be happy to answer any questions the subcommittee may have.