Testimony of Sharon Y. Bowen
Commissioner, Commodity Futures Trading Commission
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Subcommittee on Commodity Exchanges, Energy, and Credit
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Chairman Scott, Ranking Member Scott, Chairman Conaway, Ranking Member Peterson, and Members of the Subcommittee, thank you for inviting me to testify this morning on the reauthorization of the Commodity Futures Trading Commission, on which I serve as a Commissioner. It is an honor and a privilege to appear before you today.

First, I would like to express my gratitude to our extremely hard-working staff. Despite suffering from significant funding and resource constraints and the massive new mission of regulating and policing the swaps market, their performance has been exemplary. I remain impressed with their invaluable expertise and professional commitment to fulfilling our vastly increased Congressional mandate. At present, the CFTC has completed a greater percentage of its Dodd-Frank rules than other domestic financial regulatory agencies. That record of accomplishment is entirely thanks to our staff, who have shared their perspectives and insights with me in these last ten months. If Members leave this hearing with only two new pieces of information today, I hope it is that first, our staff truly are the hardest-working, most professional staff in a government agency. Second, that while our staff can accomplish a great deal with limited resources, the agency desperately needs additional funding and staff to carry out our mission of regulating and protecting the swaps and futures markets.

I would also like to extend my appreciation and thanks to my two fellow Commissioners testifying with me here today. Commissioner Giancarlo brings with him a wealth of private sector experience in the swaps industry and he makes use of it in every open meeting, every roundtable, and every discussion we have. Commissioner Giancarlo and I experienced the confirmation process together; sometimes, we would even have joint meetings with individual Senators, and that gave us a bond that I believe has made it easier for us to reach consensus on some of our mandates. Commissioner Wetjen, who now has the longest tenure of the four of us, has been an invaluable source of expertise and insight to the rest of us. He has been able to inform us of why certain actions were taken prior to our arrival. But beyond merely being a repository of institutional memory, he also deserves immense praise for serving as Acting Chairman for approximately six months last year and for his many piercing questions and insights about potential risks and impacts of a proposed CFTC action. I am fortunate to serve with my fellow Commissioners.

I also want to extend my gratitude to our Chairman, Tim Massad, who has worked hard to address a number of concerns of end-users and other stakeholders. He brings an incredibly detail-oriented viewpoint, a steel-trap memory of the evolution of the markets we regulate, and a formidable intellect. I've seen Chairman Massad tell our staff that the CFTC should be the most interesting, professional, and all-around best financial regulator in the government and I know that's a goal he strives to fulfill. It is a goal I share and I am glad we can work together to make it a reality.

My experience and what I bring to the table is broad both professionally and personally. I have a 32-year career as a lawyer on Wall Street and a 58-year career as a consumer and investor. I am also someone who personally witnessed families and friends lose their jobs, homes, and retirement accounts during the financial crisis. Frankly, they believed that they would be ok because they worked hard, had the right education, and made personal sacrifices.

While some of us may disagree about the state of systemic risks to the swaps and futures markets or the wisdom of particular Dodd-Frank requirements, I hope we can all agree on this: the Commodity Futures Trading Commission should be reauthorized. Its role in overseeing the derivatives market is critical to protecting global financial stability and the U.S. economy and thus assuring the American people that their voices and interests are being heard.

The CFTC was last reauthorized by Congress in August 2008, and as we all know only too well, the world has changed greatly since then. The last reauthorization occurred before Lehman crashed, before the national unemployment rate hit 10%, and before the Dodd-Frank Wall Street Reform Act was enacted into law, giving the CFTC new powers and responsibilities, including jurisdiction over the vast majority of the swaps market.

It is in fact nearly five years even since Dodd-Frank. In markets as dynamic as these, where trading practices and strategies are dynamic and can change within quarters, weeks, or even days, five years is a lifetime. I have a few recommendations I believe will enhance the ability of the CFTC to protect markets, investors, and consumers.

First, and most importantly, there is the issue of resources. Much has been said about the topic of funding of course, but I believe a little more discussion is needed. Frankly, I believe it would be prudent to establish some kind of mechanism that allows the Commission to self-fund. We are grateful for the $35 million increase in appropriations we received in last December's legislation to fund the government, which raised our annual budget from $215 million in fiscal year 2014 to $250 million for fiscal year 2015. However, that $35 million is a drop in the bucket considering the scope of our mission to regulate the swaps and futures markets. According to the most recent numbers I've seen, the futures market in the United States, which was the primary market we regulated prior to Dodd-Frank, is estimated to be more than $30 trillion dollars total at present.[1]

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[1] *See* Bank for International Settlements, "Derivatives Financial Instruments Traded on Organized Exchanges," available at http://www.bis.org/statistics/r_qa1503_hanx23a.pdf & Commodity Futures Trading Commission, FY

Meanwhile, the U.S. swaps market is estimated to be approximately $400 trillion dollars today.[2] As a point of comparison, the legislation that funded the entire government last December, the so-called "Cromnibus," appropriated just over one trillion dollars, and the entire US gross domestic product in 2014 was estimated as just over $17.4 trillion dollars.[3] So, by mandating in Dodd-Frank that we regulate the domestic swaps market, Congress increased our overall jurisdiction by over 1300%.

While our budget has increased in recent years, it has not kept pace with that massive increase in our mission. In fiscal year 2009, the entirety of which was prior to Dodd-Frank's passage but which did cover the heart of the 2008 financial crisis, our budget was $146 million.[4] For fiscal year 2015, our budget is $250 million, an increase of $104 million since fiscal year 2009.[5] So, we've now got $104 million dollars to regulate an additional $400 trillion of jurisdiction, and $250 million to regulate the combined, greater-than $430 trillion domestic swaps and futures markets. To use the language of finance, the government is currently making an investment that is leveraging one dollar of regulatory funding for every $1,720,000 of the swaps and futures markets.

Our staffing levels have failed to keep pace with our duties. In May 2009, we had 500 people employed at the CFTC.[6] In fiscal year 2014, we had 647 full time employees, an increase of 29%.[7] Yet, it's worth noting that we actually had fewer staff in fiscal year 2014 than we had just two years earlier; in fiscal year 2012, we had 687 full-time employees.[8] Despite weathering that nearly 6% cut in staffing levels, our staff has continued to complete our major rulemakings, such

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2014 Annual Performance Report & FY 2016 Annual Performance Plan, February 2015, at page 6, available at http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2014apr.pdf. Note, figures are in gross notional dollars. Please note that in 2009, the futures market was also smaller, being estimated at approximately $22 trillion. Commodity Futures Trading Commission, Budget and Performance Estimate for FY 2010, May 7, 2009, available at http://www.cftc.gov/reports/presbudget/2010/2010presidentsbudget01.html.

[2] Commodity Futures Trading Commission, FY 2014 Annual Performance Report & FY 2014 Annual Performance Plan, April 10, 2013, at page 6, available at http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2014apr.pdf. Note, even if one looks at gross market value instead of gross notional, the global swaps market was still valued at over $17 trillion in mid-2014. *See* Bank for International Settlements, "Amounts of Outstanding Over-the-Counter (OTC) Derivatives," available at http://www.bis.org/statistics/dt1920a.pdf.

[3] Federal Reserve Bank of St. Louis, "Gross Domestic Product," available at http://research.stlouisfed.org/fred2/series/GDPA. Note – GDP as valued in chained 2009 dollars is just over $16 trillion. Federal Reserve Bank of St. Louis, "Real Gross Domestic Product," available at http://research.stlouisfed.org/fred2/series/GDPCA.

[4] Commodity Futures Trading Commission, Budget and Performance Estimate for FY 2010, May 7, 2009, available at http://www.cftc.gov/reports/presbudget/2010/2010presidentsbudget01.html

[5] Commodity Futures Trading Commission, President's Budget - Fiscal Year 2016, February 2, 2015, at pages 1 & 7, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcbudget2016.pdf.

[6] *See* Commodity Futures Trading Commission, Budget and Performance Estimate for FY 2010, May 7, 2009, available at http://www.cftc.gov/reports/presbudget/2010/2010presidentsbudget01.html.

[7] Commodity Futures Trading Commission, President's Budget - Fiscal Year 2016, at page 8, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcbudget2016.pdf.

[8] Commodity Futures Trading Commission, President's Budget and Performance Plan – Fiscal Year 2014, April 10, 2013, at page 8, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcbudget2014.pdf.

as the recent re-proposal of the margin rule, and engaged in major successful enforcement actions, such as the more than $6 billion in fees and penalties the Commission collected in actions against various entities for manipulating notable international benchmark rates.[9] The CFTC staff has literally done more with less.

Yet, while we have been able to survive on our current funding levels, our lack of resources has not just been a challenge for us, it has also been an obstacle to industry, including end-users. With a staff that is stretched so extremely thin, reviews of various applications by derivatives clearing organizations and exchanges can take longer, delaying those organizations' efforts to improve and enhance trading for market participants. With a staff that is stretched so extremely thin, examinations of registrants are more infrequent. That slower rate of regulatory examinations will increase the likelihood that errors and problems that develop at a registrant will not be found and corrected quickly, resulting in greater risk for investors and greater compliance costs for the registrants. And with a staff that is stretched so extremely thin, our rulemaking process will move much more slowly. Not only does that invite additional regulatory uncertainty into the markets we regulate, but it also means that we are less able to craft exemptions for end-users or market participants in a timely fashion, even for those entities who have a critical and real need for them.

Our lack of resources is hampering our ability to function, and it is indirectly slowing down the business of trading, including for the purposes of hedging. Last month, I met with a number of industry participants who praised the excellent job the CFTC's staff was doing under the circumstances but also understood that the lack of funding posed risks both to their businesses and our broader financial system. In fact, they asked what they could do to get us additional funding. I urged them, like I urge all persons with similar views, to make those views known.

Obviously, this is not an appropriations bill and the House Agriculture Committee is not empowered to simply grant us additional money. However, if there was some way in this reauthorization to allow the CFTC to set fees on registrants or a de minimis fee on some trades, as the SEC is empowered to do, that would be extremely helpful.[10] The industry participants who engage with the CFTC the most are typically entities asking us to revise a regulation or grant some kind of regulatory relief. Allowing the CFTC to fund itself via the collection of extremely small fees from industry would effectively be allowing the industry to pay a de minimis amount of money to receive substantially faster service. Such a funding rubric would have the added benefit of no longer asking American taxpayers to directly foot the bill of setting regulations on the swaps and futures markets. I know that bills have been introduced during the last few Congresses that grant us some kind of fee-setting authority, and I think the Wall Street

[9] Commodity Futures Trading Commission, President's Budget - Fiscal Year 2016, at page 38, February 2, 2015, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcbudget2016.pdf.
[10] Securities and Exchange Commission, "Fee Rate Advisory #3 for Fiscal Year 2015," January 15, 2015, available at http://www.sec.gov/news/pressrelease/2015-8.html#.VQCsQzYpAyE.

Accountability Through Sustainable Funding Act introduced by Reps. DeLauro, Welch, and Courtney last Congress is the best one I've seen to date.[11] I should add that there are many ways to structure such a fee, including establishing de minimis fees on all trades, fees on certain riskier trades, or annual fees for registrants. While I may prefer one self-funding mechanism over another, I certainly prefer just about any of them over the status quo.

Second, I believe it is time to reevaluate how our system of self-regulation is functioning. Currently, our system of self-regulation doesn't reflect the current market realities or some of the core principles of Dodd-Frank. In the futures space, we require exchanges, such as the Intercontinental Exchange (ICE) or the Chicago Mercantile Exchange (CME), to be SROs. Therefore, they must enforce certain minimum reporting and financial requirements on their members.[12] The National Futures Association (NFA), which is the sole registered futures association, is also an SRO, and it can set minimum rules and standards for their members, which include futures commission merchants (FCMs), introducing brokers (IBs),[13] and retail foreign exchange dealers (RFEDs).[14]

This system, which is admittedly complex, was made more complicated in the wake of Dodd-Frank when we added the swaps market to this rubric. Under CFTC rules, each of the more than twenty swap execution facilities in existence today, is an SRO.[15] As a result, the National Futures Association, which has spent the vast majority of its more than 30-year existence focused almost entirely on the futures industry, serves as the SRO for the swaps industry.[16]

It would be wise to take a comprehensive look at this system and ensure that it is set up to work efficiently, cohesively, and effectively. If a part of it is not working or there is an area that is not receiving the appropriate level of regulation, it should be addressed. In particular, I believe it may be prudent to establish a separate SRO just for market participants who engage in swaps activity. After all, while futures and swaps may be similar in many ways, including the fact that market participants are, with a few notable exceptions, rarely retail investors, they remain quite distinct. I believe a number of the Members here today are familiar with Commissioner Giancarlo's white paper on potential improvements that might be made to our swaps rules. One of his suggestions is that we "establish standards that would enhance the knowledge,

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[11] Introduced September 16, 2014, available at https://www.congress.gov/113/bills/hr5490/BILLS-113hr5490ih.pdf.

[12] 17 CFR § 1.52, available at http://www.gpo.gov/fdsys/pkg/CFR-2012-title17-vol1/pdf/CFR-2012-title17-vol1-sec1-52.pdf.

[13] Commodity Futures Trading Commission, "Futures Commission Merchants (FCMs) & Introducing Brokers IBS)," available at http://www.cftc.gov/IndustryOversight/Intermediaries/FCMs/fcmib.

[14] National Futures Association, "Retail Foreign Exchange Dealer (RFED)," available at https://www.nfa.futures.org/nfa-registration/rfed/index.HTML

[15] Commodity Futures Trading Commission, "Core Principles and Other Requirements for Swap Execution Facilities," 17 CFR Part 37, June 4, 2013, at page 33521, available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-12242a.pdf. ([T]he Commission notes that it views SEFs as SROs, with all the attendant self-regulatory responsibilities to establish and enforce rules necessary to promote market integrity and the protection of market participants." (citation omitted)).

[16] National Futures Association, "NFA's Role in the U.S. Futures Industry," available at http://www.nfa.futures.org/nfa-about-nfa/who-we-are/NFAs-role-US-futures-industry.HTML.

professionalism and ethics of personnel in the U.S. swaps markets that exercise discretion in facilitating swaps execution, as well as certain supporting compliance and operations personnel."[17] Commissioner Giancarlo proposed to establish these standards, at least in part, via "an examination regime for interdealer brokers and other personnel…."[18] I support this particular proposal of Commissioner Giancarlo's and believe we should consider whether a new SRO for the swaps market would be better positioned to craft and maintain such an examination regime. And I believe it is in the best interests of protecting customers to do so. Establishing standards of eligibility and accountability will enhance and strengthen investor protections.

Third, I believe it would be wise to establish stricter regulations on the retail foreign exchange swaps industry. I have previously said that "[i]t is ironic, that following the enactment of Dodd-Frank, the retail foreign exchange industry is the least regulated part of the derivatives industry."[19] I continue to hold that view.

Yet, I increasingly think my prior statements on this industry understate the risks within the current retail foreign exchange regime. As Bloomberg Markets reported in December 2014, "the two biggest publicly traded over-the-counter forex companies, -- FXCM Inc. and Gain Capital Holdings, Inc., show that, on average, 68 percent of investors had a net loss from trading in each of the past four quarters."[20] Despite the likelihood that the average investor will lose money, this is an industry where leverage ratios remain at fifty-to-one, meaning that a person with a $500 account is allowed to trade $25,000. In other words, the outsized risks at play in this market can quickly cause an investor to be wiped out. And while this industry may not be as large as the broader dollar currency markets, where trillions of dollars are exchanged every day, the retail foreign exchange market is not small by any stretch of the imagination.[21] One analyst at the Aite Group estimated that twenty million individual investors globally trade $400 billion a day, "some making bets of just a few hundred dollars…."[22]

We do not have to surmise about the possibility of an event occurring in this market that causes risks to individual investors and the broader financial system – we already experienced one. On January 15th, the Swiss National Bank announced that it would no longer cap the exchange rate

[17] Commissioner J. Christopher Giancarlo, Commodity Futures Trading Commission, "Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank," at pages 72-73, January 29, 2015, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf.
[18] *Id*. at page 73
[19] Commissioner Sharon Y. Bowen, Commodity Futures Trading Commission, "Statement of U.S. Commodity Futures Trading Commissioner Sharon Bowen Regarding Recent Activity in the Retail Foreign Exchange Markets," January 21, 2015, available at http://www.cftc.gov/PressRoom/SpeechesTestimony/bowenstatement012115.
[20] David Evans, "Leverage as High as 50-1 Lures OTC Forex Traders Who Mostly Lose," Bloomberg.com, November 12, 2014, available at http://www.bloomberg.com/news/articles/2014-11-12/leverage-as-high-as-50-1-lures-otc-forex-traders-who-mostly-lose.
[21] *Id*.
[22] *Id*.

of the Swiss Franc versus the Euro, triggering chaos in the currency markets.[23] In particular, one U.S. dealer of retail foreign exchange, the aforementioned FXCM, nearly went out of business after its customers lost more than $200 million, placing the company on the hook for those losses.[24]

To ward off the risk of such a future event, I would recommend rulemaking requirements to bring the level of regulation on the retail foreign exchange markets at least up to the level of the rest of the swaps market. In fact, I believe retail foreign exchange swaps, which directly (and uniquely for the CFTC) involve retail investors, should be more regulated than the rest of the swaps market. There are a number of regulatory tools that can be utilized, from higher capital standards to best execution requirements, and from segregated customer accounts to stricter margin requirements.

Fourth, I believe it is time for us to issue new regulations on cybersecurity. President Obama eloquently spoke about this topic at our State of the Union as it applies to our economy more broadly and I discussed this topic at a recent conference in New York on operational risk.

As I said then, the fact that so much of trading is now entirely electronic brings with it the risk of cyberattack. As a result, "financial actors have become storehouses for massive amounts of data, much of it incredibly sensitive. From information about trading strategies to clients' social security numbers, the damage that could be done via a major cyberattack on an exchange, clearinghouse, Swap Execution Facility (SEF), or systemically important financial institution is considerable."[25] And the days of cyberattacks being primarily lone wolves interested in making money are gone. We have to have protections in place not only against such thieves but also against entities that may be trying to hack into a system just to try and disrupt our financial markets and thereby damage our economy.

As I said in my conference speech last month, "standardization is not necessarily our friend" with regards to cybersecurity – if there is one single national or industry wide-standard, "that just means we've created a blueprint for all our registrants to be hacked."[26] Thus, it would be prudent to establish cybersecurity regulations on futures and swaps market participants that are more rigorous than regulations on the rest of the private sector and to establish even more rigorous regulations on key market participants, such as extremely large trading entities and exchanges. The regulations on key market participants should not be one-size-fits-all prescriptions, but instead mostly a series of principles that firms should meet via their own, bespoke cybersecurity

[23] Neil MacLucas & Brian Blackstone, "Swiss Move Roils Global Markets," Wall Street Journal, January 15, 2015, available at http://www.wsj.com/articles/switzerland-scraps-currency-cap-1421320531.
[24] Reuters, "FXCM to Forgive Most Clients' Negative Balances on Swiss Franc Surge," January 28, 2015, available at http://www.reuters.com/article/2015/01/28/fxcm-forex-idUSL4N0V759V20150128
[25] Commissioner Sharon Y. Bowen, Commodity Futures Trading Commission, "Remarks of CFTC Commissioner Sharon Y. Bowen Before the 17th Annual OpRisk North America," March 25, 2015, available at http://www.cftc.gov/PressRoom/SpeechesTestimony/opabowen-2.
[26] *Id.*

protections. In other words, it would be a tiered regime of cybersecurity protections – a baseline level of protections for all futures and swaps market participants and a higher level of additional, specifically tailored protections for the most at-risk firms.

Finally, we should increase our enforcement penalties. Put simply, some of our current enforcement penalties require updating; they should not convey the message that it is just a cost of doing business to pay these penalties. For instance, if an entity engages in market manipulation that is very disruptive to the market but makes very little profit itself (or even loses money in the effort), the damages we could assess civilly could be capped at $1 million.[27] That is a sizable sum, but given the size of these markets and some of the institutions who are registered with us, the cap is too low. Similarly, if a person provides false information to the Commission in a filing, the damages could be capped at just $140,000.[28] I would support updating these enforcement penalties so that they are tough but fair and fit the scope and scale of the markets we regulate.

I am a firm believer in robust enforcement of our rules and laws, but I also believe that we have to take a multi-pronged approach to protecting consumers and investors. Beyond having rigorous enforcement, we also need to be educating consumers about the market and making it possible for them to make smart, safe choices when they choose to invest. To that end, we have established a new national campaign, called CFTC SmartCheck, to provide consumers with tools to check the backgrounds of their financial professionals and thereby protect themselves from financial fraud.[29]

I agree with Chairman Massad that "The United States has the best financial markets in the world. They are the strongest, most dynamic, most innovative, and most competitive – in large part because they have the integrity and transparency that attracts participants. They have been a significant engine of our economic growth and prosperity. The CFTC is committed to doing all we can to strengthen our markets and enhance those qualities."[30]

If anything, I would go a step farther – our financial markets are the lifeblood of our economy. They allow capital to be more efficiently invested and help allow newer, leaner, and more innovative enterprises and investors to thrive. But without fair, rigorous rules in place, the system breaks down, harming investors, businesses, and our overall economy. The CFTC has changed greatly in the last few years and it is in the best interest of the industry, investors, and the public that the Commission's authorizing legislation is up-to-date so that the CFTC can meet

[27] 7 U.S.C. §9(10).
[28] *Id*.
[29] http://smartcheck.cftc.gov/.
[30] Chairman Timothy G. Massad, Commodity Futures Trading Commission, "Testimony of Chairman Timothy G. Massad Before the U.S. House Committee on Agriculture," February 12, 2015, at page 25, available at https://agriculture.house.gov/sites/republicans.agriculture.house.gov/files/images/committee-photo-archives/Testimony%20-%20CFTC%20-%20House%20Ag%20-%20Feb%2012%202015.pdf.

today's challenges and those that are bound to unfold in the future. Thank you, and I look forward to your questions.