TESTIMONY OF THE HONORABLE SCOTT D. O'MALIA
COMMISSIONER, U.S. COMMODITY FUTURES TRADING COMMISSION

BEFORE THE
SUBCOMMITTEE ON GENERAL FARM COMMODITIES
AND RISK MANAGEMENT
HOUSE COMMITTEE ON AGRICULTURE

JULY 23, 2013

Chairman Conaway, Ranking Member Scott, and members of the Subcommittee, I am pleased to be invited here today to discuss the Commodity Futures Trading Commission ("CFTC" or "Commission")'s implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"),[1] as well as the Commission's oversight of the derivatives markets.

I'd like to first recognize the tremendous efforts by CFTC staff to implement the sweeping reforms of the Dodd-Frank Act, including the Commission's new authority to oversee the over $600 trillion swaps market. They have put in many hours of hard work over the past three years to carry out the CFTC's mission, and should be commended for their achievements.

The Dodd-Frank Act was enacted to implement the four principles agreed to by the G20 nations who finalized the Pittsburgh Communiqué on September 25, 2009.[2] These four principles are (1) reporting of all trades to a trade repository, (2) requiring that "all standardized OTC derivatives should be traded on exchanges or electronic trading platform, where appropriate," (3) "clearing through central counterparties," and (4) higher collateral charges for all uncleared over-the-counter ("OTC") derivatives contracts.

The CFTC was charged with the mandate to reduce risk, increase transparency, and promote market integrity under the reforms set forth in Title VII of the Dodd-Frank Act. Unfortunately,

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).
[2] http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf at 9.

the Commission's implementation of Dodd-Frank has made it difficult for commercial end-users to comply with CFTC regulations and made hedging more complicated and expensive.

My testimony today will focus on three main topics. First, I will discuss challenges presented by the Commission's policy approach to the implementation of Dodd-Frank and its negative impact on commercial end-users. I will include suggestions to improve CFTC regulations so that end-users receive fair treatment. I will also discuss several policy initiatives related to customer protection.

Second, I will discuss serious concerns that I have with the Commission's rulemaking process, including the abuse of no-action relief and the lack of strict adherence to the provisions of the Administrative Procedure Act ("APA"). It is my hope that Congress will be able to assist the Commission with imposing discipline on its internal policies and procedures, including amendments to the Commodity Exchange Act ("CEA").

Finally, I will discuss challenges in CFTC data utilization and the importance of technology in meeting the Commission's greatly expanded surveillance and oversight responsibilities under the sweeping reforms enacted by the Dodd-Frank Act.

I. IMPROVING CFTC REGULATIONS UNDER THE DODD-FRANK ACT

Protecting Commercial End-Users in Hedging and Mitigating Risk

Even a brief review of the legislative history of the Dodd-Frank Act demonstrates that it was Congress' intent to protect commercial end-users from Dodd-Frank's expansive regulatory reach. Many end-users assumed that CFTC regulations would not affect them and supported aspects of reform, without realizing the policy approach that the Commission would take in implementing the Dodd-Frank Act.

Excluding End-Users from the Swap Dealer Definition

The swap dealer rule is a good example of how the Commission failed to accurately interpret Dodd-Frank by broadly applying the swap dealer definition to all market participants and

ignoring the express statutory mandate to exclude end-users from its reach.[3] Instead, the swap dealer rule makes it unnecessarily difficult to determine whether an entity is a swap dealer or an end-user. For example, rather than providing for a clear bright-line test, the swap dealer rule lists numerous factors that should be considered.

Further, as I noted in my dissent to the swap dealer rule,[4] the rule exclusively implements the swap dealer definition provided by the Dodd-Frank Act in section 1a(49)(A) of the CEA,[5] and fails to implement the exclusion for persons that are not engaged in swaps trading as part of "a regular business" in section 1a(49)(C).[6] Not only that, but the Commission also failed to interpret section 1a(49)(B) of the CEA, which provides express authority for the Commission to exclude specific entities from the dealing definition for "types, classes or categories of swaps," such as physical commodities.[7]

As a result, because the rule's swap dealer definition focuses on characteristics of entities rather than their activities and ignores two important exclusions, it captures commercial end-users even though their activities involve hedging and risk mitigation and have nothing to do with swap dealing activities. As a result, end-users have to seek numerous exemptions from various CFTC regulations. This inefficient regulatory process creates uncertainty for end-users and increases the costs of hedging and mitigating risk.

This concerns me even more because members of Congress who drafted the Dodd-Frank Act repeatedly attempted to make it clear to the Commission that commercial end-users should be exempted from Dodd-Frank's swap provisions. In June 2010, Senate Banking Committee Chairman Chris Dodd and Senate Agriculture Committee Chairman Blanche Lincoln circulated a joint letter stating, "Congress does not intend to regulate end users as Major Swap Participants or Swap Dealers just because they use swaps to hedge or manage commercial risks associated with their business."[8] And in March 2012, Senate Agriculture Committee Chairman Debbie

[3] Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant," 77 FR 30595 at 30744 (May 23, 2012).
[4] Statement of Dissent, Commissioner Scott D. O'Malia (April 18, 2012), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement041812b.
[5] 7 U.S.C § 1a (49)(A).
[6] 7 U.S.C § 1a (49)(C).
[7] 7 U.S.C § 1a (49)(B).
[8] Letter from Senators Christopher Dodd and Blanche Lincoln to Congressmen Barney Frank and Collin Peterson (June 30, 2010).

Stabenow and House Agriculture Committee Chairman Frank Lucas also sent a joint letter to the Commission to reiterate these points:

> "[I]t is important for the Commission to finalize the swap dealer definition in a manner that is not overly broad, and that will not impose significant new regulations on entities that Congress did not intend to be regulated as swap dealers. The Commission's final rulemaking further defining 'swap dealing' should clearly distinguish swap activities that end-users engage in to hedge or mitigate the commercial risk associated with their businesses, including swaps entered into by end-users to hedge physical commodity price risk, from dealing . . . ."[9]

Unfortunately, the Commission failed to listen to these Congressional directives in its implementation of the swap dealer rule.

Solutions that Remove End-Users from the Swap Dealer Definition

Given the policy challenges that the Commission faces regarding the fair treatment of end-users, I would encourage Congress to expressly exclude end-users from the swap dealer definition. In the alternative, Congress may want to consider other approaches that would both encourage risk-mitigating behavior by end-users and also remove the costly burden imposed by the swap dealer definition. For example, Congress should consider permitting commercial entities to not count any of their swap trades that are cleared toward their *de minimis* swap dealing calculation, and consider applying a consistent definition of hedging activity that allows end-users to mitigate both physical and financial commercial risk.

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[9] Letter from Senator Debbie Stabenow and Congressman Frank Lucas to CFTC Chairman Gary Gensler (March 29, 2012).

Fixing Hedging and Clearing

I am concerned that the swap dealer rule does not provide any legal or factual justification for the threshold amounts used in aggregation of swap dealing activity. Under CFTC regulations, a swap dealer does not need to register with the Commission if its aggregate swap dealing activity on a yearly basis is below the arbitrary $8 billion threshold.[10] The threshold is then reduced to $3 billion after a five-year phase-in period.[11] The Commission has failed to support this decision with a fact-based rationale and has made the reduction of the threshold amount non-discretionary, instead of allowing a future Commission to determine the appropriate *de minimis* levels based on market conditions at that time.

In calculating the *de minimis* threshold, market participants are permitted to exclude trades that are executed to hedge physical positions.[12] But for some reason, the Commission's definition of "hedging activity" is different from the definition used in other rules.[13] For purposes of both simplicity and consistency, the Commission should adopt one uniform definition of hedging for all CFTC regulations, and the same definition of hedging should be applied to both swap dealers ("SDs") and major swap participants ("MSPs"). I would welcome Congressional action to clarify the scope and level of permissible hedging activity, which is the foundation of the swaps and futures markets.

Swaps used to hedge risk are not the only category of transactions that should be removed from the $8 billion *de minimis* threshold amount. Swap transactions that are cleared through a derivatives clearing organization ("DCO") mitigate risk and ensure that both parties deal at arm's length. Accordingly, these cleared swaps should also be excluded from the *de minimis* calculation either by the Commission or by Congressional action.

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[10] See Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant," 77 FR 30595 at 30634 (May 23, 2012).
[11] Id. at 30744.
[12] 17 C.F.R. § 1.3(ggg)(6)(iii) (excluding swap transaction entered into to hedge physical positions from the *de minimis* swap dealer calculation).
[13] See §§ 1.3(z) and 151.5 (defining bona fide hedge transactions in the context of position limits), §1.3(kkk) (defining hedging or mitigating commercial risk in the context of the major swap participant *de minimis* calculation), §50.50 (defining hedging or mitigating commercial risk in the context of clearing exceptions).

Defining "Financial Entity" in the CEA

Another major issue that Congress needs to address is the definition of "financial entity" in section 2(h) of the CEA, which addresses mandatory clearing.[14] This provision includes the definition of a financial entity as a person "predominantly engaged" in either activities that are within "the business of banking" or "activities that are financial in nature" as defined in the Bank Holding Company Act ("BHCA").[15] The term "financial entity" has material significance throughout Title VII and affects not only these entities' domestic operations, but also has global impact due to the recent cross-border swaps guidance.

Unfortunately, using the BHCA as the source of this part of the definition of financial entity actually hurts end-users because certain technical aspects of end-users' physical commodities transactions would fall under the banking regulators' interpretation of "activities that are financial in nature." Using the definition of "financial in nature" under the banking laws applies unnecessary restrictions to these end-users and interferes with their business operations. The definition also interferes with the Commission's mandate to ensure that the commodity markets are liquid and promote hedging and price discovery. It would be helpful if Congress could clarify the definition of "financial entity" under the CEA.

As an alternative solution, section 102(a)(6) of the Dodd-Frank Act sets forth a predominance test to determine whether or not a firm is a "nonbank financial company." The statute applies an 85% standard for gross revenue from financial activity to determine if a company is predominantly engaged in financial activities, and ultimately, a nonbank financial company. One could assume from this standard that a *de minimis* amount is, therefore, less than 15% of gross revenue from non-financial activity. Accordingly, I wonder whether the Commission should apply a similar 85/15 standard as part of our *de minimis* exception in order to provide a bright-line test for end-users (both commercial and non-bank financial) to demarcate themselves from swap dealers.

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[14] 7 U.S.C. § 2(h)(7)(C)(i)(VIII).

[15] Id.

Excluding Forward Contracts with Volumetric Optionality from Swap Definition

Another example where CFTC regulations have unnecessarily complicated common commercial transactions, and confounded end-users who want to both comply with the law and use volumetric options in their regular business, is the treatment of volumetric options in the swap definition.

The definition of swap is fundamental to CFTC regulations that oversee the derivatives markets and mitigate systemic risk. Determining whether a contract is a swap affects the determination of swap dealer registration, position limits calculations, the scope of the bona fide hedge exemption, and clearing and reporting requirements. Equally important to the definition of swap is ensuring that it does not capture the legitimate business activity of end-users.

Dodd-Frank explicitly excludes forward contracts from the definition of "swap."[16] As you know, flexibility of the terms of commodity forward contracts is essential for commercial end-users. The parties cannot always accurately predict the required needs of certain commodities at some point in the future to meet their business needs.

Unfortunately, the Commission has created a lot of confusion as to whether and under what conditions forward contracts containing terms that provide for some form of flexibility in delivered volumes (i.e., contracts with "embedded volumetric optionality") fall within the forward exclusion.

The swap definition rule suggests that an agreement with embedded optionality falls within the forward exclusion when seven criteria are met. The seventh criterion, however, caused a lot of anxiety among end-users. In essence, the Commission interpreted this criterion as requiring market participants to determine whether their exercise or non-exercise of volumetric optionality

[16] 7 U.S.C. § 1a(47)(B)(ii).

is based on factors outside their control and not on the economics of the option itself.[17] This interpretation makes no commercial sense and does not achieve any objectives of Dodd-Frank.

Needless to say, the Commission's ambiguous interpretation of the seventh criterion has made it very difficult for end-users to utilize volumetric optionality without the fear of being dragged into the swaps world. A number of end-users requested that the Commission provide clarity on this issue.[18] So far, the Commission has ignored their requests. Given the importance of these contracts, I believe that the forward-contract exclusion in section 1a(47)(B)(ii) of the CEA should be amended to exclude these types of forward contracts from the swap definition.

Raising the *De Minimis* Threshold for Special Entities

Another group that deserves to be reevaluated for fair treatment is state, city, and county municipalities that fall within the swap dealer rule as "Special Entities." As currently drafted, the rule discourages market participants from trading with Special Entities. When trading with municipal energy companies, the $8 billion *de minimis* threshold drops to only $25 million.[19] The reasoning behind this distinction was that Special Entities need even more protection because any loss incurred by a Special Entity would result in the public being left holding the bag.[20] While this rule was written with the best of intentions, by reducing the *de minimis* threshold to $25 million, the end result has been a reduction in the number of market participants that are willing to do business with Special Entities. Many counterparties that would fall well below the $8 billion *de minimis* threshold are not willing to trade with Special Entities for fear of exceeding the $25 million cap and then having to register with the Commission as swap dealers.

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[17] The seventh criterion states that the exclusion applies only when "[t]he exercise or non-exercise of the embedded volumetric optionality is based primarily on physical factors, or regulatory requirements, that are outside the control of the parties and influencing demand for, or supply of the nonfinancial commodity." 77 FR 48208 at 48238 n. 341 (Aug. 13, 2012).

[18] See, e.g., National Gas Supply Association Comment Letter (Oct. 12, 2012), American Petroleum Institute Comment Letter (Oct. 11, 2012), Edison Electric Institute Comment Letter (Oct. 12, 2012).

[19] 77 FR 48208 at 30642, 30744.

[20] Id.at 30628 (referring to documented cases of municipalities losing millions of dollars on swaps transactions because they did not fully understand the underlying risks of the instrument).

In a quick fix to repeated requests from various Special Entities, the Commission issued no-action relief allowing the *de minimis* threshold to be increased to $800 million for utility commodity swaps.[21] In trying to protect Special Entities from the perils of trading in the swaps market, we have forced them to trade with large Wall Street banks since no other entity is willing to trade with them for fear of becoming a swap dealer. Instead of providing them with greater protection, the Commission has limited the pool of counterparties with which Special Entities can trade, concentrating risk in fewer market participants. This plainly goes against the goal of reducing systemic risk.

Exempting Cooperatives from Clearing Certain Swaps

On a more positive note, I am pleased that the Commission has provided cooperatives representing smaller financial institutions, such as credit unions or farm credit organizations, an exemption for clearing certain swaps. The smaller institutions themselves have already been exempted, but after receiving requests from the cooperatives that represent groups of such organizations, the Commission has exempted them as well. Cooperatives act on behalf of their members, the end-users, when they transact in the financial markets. Therefore, the same clearing exemption should be available to these groups.

Incidentally, at least in the energy markets, traders have moved to the futures market to avoid the onerous swap dealer definition. Trading futures doesn't contribute to any swap dealer *de minimis* levels and all futures trades are cleared, thus mitigating counter party risk. This brings me to my next area of discussion—futurization.

Futurization of Swaps

As a good example of the effect of the complexity and regulatory uncertainty created by CFTC regulations implementing the Dodd-Frank Act, commercial end-users moved the lion's share of swaps trading to the futures markets. Last year, on October 15th, 2012, which is the day that the swap dealer and swap definition rules took effect, the IntercontinentalExchange ("ICE")

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[21] Staff No-Action Relief: Temporary Relief from the *De Minimis* Threshold for Certain Swaps with Special Entities, October 12, 2012.

converted all of its energy swaps into futures as requested by their customers. The exact same products that were swaps the day before were traded seamlessly as futures on a designated contract market ("DCM").

There are three main drivers behind futurization: (1) vague and over-inclusive swap dealer definition rules as I mentioned earlier, (2) the Commission's differential regulatory treatment of futures vis à vis swaps with respect to the margining requirements and (3) margin requirements for swaps.

With respect to margining, futures are margined assuming a one- or two-day liquidation period.[22] However, swaps (except for energy and agricultural swaps) require a minimum liquidation period of five days for calculating initial margin.[23] The margin is set based on a liquidation period in order to cover potential losses on a defaulted position before that position can be liquidated by the clearinghouse. This substantially higher margin for swaps results in a significant economic disadvantage to swaps contracts compared to futures contracts that have similar economic characteristics. Such differential treatment of economically equivalent contracts, simply because one is called a "swap" and the other is called a "future," makes no sense from a risk management standpoint. Instead, the liquidation period should depend on the economic characteristics of a particular contract (regardless of whether it is a swap or future) and the level of liquidity of that contract. All of these conditions should the same for two economically equivalent contracts.

Historically, the Commission has allowed DCOs to set the minimum liquidation time horizons and the Commission has relied entirely on the expertise of clearing houses to set all margin levels. Allowing the clearinghouse to set the risk, rather than the Commission's prescribing rules with arbitrary time periods, is more appropriate because of the risk management functions of clearinghouses. There is also no incentive for a DCO to lower margin levels because the DCO ultimately bears the loss for any of its members' default.

[22] 17 C.F.R. § 39.13(g)(2)(ii)(A)
[23] 17 C.F.R. § 39.13(g)(2)(ii)(C).

Harmonizing Capital and Margin Requirements for OTC Swaps

Another rule that is yet to be finalized that impacts end-users' activities is the capital and margin requirements for OTC swaps. In their letter, Senators Dodd and Lincoln point out that "Congress clearly stated that the margin and capital requirements are not to be imposed on end-users."[24]

On April 13, 2011, the Commission proposed rules regarding capital and margin requirements for uncleared swaps.[25] I supported the proposal and the exemptive relief that rule would provide to end-users. Under the proposal, when swap dealers trade with end-users, the swap dealer is not required to pay or collect initial or variation margin. This is consistent with Congressional intent.

While the margin rules, as proposed, would provide some relief to end-users, I believe end-users will be required to take a capital charge. The final result is that end-users will ultimately pay more for these transactions than they did before. It is imperative that the Commission's regulations not divert working capital into margin accounts in a way that would discourage hedging by end-users or impair economic growth. Whether swaps are used by an airline hedging its fuel costs or a manufacturing company hedging its interest rates, derivatives are an important tool that companies use to manage costs and market volatility. I agree with Sean Owens, an economist with Woodbine Associates, who stated that under the Dodd-Frank rules, "end-users face a tradeoff between efficient, cost-effective risk transfer and the need for hedge customization. The costs implicit in this tradeoff include: regulatory capital, funding initial margin, market liquidity and structural factors."[26]

[24] Letter from Senators Christopher Dodd and Blanche Lincoln to Congressmen Barney Frank and Collin Peterson (June 30, 2010).
[25] 76 FR 23732 (April 13, 2011).
[26] See Sean Owens, Optimizing the Cost of Customization, Review of Futures Market (Jul. 2012).

Swap Execution Facilities

Another rule that could potentially impact end-users is the Commission's swap execution facility ("SEF") rulemaking that was finalized by the Commission in June.[27] I am pleased that in some ways, the SEF rules have made great strides to allow for a smooth transition to this new trading environment. The rules provide a streamlined registration process and allow for flexible methods of execution, but it remains to be seen whether the Commission will be able to deliver on the requirements to approve temporary SEF registration on an expedited basis. Now, it is incumbent upon the Commission to move quickly, consistently, and transparently to approve SEF applications and provide market participants adequate time to test the new trading facilities, before mandatory trading requirements are effective.

In many ways, the final rule is consistent with the goals of the SEF clarification bill as it acknowledges the "any means of interstate commerce" clause contained in the SEF definition and provides for a role of voice and other means of execution. I am aware that the final rules may have created an uneven playing field for those SEFs that are trading products that are not required to be traded on a SEF. The rule requires all multilateral facilities to register as a SEF and comply with all the regulatory requirements if they trade these products, while platforms that have one-to-many facilities are not required to register with the Commission and are allowed to offer these products for trading. I believe the Commission should address this regulatory arbitrage as soon as possible to establish a level playing field for the new swap execution platforms.

Protecting Customers in FCM Bankruptcy Proceedings

I have now identified several areas where the Commission's policy approach and rule implementation have failed to appropriately exclude commercial end-users from the more onerous aspects of the Dodd-Frank Act that address systemic risk, and offered suggestions to

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[27] 78 FR 3347(June 6, 2013).

solve these challenges. But in the important area of customer protection, there are a couple issues where the Commission could use help from Congress.

Lessons Learned from MF Global and Peregrine

The importance of customer protection is emphasized by the recent cases involving the blatant misuse of customer funds by futures commission merchants ("FCMs"). In 2010, MF Global misappropriated over $900 million in customer funds in order to cover losses incurred by the FCM in its own proprietary trading accounts. This was made worse by the $700 million in funds that were held in MF Global's UK affiliate that remained out of reach of US customers that were entitled to these funds. It goes without saying that this was a devastating loss to the customers of MF Global.

One year later, Peregrine Financial Group and its founder and chief executive Russell Wassendorf were found to have misappropriated over $200 million in customer funds. In light of these sizable and high profile cases of FCM misconduct, both the industry and Commission have taken steps to increase the level of protection afforded to customer assets to prevent something like this from happening again.

It is inexcusable that these FCMs failed to protect customer funds. These violations were not because of a lack of regulation, but were due to the failure of these FCMs to comply with rules under the CEA. In both cases, the Commission used its enforcement authority to prosecute those responsible at these FCMs. In the case of MF Global, the Commission recently filed a law suit against Jon Corzine and Edith O'Brien that has not yet gone to trial.[28] But importantly, customers have fared better in recovering their funds that were misused. Today, customers are expected to recover approximately 96 percent of their funds,[29] albeit three years after wrongdoing was discovered. In the case of Peregrine Financial, Russell Wassendorf was convicted of mail fraud, embezzlement, and making false statements to the CFTC and the

[28] http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfmfglobalcomplaint062713.pdf.

[29] While futures customers of MF Global are expected to receive 96% of their assets, MF Global customers that had foreign investments are expected to recover between 84%-91% of their assets.

National Futures Association. Regrettably, however, customers of Peregrine continue to seek repayment of the more than $200 million in customer funds that were stolen by Mr. Wassendorf. As I noted earlier, the Commission did have regulations in place to make these actions by the respective CEOs unlawful.[30] Even so, I believe there are opportunities to make improvements in Commission oversight of customer funds. As I mention in more detail below, I believe Congress should carefully consider improving customer protections in the event of FCM insolvency.

Creating a Bankruptcy Trustee for Futures and Swaps Customers

Let me first address post-bankruptcy reforms. Since over 90% of customer assets that are held in FCMs are held by jointly registered and regulated broker-dealers/FCMs, I would support increasing the authority of the CFTC in the insolvency proceedings for these jointly-regulated entities. For example, in the case of MF Global, the Securities Investor Protection Corporation ("SIPC") placed the firm into bankruptcy, with SIPC as its trustee and the exclusive mandate to protect securities customers. Since the interests of futures customers may not align with securities investors, it makes sense for the Commission to have the power to appoint its own trustee who is familiar with the CEA.

Ensuring that Customers Come First: "Super Lien" Reforms

Further, I believe Congress should pursue granting new authority to the Commission in the U.S. Bankruptcy Code to ensure that customers are always first in order of priority in any distribution of assets of the estate by the bankruptcy trustee. Claiming customers are first in line only within the FCM is not enough, especially if they are deemed a general creditor amongst the other claimants against the holding company. The reality is—and this was the case in MF Global—that the decision of the CEO of the controlling parent company can directly impact the operation of the FCM and, therefore, its customers. By making customers first in line for the proprietary assets of the FCM and its controlling parent, the company has every incentive to strengthen its internal controls to protect customer funds. And creditors, knowing their claims would be

[30] See 7 U.S.C. § 13c(b).

subordinate to customers in the event of a shortfall in the bankruptcy accounting, would also be incentivized to ensure good internal controls are in place.

Reconsidering Pro Rata Distribution for Customers

Next, I believe Congress should carefully consider the pro-rata distribution rules in bankruptcy proceedings, including creating the opportunity for certain entities (that are willing to purchase such protection) the ability to establish third-party segregation accounts that will not be comingled in bankruptcy. Currently, if there is a shortfall in segregation, customers share the loss proportionally.[31] This is the law whether or not customer funds are held in one account (comingled) or in a separate individual account. The Commission has explored various options, but has been unable to change the pro-rata requirements without statutory amendments.

Rulemaking on FCM Residual Interest

The Commission has also proposed a new customer protection rule seeking to improve the Commission's FCM oversight.[32] The comment period is closed and the draft final rule is nearing completion. One element of this rule that has drawn significant attention is the rule changing the Commission's interpretation of residual interest. The practical effect of this rule would require FCMs to maintain a level of excess margin so that one customer's excess margin does not fund the margin shortfall of another customer 100 percent of the time. While the clearing house will view the FCM's omnibus account as being properly funded,[33] one customer's assets are being used to fund another's shortfall, which is a direct violation of the CEA.[34]

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[31] See 11 U.S.C. § 766(h).

[32] See Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations; Proposed Rule, 77 FR 67866 at 67934 (Nov. 14, 2012).

[33] This is better illustrated by means of an example: FCM A has customers B and C. Customer B has a long futures position that requires $110 in margin. Customer C has a short futures position that requires only $100 in margin. FCM A then reports these positions to the clearing house within its single customer account without identifying the individual customer positions. Since the clearing house views this as one single account, it views FCM A as having a $10 surplus. In the event Customer C's position reduces in value to the point that additional margin is required, FCM A should collect that amount directly from Customer C. If the loss in C's position only requires an additional margin contribution of $10 or less however, FCM A could use the $10 excess in Customer B's account to fund Customer C's deficiency until it collects that additional margin requirement from Customer C at a later date.

We have heard significant concerns from small FCMs in the Midwest who serve farmers and ranchers in agriculture markets. The small FCMs are less likely to be able to cover the additional funds, unlike larger firms. This could result in less competition and higher concentration of risk and counterparty exposure among FCMs.

II. IMPROVING CFTC POLICIES AND PROCEDURES

I have now identified several examples where the Commission's policy approach has resulted in negatively impacting commercial end-users in a way that I do not believe Congress intended, and outlined solutions to get us back on track with our mission to protect market participants and ensure open, competitive markets that efficiently hedge risk and foster price discovery. But, it is virtually impossible to achieve good policy outcomes without establishing a sound process for reaching those outcomes. Unfortunately, the Commission has failed to do so in our implementation of the Dodd-Frank Act.

I have serious concerns that the Commission has sidestepped many requirements that all administrative agencies must follow under the APA.[35] I believe that strong Congressional oversight of our internal policies and procedures and strong Commission oversight of CFTC staff action will help us to improve our process, ensure that public participation is a core component in our deliberations, and that decisions that significantly impact market participants happen in an open and transparent manner.

Administrative Procedure Act

For example, the Commission's position limits rule was struck down last year by the United States District Court for the District of Columbia. The court held that before setting position limits, the Commission is required by statute to determine whether position limits were "necessary and appropriate" to prevent excessive speculation in the commodity markets. Unfortunately, the Commission ignored the district court order to undertake the required analysis

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[34] "It shall be unlawful for any person to be a futures commission merchant unless . . . such person shall . . . treat and deal with all money . . . received by such person to margin . . . the trades . . . of any customer of such person . . . as belonging to such customer." 7 U.S.C. § 6d(a)(2).

[35] 5 U.S.C. §§ 551 *et seq*.

and is gearing up to defend the position limits rule in the United States Court of Appeals for the District of Columbia Circuit. Concurrently with its appeal, the Commission is drafting a new rule all over again, instead of simply evaluating the necessity for position limits as it should have done in the first place. I believe that the district court sent a strong message to the Commission in its decision to vacate the position limits rule, namely, that the Commission must carefully follow the letter of the law in its rulemaking and that shortcuts will not be tolerated. Instead of heeding the warning of the district court and recent DC Circuit opinions vacating SEC rules for violating the APA, the Commission has chosen to skirt the requirements of the APA.

Abusing No-Action Relief

To date, the Commission has promulgated 45 final rules, 3 interim final rules, and 4 interpretive statements in its implementation of the Dodd-Frank Act.[36] However, in its haste, the Commission has finalized some rules that are either unworkable or simply make no sense. As a result, the Commission has also had to adopt 7 exemptive orders related to Dodd-Frank requirements.[37]

Not only that, but instead of undertaking Commission action to amend problematic rules, CFTC staff has issued an unprecedented number of no-action letters, some of which are indefinite and have no expiration. So far, CTFC staff has issued over 100 no-action letters granting relief from its new regulations under Dodd-Frank, and I won't be surprised if this number continues to grow.[38] No-action letters are not voted on by the Commission and are not published in the Federal Register. They do not include comment periods and many impose conditions on affected parties. This process is at odds with basic principles of the APA, like public participation and the opportunity to be heard. It also goes against President Obama's Executive Orders Nos. 13563 and 13579, mandating that administrative agencies "create an unprecedented level of openness in Government" and "establish a system of transparency, public participation, and collaboration."[39]

[36] http://www.cftc.gov/LawRegulation/DoddFrankAct/Dodd-FrankFinalRules/index.htm.
[37] Id.
[38] http://www.cftc.gov/LawRegulation/CFTCStaffLetters/No-ActionLetters/index.htm.
[39] Executive Order 13563, "Improving Regulation and Regulatory Overview," (Jan. 18, 2011); Executive Order 13579, "Regulation and Independent Regulatory Agencies," (Jul. 14, 2011).

I believe that the use of the no-action relief process by CFTC staff is inappropriate for changes in Commission policy. A no-action letter is issued by a division of the CFTC and states that, for the reasons and under the conditions described therein, the staff will not recommend that the Commission commence an enforcement action against an entity or group of entities for failure to comply with obligations imposed by CFTC regulations. Although the relief is not available to all entities, usually because of some complicated precondition, those market participants that may benefit from the relief are subject to numerous other conditions, needless restrictions, and arbitrary compliance timelines.

A stark example of the inappropriateness of no-action letters to grant relief is demonstrated by the recent CFTC staff no-action letter allowing substituted compliance for certain foreign jurisdictions from the Commission's cross-border swaps guidance.[40] I am concerned that a staff letter issued by a single division, with no input or vote from the Commission, would be used as the vehicle for addressing such a major issue. This no-action letter is outside the scope of a forthcoming Commission decision regarding the comparability of European rules. Further, because the relief is not time-limited, it creates an effect similar to a rulemaking but does not go through notice-and-comment procedures. As a result, this indefinite exemption not only preemptively overrides a Commission decision, but also seems to conflict with provisions in the cross-border swaps guidance that call for a re-evaluation of all substituted compliance determinations within four years of the initial determination.

Unfortunately, this is not the first time that CFTC staff no-action letters have been used to set forth Commission policy under Dodd-Frank. Staff no-action letters are inappropriate because they are not voted on by the Commission and are not formal Commission action. They are not binding on the Commission, but affected parties comply with their conditions despite the lack of legal certainty due to practical business considerations, even though the Commission may later decide to pursue enforcement or other prejudicial action. I believe that the prolific use of no-action relief relating to Dodd-Frank provisions reflects the ad-hoc and last-minute policy

[40] No-Action Relief for Registered Swap Dealers and Major Swap Participants from Certain Requirements under Subpart I of Part 23 of CFTC regulations in Connection with Uncleared Swaps Subject to Risk Mitigation Techniques under EMIR, CFTC Letter No. 13-45 (July 11, 2013).

approach that has been far too prevalent lately at the Commission. The Commission must stop this approach and get back to issuing policy in a more formal, open and transparent manner.

The Commission cannot continue with its reactive regulatory oversight. It must re-visit the rules that have proved to be unworkable, incorporate indefinite permanent relief into amended rules, make necessary adjustments, and consistently and fairly apply such amended rules to all regulated entities.

Violating Notice-and-Comment Requirements

Another serious concern I have with the Commission's rulemaking process is the lack of notice-and-comment procedures. For example, and also in connection with its cross-border swaps guidance, the Commission recently issued an exemptive order that excludes certain foreign entities from the definition of "U.S. person" and, therefore, from compliance with the CFTC swap regulations. Even though this exemptive order goes into effect immediately, the Commission has included a post-hoc 30-day comment period. I am concerned that this final exemptive order should have complied with notice-and-comment requirements under the APA that allow parties to be heard before binding rules go into effect. I am also concerned that the Commission may be inappropriately using a good-cause exception to the APA to get around notice-and-comment requirements that are supposed to ensure careful and well-reasoned decision-making.[41]

[41] Section 553(b)(B) of the APA provides for a good-cause exception to notice-and-comment requirements: "Except when notice and hearing is required by statute, this subsection does not apply… (B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. § 553(b)(B) (emphasis added). However, section 4(c) of the CEA clearly provides that the Commission may grant exemptive relief only by "rule, regulation, or order after notice and opportunity for hearing" (emphasis added). 7 U.S.C. § 6(c). The APA further provides under section 559 that it does not "limit or repeal additional requirements imposed by statute or otherwise recognized by law." 5 U.S.C. § 559. The CEA also grants emergency powers to the Commission under exigent circumstances. See, e.g., 7 U.S.C. § 12a(9). In addition, courts have narrowly construed the good-cause exception and placed the burden of proof on the agency. See Tenn. Gas Pipeline Co. v. Fed. Energy Regulatory Comm'n, 969 F.2d 1141 (D.C. Cir. 1992); Guardian Fed. Sav. & Loan Ass'n v. Fed. Sav. & Loan Ins. Corp., 589 F.2d 658, 663 (D.C. Cir. 1978).

Issuing Interpretive Guidance Versus Rulemaking

I believe that the recent cross-border swaps guidance is also an example of yet another way the Commission's recent approach to implementing its policy has minimized public participation, open engagement, and the deliberative process from our rulemakings. By issuing interpretive guidance, and then having staff issue no-action relief that exempts a large class of persons and imposes conditions without a Commission vote, the Commission evades both APA requirements and cost-benefit analysis.

I believe that putting the label of "guidance" on this document did not change its content or consequences. The courts have held that when agency action has the practical effect of binding parties within its scope, it has the force and effect of law, regardless of the name it is given.[42] Legally binding regulations that impose new obligations on affected parties—"legislative rules"—must conform to the APA.[43] As a threshold matter, the cross-border swaps guidance rests on thin statutory authority, because Congress limited the extraterritorial application of U.S. swap regulations, and therefore the CFTC's jurisdiction, to foreign activities that have a "direct and significant" impact on the U.S. economy. Despite the statutory limitation, the cross-border swaps guidance sets out standards that it applies to virtually all cross-border activities in the swaps markets, in a broad manner similar to the application of the swap dealer definition to market participants. For practical reasons, market participants cannot afford to ignore detailed regulations imposed upon their activities that may result in enforcement or other penalizing action.[44] Accordingly, I believe that the cross-border swaps guidance has a practical binding effect on market participants and it should have been promulgated as a legislative rule under the APA. Similarly, I cannot support any future interpretive guidance that would be more properly issued as a notice-and-comment rulemaking.

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[42] See Gen. Elec. Co. v. Envtl. Prot. Agency, 290 F.3d 377, 380 (D.C. Cir. 2002) (finding that a guidance document is final agency action); Appalachian Power Co. v. Envt. Prot. Agency, 208 F.3d 1015, 1020-21 (D.C. Cir. 2000).

[43] See Chrysler Corp. v. Brown, 441 U.S. 281, 302-03 (1979) (agency rulemaking with the force and effect of law must be promulgated pursuant to the procedural requirements of the APA).

[44] "A document will have practical binding effect before it is actually applied if the affected private parties are reasonably led to believe that failure to conform will bring adverse consequences . . . ." Gen. Elec., 290 F.3d at 383 (quoting Anthony, Robert A., *Interpretive Rules, Policy Statements, Guidances, Manuals, and the Like—Should Federal Agencies Use Them to Bind the Public*?, 41 Duke L. J. 1311 (1992)) (vacating an agency's guidance document that the court found to have practical binding effect and where procedures under the APA were not followed).

Avoiding Cost-Benefit Analysis

Further, by issuing interpretive guidance instead of rulemaking, the Commission has also avoided analyzing the costs and benefits of its actions pursuant to section 15(a) of the CEA,[45] because the CEA requires the Commission to consider costs and benefits only in connection with its promulgation of regulations and orders. Compliance with the Commission's swaps regulations entails significant costs for market participants. Avoiding cost-benefit analysis by labeling the document as guidance is unacceptable.

I have always advocated that the Commission's rulemaking must include a thorough cost-benefit analysis, both qualitative and quantitative, to ensure that new rules do not impose unreasonable costs on the public. Frankly, the Commission's cost-benefit provision in the CEA does not require the Commission to undertake any quantitative analyses of its proposed rules. Last year, the CFTC Inspector General found that the Commission used inadequate cost-benefit methodology for the adoption of regulations implementing the derivatives provisions of Dodd-Frank. The study found that the CFTC General Counsel played a dominant role in the cost-benefit analysis to the derogation of the CFTC Chief Economist, which has been detrimental to other agency rulemakings.

Rigorous cost-benefit analysis is simply a common sense tool designed to ensure that the benefits of any regulation exceed its costs and that regulators adopt the least burdensome approach to achieve the desired regulatory outcome. I am pleased to see that the House has passed a cost-benefit analysis bill amending the CEA and requiring the Commission to conduct quantitative economic analysis on its rules. In essence, the United States Court of Appeals for the District of Columbia Circuit found that the Commission's cost-benefit determination in connection with its recent commodity pool operator/commodity trading advisor ("CPO/CTA") rules, which lacked quantitative analysis, was in compliance with section 15(a) of the CEA because the statute

[45] 7 U.S.C. § 19(a).

imposes few requirements to quantify or estimate the cost of Commission rule proposals in favor of very high level, theoretical impacts.[46]

Even though the Commission has nearly completed its rulemaking to implement the Dodd-Frank Act, I believe it makes sense for Congress to draft and pass new, more specific cost-benefit analysis requirements for the Commission to ensure that future regulations undergo a quantitative and qualitative analysis that is consistent with the cost-benefit standards applied by other federal government agencies in their rulemaking. I support Chairman Conaway's bill H.R. 1003 as it would require the Commission to conduct a higher standard of analysis than has been previously utilized.

Internal Policies and Procedures

One area of concern that I would like to draw to your attention is the importance of a strong Commission that faithfully adheres to our principles of democratic government. Each of the five Commissioners is appointed by the President, with the advice and consent of the Senate, to carry out the mission of the CFTC to supervise the commodity markets. I am concerned that we have strayed from faithfully executing this directive as a Commission that is fully accountable to Congress and the public.

When I first arrived at the Commission in 2009, fellow Commissioner Mike Dunn, a distinguished public servant for many years, impressed upon me the importance of consistency and transparency in order to achieve good government and policy outcomes. I believe that we have lost sight of these guiding principles in our rush to implement the Dodd-Frank Act.

Stronger Commission Oversight of CFTC Staff Action

CFTC regulations ensure that the Commission is made accountable for all enforcement matters by requiring a Commission order to initiate investigations by the Division of Enforcement. Just

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[46] Inv. Co. Inst. v. Commodity Futures Trading Comm'n, No. 12-5413, Slip. Op at 14 (D.C. Cir. June 25, 2013) (stating that "[t]he statute only requires the Commission to address costs and benefits" and that the Commission does not "need [to] count costs" because the statute does not "mandate" it).

recently, I dissented on an enforcement matter that involved a radical procedural shift in the authorization of investigations for potential violations of the CEA. What I found troubling is that the Division of Enforcement sought to circumvent the powers of the Commission by proposing to bring investigations on a summary basis through the use of an "absent objection" process. I was surprised to be advised by the Commission's Office of General Counsel that the Commission cannot block a staff-initiated absent objection circulation because this process is not a Commission "vote."

To ensure fairness in terms of true separation of functions, Congress gave power to the members of the Commission to reconsider CFTC staff recommendations by independently assessing facts and legal justifications for initiating various actions. In other words, Congress intended that any decision to bring an investigation by the CFTC is reflective of a shared opinion of the majority of the Commissioners, rather than a unilateral assessment by the Division of Enforcement's staff. The new absent objection process described by the Office of General Counsel is a clear abrogation of the Commission's powers and a violation of Commission rules relating to investigations.[47]

While I support the Division of Enforcement's efforts to expeditiously investigate possible fraudulent activity, I also recognize that the Commission possesses certain responsibilities to execute its law-enforcement powers and that these responsibilities should not be brushed off to achieve an "efficient" investigative process.

Stronger Congressional Oversight of Commission Action

Congressional oversight will help to instill discipline in our internal policies and procedures. I believe the following is necessary: (1) Congress should demand a full review of the Commission's policies and procedures for Commission action and interpretation of the CEA and (2) the Commission should adopt policies and procedures that are identified to ensure that no-action relief is not abused, restore a strong Commission with appropriate accountability to the public, require the basic application of APA notice-and-comment procedures, and undertake

[47] 17 C.F.R. § 11.4 (stating that the Commission is authorized to issue a subpoena) (emphasis added).

rigorous cost-benefit analysis review. If Congress is dissatisfied with the Commission's past practices and procedures, I believe that Congress should enact reforms to the CEA to impose discipline on the Commission so that it complies with the APA and other laws.

III. IMPROVING CFTC UTILIZATION OF DATA AND TECHNOLOGY

A critically important component to any solution for the Commission's approach to its greatly expanded mission is the use of technology in order to accept, sort, aggregate, and analyze the new sources of market information provided for under the Dodd-Frank Act. I'd like to highlight two major challenges in data and technology: (1) problems faced by market participants in the swap data reporting rules and (2) problems faced by the Commission in understanding the massive data flows as a result of our enhanced oversight of the swaps and futures markets.

Challenges in Swap Data Reporting Rules

I would like to bring the Commission's approach to swap data reporting to your attention as an illustrative example of the Commission's rulemaking getting in the way of our mission to oversee trading activity and mitigate systemic risk. CFTC rules have seriously impaired the Commission's ability to effectively and immediately monitor the markets and conduct its expanded oversight responsibilities.

Under the Dodd-Frank Act, swaps data must be reported in two forms. First, basic data on swap transactions such as time, price, and notional size must be reported to a swap data repository ("SDR") and must be available to the general public. Second, more detailed and non-public information on uncleared swap transactions must be sent to SDRs under Part 45.[48] This particular swap data would include information on the counterparties to the swap and other detail that is significantly greater than what the public would need to know.

Unfortunately, the Commission failed to follow Dodd-Frank's directives when it implemented its reporting rules. Instead, the Commission required that market participants report all swaps, both

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[48] §§ 727, 729 of the Dodd-Frank Act.

cleared and uncleared, to SDRs in order to comply with the Commission's regulations.[49] The Commission complicated matters further by failing to definitively state who—the counterparties to the swap, the SEF or DCM on which the swap was traded, or the clearinghouse through which the swap was cleared—had the authority to decide which SDR would receive the data.[50]

The lack of clarity in our regulations, just as in the other examples I previously discussed, has led to both confusion and litigation. This past spring, the Commission was called upon to decide who had the authority to determine which SDR would receive the swap data. CME filed a request for a rule approval that would give them the authority to send swap data to the SDR of their choice. After considering the issue for close to three months, the Commission approved CME's new rule.[51] DTCC, a competing SDR, filed suit soon after and claimed the Commission's approval was inconsistent with the Commission's reporting requirements under its swap data reporting rule.[52]

Although correcting the inconsistencies in the Commission's rulemaking is something the Commission must address as soon as possible, there still remains an unresolved issue with respect to cleared swaps. The Dodd-Frank Act did not specifically address regulatory reporting of cleared swap data. I believe Congress should now re-examine the issue and decide if the Commission's current regulations meet both the letter and the spirit of Dodd-Frank.

Repeal of Swap Data Repository Indemnification Requirement

While on the subject of data reporting, I would like to bring up one more important issue. The Dodd-Frank Act requires foreign governments to provide an SDR with an indemnification agreement in order to have direct access to the swap transaction data for counterparties that are within the foreign government's jurisdiction.[53] Needless to say, foreign governments are either prohibited or unlikely to provide an SDR with an indemnification agreement. The Commission cannot require unfettered access to foreign trade repositories until the law is changed and this

[49] See Part 45 of the Commission's regulations.
[50] See §§ 45.3 and 45.8 of the Commission's regulations that provide seemingly contradictory instructions on which market participants and registered entities have the responsibility for reporting swap transactions.
[51] http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/statementofthecommission.pdf.
[52] http://www.dtcc.com/dtcc.v.cftc.pdf.
[53] See § 728 of the Dodd-Frank Act.

imbalance is corrected. I am pleased to see that the House has passed the bill addressing the indemnification provision.

Challenges in CFTC Data Utilization

However, even if the Commission fixes its swap data reporting rules, the Commission still lacks the ability to utilize and analyze the regulatory reporting data it receives from SDRs.

Since the beginning of 2013, certain market participants have been required to report their interest-rate and credit index swap trades to a SDR. Unfortunately, the Commission has made very little progress in analyzing and utilizing the data. With the Commission's current technology, things are not going well.

For example, the data submitted to SDRs and, in turn, to the Commission, is not usable in its reported format. Earlier this spring, the Surveillance staff admitted that they couldn't spot the London Whale trades in the Commission's current data files.

This problem is caused by the Commission's failure in its swap data reporting rules to specify the data format that reporting parties must use when sending their swaps to SDRs. In other words, the Commission told the industry what information to report, but didn't specify which language or format to use. As it turned out, reporting parties have their own internal nomenclature that is used to compile swap data. Without a Commission regulation identifying a specific nomenclature that must be used, reporting parties are free to use their own.

The end result is that even when market participants submit the correct data to SDRs, the language received from each reporting party is different. In addition, data is being recorded inconsistently from one dealer to another. Now multiply that number by the number of different fields the rules require market participants to report. Further, the abused no-action process has allowed unidentified gaps to appear in the data without explanation.

Aside from the need to receive more uniform data, the Commission must significantly improve its own IT capability. The Commission has failed to make technology investment a top priority. Our ability to adapt our existing systems to our new data requirements is a major challenge. Consequently, we don't have the capacity to undertake review of order book data, which is critical to spotting manipulative trading schemes.

Solving our data dilemma must be the Commission's top priority. We must focus our attention to both better protecting the data we have collected and developing a strategy to understand it. Until such time, nobody should be under the illusion that promulgation of reporting rules has enhanced the Commission's surveillance capabilities. As Chairman of the Commission's Technology Advisory Committee ("TAC"), I have formed a working group comprised of various market participants, including SDRs and DCOs, to leverage the expertise of this group to resolve this problem as soon as possible.

Challenges in Data Privacy

As I mentioned before, the ability of the Commission to access and analyze transaction data is paramount to the agency's regulatory oversight responsibilities. Access to data is crucial to developing new strategies and surveillance tools, but it comes with an enormous burden of responsibility to protect section 8 data (disclosure of information by the Commission).[54] In our cooperation with foreign regulators to achieve the G20 objectives, the Commission must address access issues and privacy concerns.

Currently the Commission's Inspector General is investigating whether or not market data was properly controlled by the Office of the Chief Economist when visiting scholars/contractors were assisting the Office of the Chief Economist in research efforts. While I support collaborative study programs that bring in new and innovative thinking, it is vital that the Commission has policies and procedures in place to protect against the illegal release of market data. It would not be unreasonable for the Subcommittee to request a thorough review of the Commission's data privacy policies and procedures and a subsequent briefing by the Inspector General when his

[54] 7 U.S.C. 12(e).

investigation is complete. Ensuring that the Commission can fulfill its responsibilities under the Dodd-Frank Act constitutes appropriate Congressional oversight. It is also imperative for foreign regulators to have confidence that U.S. policy will protect the data of their citizens, just as we have every right to expect that for U.S. citizens.

Technology Plan: A Solution to Challenges in Data Reporting and Utilization

Given the Commission's expanded regulatory responsibilities, it is imperative for the Commission to develop a technology plan that can assist the Commission with meeting its regulatory objective. I believe the Commission must develop a five-year strategic plan that is focused on technology, with annual milestones and budgets. To keep up to speed with the challenges of enhanced regulatory oversight, this technology plan would require each CFTC division to develop a technology budget that reflects the regulatory needs and responsibilities of that particular division.

As part of developing the CFTC strategic plan, Commission staff is working with goal teams and divisions to highlight the major technology initiatives by specific goal. These initiatives will form the basis for the IT strategic plan. While I am encouraged by the process, I will wait to review the recommendations before I can say with confidence that the Commission understands both its own shortcomings and immediate priorities, and how it intends to oversee the swaps and futures markets over the next decade.

Like the review of the no-action relief process, this Committee has every right to expect that the Commission develops and explains its strategy for deploying technology. The Commission needs to leave behind its 20th century regulatory ways in order to oversee this modern 21st century marketplace.

Electronic Monitoring of Customer Fund Balances: Industry Solution Powered by Technology

I'd like to close my testimony by focusing on a success story: the Commission's pursuit of enhancements to its oversight ability by leveraging industry resources. In response to the

egregious lack of regulatory compliance exposed by the failures of MF Global and Peregrine, there was a positive and immediate industry response that solved a gaping hole in FCM oversight. Following the Peregrine failure, which exposed the absence of electronic monitoring of customer fund balances held by the FCM and custodian banks, I called an emergency meeting of the TAC. At this meeting, I tasked the National Futures Association ("NFA") and CME, which are the Self-Regulatory Organizations ("SROs") of the FCMs, to develop a technology solution to monitor and reconcile the balances held by the FCMs and custodian banks. I am proud to say that NFA and CME delivered the technology solution. Since January 2013, an automated system linking FCMs and custodian banks has been in place to monitor changes in expected balances to within less than 1 percent deviation in customer accounts. The system is being expanded to carrying brokers and clearinghouses as well. This new technology capability was not mandated by CFTC regulations and was not paid for by taxpayers. This is a prime example of having industry solutions that protect customers and augment the Commission's oversight ability.

CONCLUSION

The Commission has been given the momentous task of creating a regulatory environment that increases transparency and improves stability in the financial markets. The Commission, in implementing such broad and ambitious goals, was tasked with transforming Dodd-Frank objectives into a workable regulatory framework. Given the intrinsic complexities of the financial markets, the Commission must come up with clear and consistent rules that take into account the global nature of derivatives trading. Although it is difficult to achieve these goals without making mistakes along the way, when flaws are uncovered, it is imperative for the Commission to work with market participants to come up with better solutions to implementing Dodd-Frank objectives. If the Commission does not faithfully implement the statute or make the necessary conforming updates to its rules, this Committee has every right and responsibility to make the necessary and immediate changes it sees fit. I am happy to continue to work together to provide any information the Subcommittee requires to ensure the Commission is operating as authorized and as mandated by the Dodd-Frank Act.

I appreciate the opportunity to testify today and am happy to answer any of your questions.

Thank you.