

**TESTIMONY OF GARY GENSLER**  
**CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION**  
**BEFORE THE**  
**U.S. HOUSE COMMITTEE ON AGRICULTURE**  
**WASHINGTON, DC**  
**February 29, 2012**

Good morning Chairman Lucas, Ranking Member Peterson and members of the Committee. I thank you for inviting me to today's hearing on the Commodity Futures Trading Commission's (CFTC) 2012 agenda. I also thank my fellow Commissioners and CFTC staff for their hard work and commitment to protecting the public and promoting transparent and efficient markets. I'm pleased to be here with CFTC Commissioner Jill Sommers.

**CFTC Mission**

At its core, the CFTC's mission is to ensure the integrity and transparency of derivatives markets – both the futures and swaps markets. Each part of our economy relies on a well-functioning derivatives marketplace. These markets are critical for farmers, producers, ranchers and other end-users in the real economy – the non-financial side of the economy that provides 94 percent of private sector jobs. End-users can lock in a price or rate and manage their risk through these markets. The futures and swaps markets allow companies to focus on what they do best – servicing their customers, producing products, innovating, and investing in our economy. These markets are also critical for pension funds, mutual funds, community banks and

insurance companies, and the Americans who rely upon these entities for their savings and financial needs.

The CFTC has historically been charged with overseeing the commodity futures markets. In 2010, Congress expanded the CFTC's mission to also oversee the previously unregulated swaps marketplace. At approximately \$300 trillion, the domestic swaps market is nearly eight times the size of the futures market.

Combined these markets help their users hedge or transfer \$22 of risk for every dollar of goods and services produced in the U.S. economy. Futures and swaps markets touch nearly every aspect of our economy from the food we eat, to the price at the pump, to our mortgages and credit cards, and to our retirement savings. Thus, it is essential that these markets are transparent and efficient and work for the benefit of the American public. And when markets are open and transparent, they are safer and sounder, and costs are lower for companies and their customers.

### **CFTC 2012 Agenda**

After a very full year in 2011, the CFTC has a significant agenda this year to further enhance the futures and swaps markets to better protect the public. To start, I'll review what is ahead with regard to swaps a market reforms. I then will discuss further initiatives for enhancing customer protection and touch on some steps we are looking at to address changing market

structure. I will close by discussing the CFTC's request for additional resources to best accomplish these goals.

*Completion of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) Rules*

The CFTC has made significant progress in completing the reforms that will bring transparency to the swaps market and lower its risk to the rest of the economy. But there is much work yet to be done.

During the rule-writing process, we have benefitted from significant public input. CFTC Commissioners and staff have met over 1,300 times with the public, and we have held 16 public roundtables on important issues, including a two-day roundtable beginning today on further protections for customer money.

We substantially finished our proposal phase last spring, and then largely reopened the mosaic of rules for additional public comments. We have accepted further public comment after the formal comment periods closed. The agency received 3,000 comment letters before we proposed rules and 28,000 comment letters in response to proposals.

Last summer, we turned the corner and started finalizing rules. To date, we've completed 28 rules with just over 20 more to go. Attached to this testimony is a more complete list of rules we've finished, as well as proposed rules. It's my anticipation that we will finish most of the

rule-writing work by this summer; however, it's possible that a handful won't be finished until later this year. While the statute generally called for completion of the rules in one year, for most of them, it has taken us longer. We are completing rules in a thoughtful, balanced way – not against a clock.

To promote transparent and competitive markets, we've been able to complete seven key reforms. Among these reforms, the Commission already has begun to receive position information for large traders in the swaps markets for agricultural, energy and metal products. Based on completed registration rules, three swap data repositories have already filed with the CFTC. In December, we finalized rules for the reporting of swaps transactions both to the public and to regulators, which will begin to take effect as early as July of this year. For the first time, the public and regulators will have specific information on the swaps markets, in aggregate and transaction-by-transaction. By contrast, none of this information was available leading up the 2008 crisis.

Looking forward, we hope to complete rules with regard to designated contract markets (DCMs), followed later this spring by rules for swap execution facilities (SEFs). These rules will be critical to bringing transparency and the benefits of competition to both buyers and sellers in the swaps market before they transact.

Last week, the Commission proposed a new block trading rule with a revised methodology for determining block sizes that benefitted from public input and a review of market data. As we have discussed in this Committee during previous hearings, the Commission

is mindful that there are times when a reproposal of a rule is necessary to help ensure the Commission gets it right.

The CFTC also has made significant progress on rules to bring swaps into central clearing. We completed rules establishing robust risk management requirements for derivatives clearing organizations. We finished a rule on the process for clearinghouses to submit swaps that may be mandated for central clearing. In addition, the Commission adopted an important customer protection enhancement, the so-called “LSOC rule” (legal segregation with operational commingling) for swaps. It prevents clearing organizations from using the cleared swap collateral of non-defaulting, innocent customers to protect themselves and their clearing members.

To further facilitate broad access to these markets and promote competition, the Commission hopes in the near term to consider final rules on client clearing documentation, risk management, and so-called straight-through processing, or sending transactions immediately to the clearinghouse upon execution.

We also are looking to soon finalize the end-user exception. Consistent with congressional intent, our proposal would ensure non-financial companies using swaps to hedge or mitigate commercial risk will not be required to bring swaps into central clearing. The Commission’s proposed rule on margin for swap dealers likewise provides that such non-financial companies will not have to post margin for uncleared swaps.

The Commission has received substantial public input on the treatment of swaps among affiliates of the same business entity. The CFTC's final rules on real-time reporting and external business conduct standards include exceptions for such swaps. To address commenters' questions about a possible clearing requirement between affiliates of financial entities, I expect the Commission to consider a proposal and take public comments later this year.

The CFTC has begun to finalize rules to regulate swap dealers and lower their risk to the rest of the economy. First, we finished rules requiring registration of swap dealers with the National Futures Association (NFA). Second, we completed rules establishing and enforcing robust sales practices in the swaps markets. And third, a rule finalized this month requires swap dealers and major swap participants to establish policies to manage risk, as well as to put in place firewalls to prevent conflicts of interest between trading and research and trading and clearing units.

Later this year, we will consider final rules on capital and margin rules, which will have the benefit of close consultation with other regulators, both domestic and international. I also anticipate the Commission will explicitly seek public input on the extraterritorial application of Title VII of the Dodd-Frank Act.

The Dodd-Frank Act was clear on the meaning of swap and swap dealer, but the law called on the CFTC and the Securities and Exchange Commission (SEC) to act jointly in further defining these terms. We have benefitted from significant public input on the rule relating to entity definitions, and we are looking to finish it in the near term. We are taking into account all

public comments, including those from farm credit institutions and agricultural cooperatives. The product definitions rule will follow in the spring.

Furthermore, the CFTC is working with participants in the electricity markets on possible exemptive orders for rural electric cooperatives, municipal public power providers and regional transmission organizations.

The Commission also is working with the banking regulators and the SEC on the Volcker rule. In adopting the Volcker rule, Congress prohibited banking entities from proprietary trading, an activity that may put taxpayers at risk. At the same time, Congress permitted banking entities to engage in market making, among other activities. One of the challenges in finalizing a rule is achieving these dual objectives. It will be critical to hear from the public on how to best achieve Congress' mandate. The CFTC's comment period closes April 16, and I very much look forward to the substantial public input I anticipate we will receive on this rule.

The global nature of the swaps markets makes it imperative that the United States actively consults and coordinates with foreign authorities. The Commission is working with our foreign counterparts to promote robust and consistent standards and avoid conflicting requirements in the global marketplace. CFTC staff is sharing many of our comment summaries and drafts of final rules with international regulators. We have ongoing dialogues with regulators in the European Union (EU), Japan, Hong Kong, Singapore and Canada. Last week, I met with EU Commissioner Michel Barnier during his visit to Washington. Next week, I will be in Basel to meet with the Financial Stability Board to discuss timely implementation of swaps

reforms in each of the major market jurisdictions. I then travel to Brussels to meet with key European officials and industry leaders.

### *Clearing Mandate*

Congress gave the CFTC an important role to play in determining which swaps must be mandatorily cleared. The clearing of standardized swaps will lower risk and make markets more competitive. Under the congressionally mandated process, the Commission will have 90 days to review a clearinghouse's submission and determine whether the swap or group of swaps is required to be cleared. Last year, the CFTC finalized a rule on the process for review of swaps for mandatory clearing. Earlier this month, we asked each registered clearinghouse to submit for the agency's review all the swaps that it was clearing as of February 1, 2012, including all pre-enactment swaps. Staff is now reviewing these submissions and preparing recommendations for the Commission regarding which swaps or groups of swaps should be required to be cleared. During the Commission's review period, there will be a 30-day period for the public to provide comments. Though much of the timing depends on the clearinghouses, I anticipate that this comment period may begin this spring.

### *Implementation*

As we move on from the rule-writing process, a critical part of our agenda is working with market participants on phased implementation of these reforms. We have reached out broadly on this topic to get public input. Last spring, we published a concepts document as a



guide for commenters, held a two-day, public roundtable with the SEC, and received nearly 300 comments. Last year, the Commission proposed two rules on implementation phasing relating to the swap clearing and trading mandates and the swap trading documentation and margin requirements for uncleared swaps. We have received very constructive public feedback and hope to finalize the proposed compliance schedules in the next few months.

In addition to these proposals, the Commission has included phased compliance schedules in many of our rules. For example, both the data and real-time reporting rules, which were finalized this past December, include phased compliance. The first required reporting is as early as July for interest rate and currency swaps. Other commodities have until October. Additional time delays for reporting were permitted depending upon asset class, contract participant and in the early phases of implementation.

The CFTC will continue looking at appropriate timing for compliance, which balances the desire to protect the public while providing adequate time for industry to comply with reforms. Furthermore, to ensure a smooth transition for market participants, we have given them exemptive relief from the effective dates of certain rules until July 16, 2012.

As swaps market reforms are implemented, market participants will continue to seek guidance, and in some cases petition for exemptions. The CFTC wants to be as responsive as possible to these inquiries, and this is an important part of our 2012 agenda. In the case of the large trader reporting requirements for the physical commodity swaps market, Commission staff worked with market participants and delayed requirements for two months to accommodate

technical requirements. CFTC staff also engaged with market participants to ease the process of compliance. In addition to regular dialogue, our staff developed a guidebook of data standards, which can be found on our website. Just as we did with large trader reporting, staff is reaching out to market participants regarding the data rule we completed in December, and we will continue this type of engagement in other areas.

Another significant agenda item for this year will be the registration of new market participants. This process has already begun for SDRs and foreign boards of trade (FBOTs). Since the FBOT rule was finalized in December, three have requested to be registered. We expect other FBOTs that are currently operating under staff no-action letters to shortly request to be registered. We also are working with two new entities seeking to register with the CFTC as designated clearing organizations. In January, we finalized the registration rule for swap dealers and major swap participants, and we will be working, along with the National Futures Association, on these entities' registration and related questions. In addition, Commission staff estimates that 20-30 entities will seek to become SEFs, and I anticipate they would begin to register later this year.

The agency also has a lot of work to do internally this year to further prepare for the implementation of reforms. A year ago, the Commission published a new strategic plan for fiscal years 2011-2015 that incorporates the agency's expanded responsibilities to oversee both the futures and swaps markets. Importantly, the strategic plan also includes a new and tougher approach to agency performance measures to more accurately evaluate our progress. In addition, the CFTC's new responsibilities necessitated an agency restructuring to ensure the Commission

uses its resources as efficiently as possible. The Commission created the Division of Swap Dealer and Intermediary Oversight and the Office of Data and Technology. The reorganization was put in place last October.

Our new Office of Data and Technology has a number of critical objectives to achieve in support of both swaps and futures oversight. The office will establish connections with SDRs so that the CFTC can collect and analyze swaps data for surveillance and enforcement purposes. It is taking on the challenge of how we aggregate data across SDRs, as well as how we aggregate it with futures market data. The office also will be working with the Treasury Department and international regulators on legal entity identifiers. Given our increasing oversight needs and the events of May 6, 2010, we will begin collecting daily order books from trading platforms for surveillance and market oversight purposes. The technology office also will continue to update and improve automated surveillance, including greater use of alerts.

Building on newly available data to the Commission, the CFTC plans to begin publishing aggregated swaps trader data. The public has benefited for years from the futures market data we have published in our Commitment of Traders reports. Our goal is to provide similar transparency to the public for the swaps market.

In October, the Commission adopted a final rule to establish position limits for physical commodity derivatives. The limits will come into effect once the joint rule further defining the term “swap” is completed and the Commission has received a year’s worth of data on the relevant swap markets.

## *Customer Protection*

Segregation of customer funds is a core foundation of customer protection in both the futures and swaps markets. The CFTC already has taken a number of steps in this area. The completed amendments to rule 1.25 regarding the investment of funds bring customers back to protections they had prior to exemptions the Commission granted between 2000 and 2005. Importantly, this prevents use of customer funds for in-house lending through repurchase agreements. In addition, clearinghouses will have to collect margin on a gross basis and futures commission merchants (FCMs) will no longer be able to offset one customer's collateral against another and then send only the net to the clearinghouse. And the LSOC rule for swaps ensures customer money must be protected individually all the way to the clearinghouse.

We will continue looking at options to further protect customers. Today and tomorrow Commission staff are hosting public roundtable sessions to examine additional enhancements. Also participating are other regulators, including the SEC and NFA. Panel topics include protections for the collateral of futures customers, consistent with the already-approved LSOC rule for cleared swaps. Additional discussion topics are alternative custodial arrangements for segregated funds, enhancing the controls over the disbursement of customer funds, and increasing transparency to customers and to the CFTC regarding the location and investment of customer funds. Also on the agenda are revisions to the bankruptcy rules for FCMs, protection of customer funds at FCMs to be traded on foreign futures markets, issues associated with entities dually registered with the CFTC as FCMs and the SEC as broker-dealers, and enhancing

the self-regulatory structure. CFTC staff is actively seeking public input on these topics, and members of the public can submit comments through our website.

### *Changing Market Structure*

This year, the Commission also will continue working to adapt our oversight to changing market structure, including emerging trends related to electronic trading. Instead of being traded in the pits, nearly 90 percent of futures and options on futures are traded electronically. While market participants used to be personally involved in each of their trades, they now often rely on algorithms to execute their trades. Humans are much more frequently depending on the judgment programmed into machines to execute their trading strategies. The makeup of the market also has changed. In contrast with the early days of the CFTC, swap dealers, managed money accounts and other non-commercial reportable traders make up a significant majority of many of the futures markets. Most of the trading volume in key futures markets – up to 80 percent in many markets – is day trading or trading in calendar spreads.

I expect the Commission will consider putting out for comment a concept release concerning the testing and supervision of automated market participants. These concepts will be designed to address potential market disruptions that high frequency traders and others who have automated market access can cause. Furthermore, the Commission's Technology Advisory Committee has established a subcommittee to specifically examine automated and high frequency trading.

In addition, the CFTC will continue working with the markets and the SEC on recommendations from the Joint-SEC-CFTC Advisory Committee on Emerging Regulatory Issues with regard to cross-market circuit breakers, pre-trade risk safeguards, effective testing of risk management controls and supervisory requirements regarding algorithmic trading.

The Commission staff also is developing proposed rules on the reporting of ownership and control information for trading accounts. These rules would enhance the Commission's surveillance abilities and increase market transparency.

## **Resources**

The CFTC is a good investment for the American public. But the agency needs sufficient resources to do its job. The CFTC's budget request strikes a balance between important investments in technology and human capital, both of which are essential to carrying out the agency's mandate under the Commodity Exchange Act and the Dodd-Frank Act.

As we move into FY 2013, the CFTC will need additional resources consistent with the agency's expanded mission and scope. At our current size of about 700 people, we are but 10 percent larger than our peak in the 1990s. Since then, though, the futures market has grown fivefold, and Congress added oversight of the swaps market, which is far more complex and nearly eight times the size of the futures market the agency currently oversees.

The budget request estimates the need for an appropriation of \$308 million and 1,015 staff-years for the agency. This request is a significant increase over the \$205 million FY 2012 enacted appropriations level, but it is much needed given the dramatic growth of the markets we oversee.

The CFTC will continue working hard to effectively oversee the futures market and implement reforms for the unregulated swaps market. Without sufficient funding, however, the nation cannot be assured that this agency can oversee the futures and swaps markets, that customers are protected, and that the public gets the benefit of transparent markets and lower risk.

## **Conclusion**

The financial crisis brought our economy to a standstill. While there are signs of recovery, Americans continue to face a challenging economy and are seeing budgets squeezed because of increasing prices at the pump. Thus, it is essential that the futures and swaps markets are transparent, competitive and work for the benefit of the America public.

The financial crisis exposed that swaps helped concentrate risk in the financial system that spilled over into the real economy, affecting businesses and consumers across the country. The derivatives reforms in the Dodd-Frank Act, once implemented, will lead to significant benefits for the real economy and all the Americans who depend on pension funds, mutual funds,

community banks and insurance companies. They will benefit from lowering the risk of the swaps market and increasing transparency.

Some have raised cost considerations about these reforms. But there are far greater costs – the eight million jobs lost, millions forced out of their homes, shuttered businesses and the uncertainty throughout the economy that came from risk, which spilled over from Wall Street.

Thank you for inviting me today, and I'd be happy to take questions.



## **CFTC Dodd-Frank Update**

### **Final Rules & Guidance**

- Agricultural Commodity Definition
- Agricultural Swaps
- Anti-manipulation
- Business Affiliate Marketing and Disposal of Consumer Information
- Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations
- Derivatives Clearing Organization - General Provisions and Core Principles
- External Business Conduct Standards
- Foreign Boards of Trade - Registration
- Internal Business Conduct Standards (Duties, Recordkeeping, & CCOs)
- Investment Advisor Reporting on Form PF (Jt. with SEC)
- Investment of Customer Funds (Regulation 1.25)
- Large Trader Reporting for Physical Commodity Swaps
- Position Limits for Futures and Swaps
- Privacy of Consumer Financial Information
- Process for Review of Swaps for Mandatory Clearing
- Process for Rule Certifications for Registered Entities (Part 40)
- Real Time Reporting for Swaps
- Removal of References to or Reliance on Credit Ratings
- Reporting Certain Post-Enactment Swap Transactions (IFR)
- Reporting Pre-Enactment Swap Transactions (IFR)
- Retail Commodity Transactions – Interpretive Guidance on “Actual Delivery”
- Retail Foreign Exchange Intermediaries – Regulations & Registration
- Retail Foreign Exchange Transactions – Conforming Amendments
- Segregation for Cleared Swaps
- Swap Data Recordkeeping and Reporting Requirements
- Swap Data Repositories – Core Principles, Duties & Registration
- Swap Dealers and Major Swap Participants - Registration
- Whistleblowers

### **Proposed Rules & Guidance**

- Block Rule
- Capital for Swap Dealers & Major Swap Participants
- Client Clearing Documentation, Straight Through Processing, Clearing Member Risk Management
- Commodity Options
- Conforming Rules
- Designated Contract Markets – Core Principles

## ATTACHMENT

- Disruptive Trade Practices
- End-User Exception
- Entity Definitions (Jt. with SEC)
- Governance and Conflict of Interest (DCM, DCO, & SEF)
- Harmonization of CPO/CTA Reporting
- Identify Theft (Jt. with SEC)
- Implementation Phasing for Clearing & Trading Mandates
- Internal Business Conduct (Documentation, Confirmation, & Portfolio Reconciliation)
- Margin for Uncleared Swaps
- Process for “Made Available to Trade” Determinations
- Product Definitions (Jt. with SEC)
- Reporting of Historical Swaps
- Segregation for Uncleared Swaps
- Swap Execution Facilities – Core Principles & Registration
- Volcker Rule

### **Final Orders**

- Delegation to National Futures Association (NFA) – Certain exemptions for Commodity Pool Operators
- Delegation to NFA - Foreign Exchange Intermediary Registration function
- Delegation to NFA - Swap Dealer & MSP Registration function
- Exemptive orders – Effective Date for Swaps Regulation
- Treatment of Grandfather Relief Petitions - Exempt Boards of Trade & Exempt Commercial Markets
- Treatment of Grandfather Relief Petitions – Transactions done in Reliance on 2(h)

### **Studies**

- Feasibility of Requiring Use of Standardized Algorithmic Descriptions for Financial Derivatives (Jt. with SEC)
- International Swap Regulation (Jt. with SEC)
- Study on Oversight of Carbon Markets (Jt. with various other Agencies)