STATEMENT OF GARY GENSLER
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BEFORE THE
HOUSE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON AGRICULTURE, RURAL DEVELOPMENT, FOOD AND DRUG ADMINISTRATION, AND RELATED AGENCIES
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Good morning Chairman Kingston, Ranking Member Farr and members of the Subcommittee. I thank you for inviting me to today's hearing on the Commodity Futures Trading Commission's (CFTC) fiscal year (FY) 2012 budget request. Though I will focus my testimony on the resource needs of the CFTC for FY 2012, I also will address the CFTC's funding situation during FY 2011.

Before I begin, I want to congratulate Congressmen Kingston and Farr for becoming Chairman and Ranking Member of this Subcommittee. I look forward to working with you, your staffs and all members of the Subcommittee.

CFTC Mission

The CFTC is a good investment for the American public, overseeing vast markets with a relatively small staff. At its core, the mission of the CFTC is to ensure the integrity and transparency of derivatives markets so that hedgers and investors may use them with confidence. Derivatives emerged as tools to allow producers and merchants to be certain of the prices of commodities that they planned to use or sell in the future. Derivatives markets are used to hedge risk and discover prices and work best when they are transparent and free from fraud and manipulation.

The CFTC has historically been charged with overseeing one part of the derivatives market – the commodity futures markets. These markets have been around for more than a century. Initially, there were futures on agricultural commodities, such as wheat, corn and cotton. The markets have grown to include contracts on energy and metals commodities, such as crude oil, heating oil, gasoline, copper, gold and silver, and contracts on financial products, such as interest rates, stock indexes and foreign currency. These markets – and our regulatory oversight – affect tens of thousands of farmers, ranchers, oil producers, corporations, municipalities, pension funds and anybody else who wants to hedge a risk and get the benefits of transparent pricing in competitive markets.

Each part of our nation's economy relies on a well-functioning derivatives marketplace. It is essential so that producers, merchants and other end-users can manage their risks. It allows those companies to lock in prices for the future. Such price certainty allows companies to better make essential business decisions and investments. Thus, it is critical that market participants have confidence in the integrity of these price discovery markets.

Though the CFTC is not a price-setting agency, rising prices for basic commodities – agricultural and energy – highlight the importance of having effective market oversight that ensures integrity and transparency.

The CFTC fulfills its statutory mandate through market surveillance, industry oversight and enforcement. We pursue fraud, such as Ponzi schemes, and market manipulation. We oversee futures exchanges and clearinghouses. We process registration applications, rule reviews, appellate filings and examinations of exchanges and clearinghouses. The CFTC is a cop on the beat that protects markets in commodities and derivatives from fraud, manipulation and other abuses.

CFTC Scope

The CFTC and its predecessors have overseen the commodity futures markets since the 1920s. A new type of derivatives called swaps, however, came around in the 1980s and remained unregulated until the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. That legislation expanded the CFTC's oversight to, for the first time, include both the futures and swaps markets. It also gave the CFTC new regulatory responsibilities. The Securities and Exchange Commission will have similar jurisdiction over the securities-based swaps markets.

The swaps market that the Dodd-Frank Act tasks the CFTC with regulating has a notional amount roughly seven times the size of that of the futures market and is significantly more complex. The notional value of the U.S. futures market in December was approximately $36 trillion. Based upon figures compiled by the Office of the Comptroller of the Currency, the largest 25 bank holding companies currently have $277 trillion notional amount of swaps.

Further, the Dodd-Frank Act expands the CFTC's regulatory authority to include new types of entities, such as swap dealers, swap execution facilities (SEFs) and swap data repositories (SDRs). The swaps market is more complex than the futures markets because it includes customized bilateral hedging arrangements. Whereas all futures trade on exchanges, some swaps will continue to be traded over-the-counter.

Implementing the Dodd-Frank Act

The CFTC is working deliberatively, efficiently and transparently to implement the Dodd-Frank Act. We initially organized our effort around 30 teams responsible for different rulemaking areas. A number of months ago we also set up a 31st rulemaking team tasked with developing conforming rules to update the CFTC's existing regulations to take into account the provisions of the Act.

At this point in the process, the CFTC has come to a natural pause as we have now proposed rules in 28 of the 31 areas required by the Dodd-Frank Act. As we receive comments from the public, we are looking at the whole mosaic of rules and how they interrelate. We will begin considering final rules only after staff can analyze, summarize and consider comments, after the Commissioners are able to discuss the comments and provide feedback to staff, and after the Commission consults with fellow regulators on the rules.

One component that we have asked the public about is phasing of rule implementation. Public comments will help inform the Commission as to what requirements can be met sooner and which ones will take a bit more time.

One proposed rule that we have yet to promulgate relates to margin requirements for swaps. In the Dodd-Frank Act, Congress recognized the different levels of risk posed by transactions between financial entities and those that involve non-financial entities. Consistent with this, proposed rules on margin requirements should focus only on transactions between financial entities rather than those transactions that involve non-financial end-users.

FY 2012 Budget Request

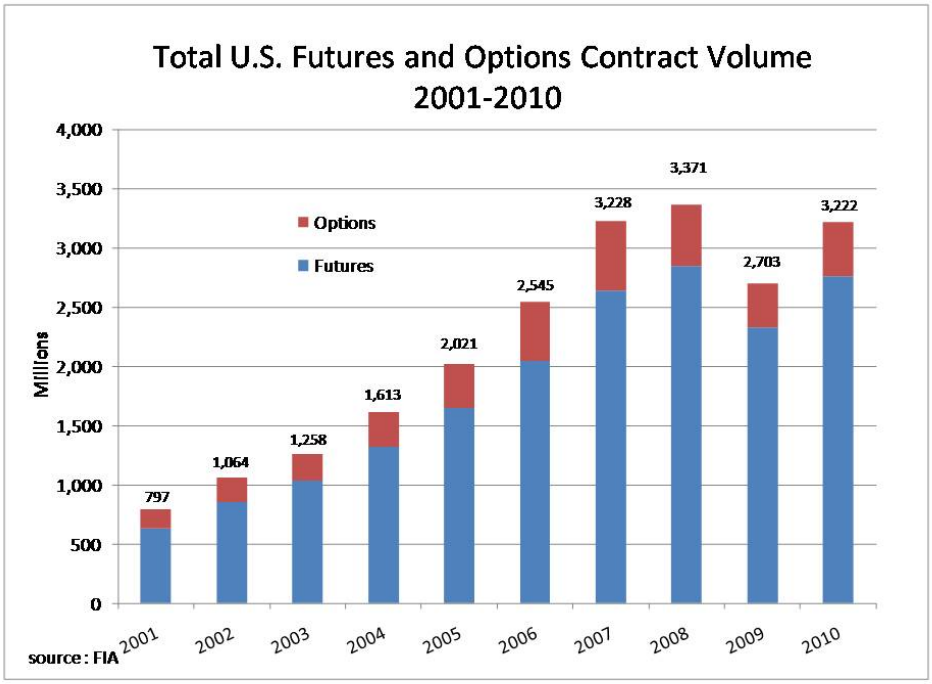
The President's Budget proposes that $308 million be appropriated for the CFTC for FY 2012 to remain available until expended through FY 2013. This funding level would enable the agency to perform its responsibilities both in the oversight of commodity futures markets and in beginning to oversee the swaps markets.

In 2008, both the financial system and the financial regulatory system failed the test for the American public. Though there were many causes to the crisis, the unregulated swaps market played a central role. The President's budget request asks for $140 million more than our FY 2010 funding level because the 2008 financial crisis was very real, and Congress mandated that regulation be brought to the swaps market. An investment in the CFTC is warranted, because, as we saw in 2008, without oversight of the swaps market, billions of taxpayer dollars may be at risk.

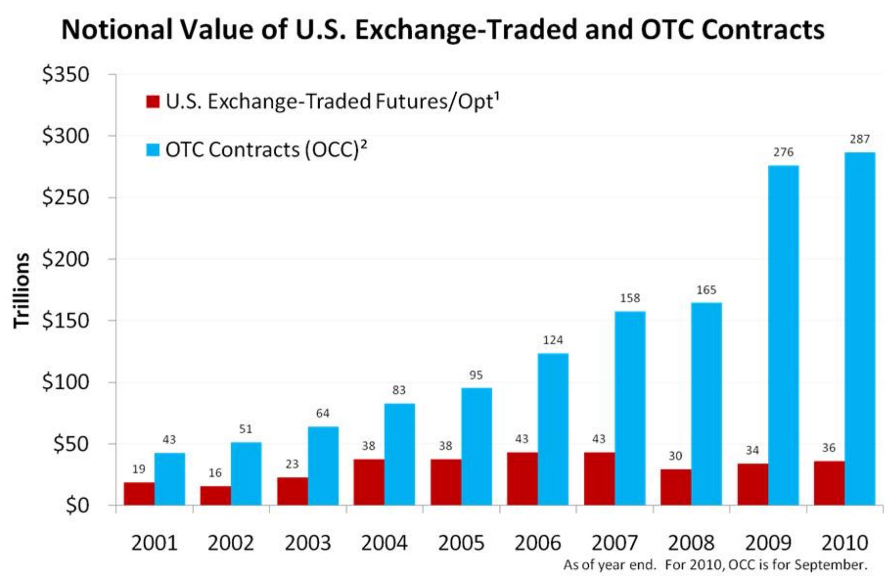
The CFTC's resources are used primarily on staff and technology.

The agency peaked in staff in 1992 at 634 staff, but staff levels were cut nearly 25 percent in the early 2000s to our lowest level of approximately 440 in 2007 and 2008. With the help of Congress, CFTC staffing levels just this past year returned to our levels of the late 1990s – the level needed to oversee the commodity futures markets at that time.

We currently have 676 thoughtful, experienced and hardworking staff who are dedicated to the agency's mission. In the last ten years, however, futures trading volume has increased more than four-fold. The number of actively traded futures and options contracts increased more than nine-fold. We have moved from an environment with open-outcry pit trading to highly sophisticated electronic markets.



The President's budget would provide funding for 983 employees. Though we are asking for an increase in funding to support 45 percent more staff, it is in light of a Congressional mandate that expands our scope more than seven fold.



[1] U.S. Exchange-Traded Futures/Options are those traded on CFTC Designated Contract Markets
[2] OCC data (Office of the Comptroller of the Currency) is for the top 25 bank holding companies with the most derivative contracts and "OTC" includes "Forwards," "Swaps," "Options" and "Credit Derivatives."

Effective oversight of the markets requires that we invest in both staff and technology. We need staff to process registration applications, conduct surveillance and rule enforcement reviews, investigate fraud and manipulation and perform many other functions that computers alone cannot. But we also need technology to pursue automated surveillance to oversee the markets and to make our oversight more efficient.

Despite rapid advances in technology and the increased size of regulated derivatives markets, funding for the CFTC has lagged behind the growth of the markets. While market participants have the technology to automate their trading, we do not yet have the resources to employ modern technology to automate our surveillance.

Last year, we used about 18 percent of our budget – $31 million – on technology initiatives. The CFTC needs to make further investment in technology to efficiently oversee both the futures and swaps markets. Only through investment in the CFTC will we be able to adequately oversee the commodity futures and swaps markets and protect the American public. The President's FY 2012 budget provides for $66 million to be used on technology, which would increase the proportion of our budget used on technology to more than 21 percent.

To put the CFTC's funding request in perspective, I might note that the CFTC current staff of 676 compares to approximately 800,000 people employed by U.S. brokerage firms, according to the Department of Labor's Bureau of Labor Statistics. That is out of a financial industry that employs 5.6 million people. Furthermore, the CFTC's funding request of $308 million compares to approximately $814 billion in annual revenues of the top 25 bank holding companies according to industry filings with the Federal Reserve. The CFTC's technology budget of approximately $20 million during FY 2011 compares to about $20-25 billion spent by U.S. broker/dealers on technology initiatives per year, according to a presentation recently given to the CFTC's Technology Advisory Committee by the TABB Group.

Detailed Funding Request

The requested funding increase to cover statutory authorities includes resources to accomplish the following goals:

Modernizing Information Technology and Establishing a New Group for Data. The Commission's FY 2012 budget request includes $66 million for technology. The requested budget includes $41 million to fulfill our pre-Dodd-Frank information technology requirements. This increase allows the Commission to invest in technology in an effort to keep pace with the futures marketplace that is becoming increasingly populated by algorithmic and high-frequency traders.

Technology will play a critical role in leveraging financial and human resources as the CFTC executes its expanded oversight and surveillance responsibilities pursuant to the Dodd-Frank Act. Accordingly, the Commission will establish a new group for the collection, management and analysis of data. This group will facilitate improved oversight and enforcement in the derivatives markets through the use of technology and data. It also will serve as the primary interface for market participants in adapting to the new data standards and reporting requirements for market data required under the Dodd-Frank Act.

The CFTC's FY 2012 budget request includes $25 million for technology needed to implement the Dodd-Frank Act. The resources requested are necessary for the CFTC to invest in direct data links to swap data repositories that are being established in the United States and internationally. The CFTC also must have the technology to aggregate and summarize the data for purposes of oversight and surveillance.

Establishing and Staffing a New Swap Dealer and Intermediary Oversight Program. The Dodd-Frank Act creates two new categories of registrants: "swap dealer" and "major swap participant." Staff will be needed to regulate them for robust business conduct standards, record-keeping and reporting requirements and capital and margin requirements. To effectively oversee swap dealers and major swap participants, the CFTC will create a new oversight program for these registrants.

Initial estimates are that there could be approximately 300 entities – compared to 127 futures commission merchants that are currently registered with the Commission (though other intermediaries are registered with the Commission, such as commodity trading advisors and commodity pool operators, the Commission only reviews FCMs due to resource constraints) – that will seek to register as swap dealers, FCMs or retail foreign exchange dealers.

Given the resource needs of the CFTC, we are working very closely with self regulatory organizations, including the National Futures Association (NFA), to determine what duties and roles they can take on in the swaps markets. In particular, we proposed rules that swap dealers would be required to be members of the NFA. This could facilitate the NFA taking on responsibilities related to registration and examination of swaps dealers. Nevertheless, the CFTC has the ultimate statutory authority and responsibility for overseeing these markets. Therefore, it is essential that the CFTC have additional resources to reduce risk and promote transparency in the swaps markets.

The CFTC had 82 staff at the end of FY 2010 responsible for overseeing intermediaries relating to pre-Dodd-Frank authorities. An additional 30 full-time equivalent (FTE) staff are requested for the new Swap Dealer and Intermediary Oversight Program for FY 2012, for a total of 112 FTE. The requested FTE resources will be essential to fulfill significant responsibilities related to registrants.

Clearing of Standardized Swaps through CFTC-Registered Derivatives Clearing Organizations. The Dodd-Frank Act requires that standardized swaps be cleared through CFTC-registered DCOs. It also requires that the CFTC review and examine systemically important DCOs for compliance on a yearly basis, which we do not currently have the resources to do. Clearing has lowered risk in the futures marketplace since the 1890s. As of the end of the last fiscal year, the CFTC oversaw 14 DCOs. Based on information we have received from potential new clearinghouses, we anticipate a 50 percent increase in DCOs to 20 or 21. The Commission has 40 FTE allocated to clearing oversight and risk surveillance. We are requesting an increase of 30 FTE for that team to address the significant increase in the number of DCOs, the more complex nature of the swaps markets and the Congressional mandate that we annually examine systemically important DCOs. This would bring total staffing levels to 70. The requested FTE resources will be essential to fulfill responsibilities related to clearing.

Oversight of Swap Execution Facilities and Designated Contract Markets. The CFTC will need additional staff to implement many new provisions related to the oversight of swaps trading activity as well as to oversee futures trading activities. These include procedures for the review and oversight of an entirely new regulated market category: SEFs. Staff in the Division of Market Oversight must establish and implement procedures for the review of new SEF applications and for the annual examination of the operations of SEFs, as well as any DCMs that offer swaps for trading. While the CFTC currently oversees 16 DCMs, based on industry comments, we that anticipate 30-40 entities will apply to register as SEFs.

Further, additional staff is necessary to evaluate data on swaps trading activity to implement the Dodd-Frank Act’s real time reporting provisions and to establish appropriate block trade levels. At the end of FY 2010, the Commission had 40 staff responsible for our pre-Dodd-Frank responsibilities to oversee futures exchanges. The President’s request would increase that level to 62 FTE while adding 38 FTE to implement new Dodd-Frank Authorities during FY 2012 for a total of 100 FTE.

Market Surveillance, Position Limits and Swap Data Repositories. The Dodd-Frank Act substantially expanded the responsibilities of the CFTC’s Market Surveillance Unit in a number of critical ways. The Market Surveillance Unit currently administers a Commission-set position limit regime for a total of nine agricultural futures contracts listed on designated contract markets (DCMs). Under the Dodd-Frank Act, resources must be dedicated to implementing and enforcing new aggregate position limits that are expected to be adopted that will cover both the futures market and some portion of the swaps market. These limits would apply to 28 agricultural, energy and metals commodities.

The Commission also must establish and implement new procedures and monitoring mechanisms to ensure that swaps data is appropriately reported to SDRs. Such data must be properly monitored, maintained and made available to the Commission and other regulators. In addition, the Commission must have sufficient resources to analyze swaps data, detect and prevent market abuses and systemic problems and to prepare semi-annual reports on the swaps markets mandated by the Dodd-Frank Act. Initial estimates are that the Commission will receive at least five SDR applications upon the general effective date of the Dodd-Frank Act

The Commission requests resources for 42 FTE to implement these new authorities during FY 2012. The Commission also is requesting 105 FTE to carry out pre-Dodd-Frank authorities in the areas of market surveillance, trade practice surveillance and data management and analysis responsibilities. This would bring total FTE for these functions to 147 FTE.

Enhanced Enforcement Authority. The Commission’s Enforcement program is operating with approximately 167 FTE. The Dodd-Frank Act significantly enhanced and expanded the Commission’s responsibility to police the markets for fraud, manipulation and other abuses and will result in a substantial increase in the Commission’s workload. The CFTC requires 68 additional FTE for the Enforcement program in FY 2012 – 33 for pre-Dodd-Frank authorities and 35 for new Dodd-Frank authorities – to reach a total of 235 FTE.

Enhancing Consumer Education. To enhance consumer protection, the Commission will reorganize the Commission's current consumer education and protection functions into a single office. This group will focus on the design, implementation and oversight of the Commission's customer education and outreach program. This program will allow a significant increase in the Commission's consumer outreach and education. In addition, we will establish a program to implement and administer the whistleblower requirements of the Dodd-Frank Act.

Enhancing Legal Analysis. As novel and complex legal and economic issues arise in the development and application of rules to implement the Dodd-Frank Act, the Office of General Counsel need to grow from 50 FTE to 70 FTE during FY 2012. This staffing level is essential to support all of its programs.

Regulating Foreign Boards of Trade. Currently, the Chief Counsel's Office in the Commission's Division of Market Oversight has a single FTE dedicated to the processing of no-action requests from foreign boards of trade (FBOTs) seeking to permit direct access to their trading platforms by members based in the United States. Currently, 20 FBOTs operate in the United States based upon no-action letters dating back to 1999. We expect those 20 FBOTs to register with the CFTC, plus an additional six to 10 FBOTs who have recently expressed an interest in becoming registered. The Dodd-Frank Act's establishment of the new category of registered FBOTs requires an increase of two FTE dedicated to FBOT matters to raise the total to three FTE.

Ensuring U.S. Interests in the Global Marketplace. The Office of International Affairs, which currently has nine staff, requires four additional professional staff to address the increasing global reach of the futures and swaps markets for a total of 13 staff. The Dodd-Frank Act specifically mandates that the Commission consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of swaps and futures.

Broadening Economic Analyses. Swaps vary substantially in terms of economic structure and will require expanded economic analyses. The Office of the Chief Economist, which employed 14 FTE at the end of FY 2010, requires six additional FTE for a total of 20 to expand the use of econometric and analytic techniques to the swaps marketplace to gauge the effects of market activities and the regulation of those activities.

FY 2011 Budget

Before I conclude, I will briefly address the CFTC's funding levels for FY 2011. The President's FY 2011 budget requested an appropriation of $261 million for the CFTC to oversee the commodity futures markets and to prepare for oversight of the swaps market. The Dodd-Frank Act goes effective for Title VII in July of this year. I'll note that 2011 is a year mostly dedicated to rule-writing. The President's budget requested that we bring on new staff throughout this year so that they can be trained and ready for the agency to oversee the swaps market in the fall. The President's budget also called for an increase in CFTC staff for pre-Dodd-Frank authorities to keep up with the growing futures markets. Further, the President's budget called for a significant increase in the CFTC's technology budget to keep up with the rapidly evolving futures markets.

The CFTC currently is operating at the agency's FY 2010 operating budget of $168.8 million. This funding level, however, is simply not sufficient for the CFTC's expanded mission to oversee both the futures and swaps markets. I look forward to working closely with this Subcommittee to ensure that the CFTC is adequately resourced to police the markets and protect the public.

Conclusion

Financial markets are complex, global and interconnected, and they perform essential functions for American businesses. The derivatives markets allow producers, merchants, corporations, municipalities, nonprofit organizations, pension funds and other end-users to lower their risk by locking in prices and rates in the future. This helps promote a vibrant economy.

We recognize that the budget deficit presents significant challenges to Congress and the American public. But we cannot forget that the 2008 financial crisis was very real. Thus Congress responded and said that the swaps market must be regulated and overseen, significantly expanding the scope of the CFTC. It is important that we align the CFTC's funding with its expanded mission.

The Commission looks forward to working with the Congress and the Administration to address the challenges outlined here and to secure the necessary funding to strengthen market integrity, lower risk, protect investors, promote transparency and continue to restore health to the economy.

Thank you, and I'd be happy to answer any questions you may have.