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Good morning Chairman Scott, Ranking Member Scott, and members of the subcommittee. I would like to thank you for inviting me to appear before the subcommittee this morning and allowing me to share some of my thoughts on the reauthorization of the U.S. Commodity Futures Trading Commission (CFTC). It is a pleasure to be here today.

Reauthorization provides Congress an opportunity to reflect on the work of the commission and determine legislative solutions to any identified inadequacies. I appreciate the subcommittee's efforts to approach reauthorization thoughtfully by listening to all stakeholders, such as in the subcommittee's hearing with end-users on March 24 and with market participants on March 25, as well as in today's hearing.

Since I joined the commission in 2011, the agency has largely completed its rulemakings under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which includes registering swap dealers and major swap participants, implementing the commission's clearing and trading mandates for swaps, and setting up a regulatory-reporting regime for swaps. We now have more than 100 swap dealers provisionally registered with the CFTC, clearing mandates in place for liquid swaps and trading mandates requiring liquid swaps to be executed on designated contract markets (DCMs) or one of the more than 20 newly provisionally registered swap execution facilities (SEFs), as well as new reporting obligations for market participants. Additionally, the agency has strengthened the risk-management practices of registered clearinghouses, enhanced protections of customer funds held by futures commission merchants (FCMs), and issued a concept release addressing risk-management enhancements for automated trading systems and the firms that deploy them. Compliance with most of these rules has begun in full.

Since the beginning of 2014, as the commission has continued its efforts to implement the new swaps market structure under Dodd-Frank and harmonize those efforts internationally, it also began to focus on revisiting policies that had an unintended impact on the end-user community of derivatives-market participants. The commission recognizes the importance of limiting costs to these end-users.

I commend Chairman Massad for his continued pursuit of this agenda. Under Chairman Massad's leadership, the commission considered amendments to the so-called residual interest rule, which was adopted unanimously by the commission, and is currently considering amendments to the 1.35 recordkeeping rule, the treatment of forwards with embedded volumetric optionality, and the treatment of trade options as defined under the Commodity Exchange Act (CEA).

The commission also has enjoyed an increase in resources needed to accomplish its mission, for which the agency and its staff are grateful. This year the commission requested $322 million to pursue its mission activities, an increase of $72 million over its current operating budget. These additional funds would allow the agency to improve its examinations of clearinghouses, FCMs, and swap dealers; deploy additional technology to perform surveillance of increasingly automated markets as well as rationalize data; and enforce the commission's rules. Given the increase in scope of its responsibilities and the consequent risks of inadequate oversight of the complex and global derivatives markets, the commission can, and would continue to, appropriately deploy future, additional funds and deliver a good return on the taxpayer investment.

I have organized my testimony today with the goal of offering a constructive viewpoint on where the commission and the derivatives marketplace stand generally, and with respect to implementation of Dodd-Frank more specifically. Toward that end, my testimony will address multiple topic areas, including (1) key rules the commission should promulgate to continue implementation of Dodd-Frank; (2) the cross-border implications of the commission's rules (identifying several discreet issues in particular); (3) swap-trade execution; (4) clearing and FCM risk management; and (5) swap reporting and data. In each of these topical areas my testimony identifies whether congressional action is needed to address insufficiencies in authority or clarity concerning congressional intent, or whether commission action is recommended (based on existing, adequate authority from Congress). Finally, this testimony identifies developing trends in the derivatives markets that the committee should be aware of and monitor while serving in its role as an authorizing committee of the CFTC.

1. DODD-FRANK RULEMAKINGS RELATED TO UNCLEARED SWAPS AND FEDERAL POSITION LIMITS

There are three key rulemakings required under Dodd-Frank that the commission should complete and finalize: the rulemaking on margin requirements for uncleared swaps; the rulemaking on capital requirements related to uncleared swaps; and the rulemaking on federal position limits.

Rulemaking on Margin for Uncleared Swaps. Perhaps the most important remaining rulemaking is the commission's margin rule. The new market infrastructure for swaps agreed to by the G20, and required under Dodd-Frank, mandates clearing for liquid swaps, and appropriate margin requirements for those swaps that are not cleared. Measured in notional volumes, the market for cleared swaps steadily has increased since 2008, but the uncleared swap market remains substantial and in need of appropriate risk-management safeguards. Margin is an essential tool to mitigate the default risk associated with uncleared swaps as well as the consequent systemic risk that may follow the default of a large market participant.

In September, the commission re-proposed its rule on margin for uncleared swaps, working in close cooperation with relevant domestic and international regulators. Importantly, and consistent with Congressional intent, the proposal exempts commercial end-users from the margin requirements that apply to swap dealers and certain financial entities. The commission should finalize the margin rule as quickly as possible to provide certainty on the requirements for one of the last component parts of the post-reform, swaps-market structure. In finalizing this rule, the commission must continue to coordinate with regulators both in the United States and abroad. The importance of global harmonization cannot be overstated given the risk of regulatory arbitrage if material differences in margin requirements exist among major financial markets.

Rulemaking on Capital Requirements Related to Uncleared Swaps. The commission should proceed soon with its rulemaking on capital requirements related to uncleared swaps. When the commission first proposed capital requirements for certain swap dealers and major swap participants in 2011, it aligned the comment periods for the proposed capital and margin rules so that commenters would "have the opportunity to review the proposed capital and margin rules together before the expiration of the comment periods for either proposed rule." This was done because to the extent that uncleared swaps are not fully margined, additional capital may be appropriate to address the resulting increased risk in the swaps marketplace. The commission should continue to be mindful of this interaction in finalizing the capital rule and should ensure that it does not create improper incentives that may increase costs for end-users.

Rulemaking on Federal Position Limits. Following the vacating by a federal district court of the original position-limits rule in 2012, a rule was re-proposed on December 12, 2013. The comment period to that proposal has been re-opened several times, and as of today, the CFTC has received over 500 comments. Mindful of the potential impact this rule could have on the public, last year the CFTC held a public roundtable and an Agricultural Advisory Committee meeting that addressed position limits, and in February the CFTC's Energy and Environmental Markets Advisory Committee held a public meeting to hear from commercial end-users and other participants in the energy markets on the subject.

As reflected in Dodd-Frank, Congress intended for the CFTC to apply federal position limits on DCMs and SEFs. I note that Congress gave the agency broad authority to craft a position-limits rule that protects against excessive speculation without curtailing legitimate hedging activities, including certain types of anticipatory hedging. In finalizing a rule, the CFTC should consider the effect on commercial end-users, farmers, ranchers, and other participants who use our markets to hedge risk, and ensure that we provide the appropriate flexibility for granting bona-fide hedge exemptions.

2. CROSS-BORDER IMPLICATIONS OF CFTC RULES

As mentioned, one of the most important tasks before the commission is to continue assessing the cross-border impact of Title VII and consider ways to appropriately harmonize its implementation efforts with those of non-U.S. regulators. Along these lines, the following issue areas are particularly important for the commission to be engaged in over the coming weeks and months.

Equivalency Decision for U.S. Clearinghouses by the European Union. The CFTC continues to negotiate with the European Commission and European Securities and Markets Authority on whether our clearinghouse regulatory framework should be deemed equivalent to the European Union's clearinghouse regulations. The European Union has extended the deadline for the determination to June 2015. Without an agreement, higher capital standards would apply to European banks that clear their trades through registered clearinghouses in the United States, which could disrupt the ability of European banks to use our markets. The CFTC continues to consult with European regulators to work through the remaining issues, and I commend Chairman Massad and commission staff for their efforts. Considerable progress has been made and an equivalency decision should be made soon by the European Commission.

Staff Advisory on U.S. Personnel. On November 14, 2013, CFTC staff issued an advisory that would apply the commission's transaction-level requirements under Dodd-Frank, such as mandatory SEF trading, to swaps between a non-U.S. swap dealer and its non-U.S. client where the non-U.S. swap dealer regularly uses personnel located in the United States to arrange, negotiate, or execute such swaps. The commission had previously determined in its cross-border guidance that swaps between two non-U.S. persons that are not guaranteed by U.S. persons lack a sufficient nexus with U.S. commerce for the commission's transaction-level requirements to apply. Shortly after the staff issued the advisory, the commission requested comment from the public on its subject matter and the staff provided no-action relief delaying its applicability.

Now that the comment period has been closed for some time, the commission should take action to clarify the matters discussed in the staff advisory. Commission action in this regard should be accompanied by an appropriate implementation period to permit the marketplace to come into compliance without undue cost or burden. The current no-action relief expires in September of this year, so the commission must act promptly or otherwise provide adequate additional time for compliance upon formulating its policy.

QMTF and Foreign SEF Regime. In collaboration with the commission's European colleagues, last year the commission provided relief from registration for qualified swaps-trading venues in Europe (QMTFs). This relief applied to QMTFs that have sufficient pre- and post-trade price transparency requirements, and provide non-discriminatory access to market participants. QMTFs also have to meet certain regulatory requirements in their home jurisdictions. So far, no foreign trading venues have used the QMTF relief. The commission should continue to work with the Financial Conduct Authority in the United Kingdom and other global regulators to resolve any issues relating to the QMTF regime.

The commission also should invoke its statutory authority and promulgate rules creating a permanent regime for non-U.S. swap-trading venues, under which entities from a variety of jurisdictions could request exemption. The commission, however, also must carefully consider the impact of such action on its own SEF framework and standards in order to protect the swaps marketplace and preserve the competitive standing of SEFs. Both efforts would help address some of the regulatory fragmentation (discussed below) the swaps market has experienced since the commission's SEF framework and trading mandate went into effect.

3. SWAP-TRADE EXECUTION

In 2012, the commission completed rules providing for the registration of SEFs, which are regulated trading platforms designed to provide pre-trade transparency, reduce risk, and improve pricing for the buy-side, commercial end-users, and other participants that use these markets to manage risk. On February 15, 2014, the commission implemented the first trading mandate for cleared interest rate and credit default swaps in the U.S. derivatives market. As of the most recent data, over $7.7 trillion notional of interest rate and credit swaps were traded in one month on SEF platforms under the CFTC's oversight.

The requirement that certain swaps trade on SEFs or DCMs was a momentous change for a marketplace that previously traded largely on an over-the-counter basis. A great many users of swaps were required to connect to execution venues and execute their swaps pursuant to certain trading protocols for the first time. Additionally, there was much uncertainty regarding the applicability of the execution requirement to swaps that were executed as part of a package with other swaps, futures, or securities (i.e., "package trades").

Complicating matters further, the United States was the first country in the world to impose a trading mandate for swaps. While U.S. persons have been trading the most liquid swaps – particularly those denominated in U.S. dollars – in a more highly regulated trading environment (i.e., on provisionally registered SEFs), the rest of the globe continues to trade swaps bilaterally, or on trading venues that are subject to lesser regulatory requirements than SEFs. The G20 committed to reforms that would require swaps to trade on regulated venues where appropriate, so it is expected that eventually there will be comparable trading venues in other jurisdictions. No other country, however, has achieved that objective as of now (Japan expects to impose a swaps trading mandate by the fall of 2015, but the European Union is not expected to impose one before 2017).

This is an important context to the analysis of the commission's SEF and trading-mandate rules, and largely explains why non-U.S. entities have demonstrated a preference for avoiding execution on SEFs. Because SEFs are regulated trading environments and serve as self-regulatory organizations (SROs) for their platforms, SEF participants incur costs and face compliance burdens not found in other jurisdictions. Unless commercially or legally compelled to do so, market participants largely have chosen to avoid subjecting themselves to these higher costs and increased compliance risks associated with SEFs.

Policymakers therefore should be careful not to draw the wrong conclusions from the fact that many non-U.S. persons have avoided trading on SEFs. Indeed, while subject to core principles and commission rules, required to function as SROs, and required to provide specific trading protocols for their participants, SEFs nonetheless are designed to be, and are – relatively speaking – flexible trading platforms as compared to DCMs. For instance, SEFs can offer requests for quote (RFQs) and conduct work-up sessions, and can conduct RFQs and work-ups using voice methods. Independent brokers, moreover, can continue brokering trades for mandated swaps outside of the SEF environment so long as the trade is "crossed" against a SEF order book.

Notwithstanding this fact, there are a number of steps the commission should take to further realize congressional mandates to promote trading of swaps on SEFs as well as promote pre-trade price transparency, both of which appear in the text of Dodd-Frank. These steps are described below under the categories of (i) initiatives that would further promote the trading of swaps on SEFs, and (ii) initiatives that would provide needed clarity to the SEF market structure.

i. Initiatives That Would Promote the Trading of Swaps on SEFs

The following policies should increase trading volumes on SEFs.

Floor Trader Designation for Market Makers. When the commission finalized its swap-dealer-registration rule, it provided that those trading entities that are registered as "floor traders" and meet a number of specified conditions under the rule do not have to register as swap dealers. This exemption was designed to promote market-making activities by non-traditional liquidity providers for the purpose of promoting liquidity formation on SEFs, and recognized that swap-dealer registration was not necessary or appropriate when the trading activity of the floor trader was anonymous and cleared at a clearinghouse (thus avoiding a traditional dealer-customer relationship).

The conditions for the floor-trader exemption need to be revised to make compliance practicable while ensuring that floor traders do not pose an increased risk to the marketplace. This would encourage more liquidity provision by non-dealer market makers and even more automation in execution. There are important policy debates associated with increasingly automated execution, as mentioned below in the developing trends discussion of this testimony. Separate risk-management requirements for intermediaries and registered clearinghouses currently in place, as well as other future initiatives to appropriately register non-dealer liquidity providers, are designed to address concerns raised by this automation trend.

Name Give-Up. Due to post-trade affirmation services or the SEF's rules, there are instances where counterparty identities are revealed after trades are executed on SEFs through an anonymous order book trading protocol. The commission should require that trades that start anonymously on an order book must remain anonymous post-trade. This will promote a more competitive, transparent, and liquid swaps market. On April 2, 1015, Commissioner Bowen hosted a meeting of the Market Risk Advisory Committee where this issue was discussed, and the consensus of the participants was that the commission should take action to end this practice through commission guidance or rulemaking.

Embargo Rule – Work Ups. The embargo rule in part 43 of the commission's real-time public reporting rules may impair a SEF's ability to generate liquidity during a work-up session. Immediately after an order or RFQ is executed, a SEF can conduct a work-up session, whereby a SEF's participants buy or sell additional quantities of the executed swap at the same price. These sessions can start and end within seconds or minutes, and can be a significant source of swaps-trading volume on SEFs.

The embargo rule prohibits the disclosure of swap transaction and pricing data to a SEF's market participants prior to the transmission of the data by the SEF to a swap data repository (SDR). Before the data is sent to the SDR, it needs to be enriched and converted. The embargo rule introduces latency into the work-up process by making the SEF wait until each order that results during a work-up is transmitted to the SDR before another work-up order can take place. SEFs conducting work-ups have expressed concerns about liquidity generation with the application of the embargo rule to work-ups. In addition, the time delay can frustrate the ability of market participants to trade at the price agreed to through the work-up session. Providing relief from the embargo rule for work-up sessions would promote more liquidity on SEFs, something the commission could do under existing authority.

ii. Initiatives that would Provide Clarity around the SEF Market Structure

The following actions would address uncertainties caused by commission rules concerning the current SEF market structure, and could minimize legal and compliance concerns that frustrate participation on SEFs.

MAT Determinations. The commission should replace the current "made available to trade" (MAT) process with a commission-initiated process that identifies the swap instruments subject to the mandate. Under the existing process, a single SEF's commercial interests in mandating (or not mandating) a swap dictates whether the commission will review a proposed mandate. This is not the best approach to make policy decisions for the entire market. A commission-initiated determination would be more orderly and would eliminate many questions around the scope of a mandate – including its applications to package trades (see below) – by including a traditional comment period process. No additional authority is needed by the commission to pursue this policy change.

Package Trades. Commission staff provided relief from the trading requirement for package trades on May 1, 2014, and subsequently held a public roundtable to identify practical and jurisdictional concerns that affect their trading on SEFs. Having heard from the public on the issue, the staff set forth a phased compliance approach that has since brought package trades involving all MAT legs, and MAT legs with non-MAT cleared legs, onto SEFs with minimal disruption to the marketplace. On November 10, 2014, staff granted further relief for SEFs for package trades with futures legs until November 2015, and for more complex package trades (e.g., transactions that include MAT legs with uncleared swaps, a non-swap instrument, or security-based swap legs) until February 2016, to be executed by any means of execution.

The commission should consider whether to formalize making some of this temporary relief permanent in order to provide more certainty and flexibility for these transactions. In the meantime, the commission will continue to examine how the market has reacted to the expiration of previous package-trade relief.

Block Trades. The commission's requirement that a block trade "occurs away" from the SEF has created additional complexity for trading large transactions, and executing block trades away from the SEF has presented difficulties for SEFs and FCMs to conduct the required pre-execution, credit-check screenings. The commission should similarly consider whether to make permanent the existing no-action relief that allows executing block trades on or pursuant to a SEF's rules, which expires at the end of this year, or clarify other ways for market participants to execute block trades.

Error Trades. Some swap trades are rejected by a clearinghouse because of operational or clerical errors made by market participants or SEFs. While these operational and clerical errors otherwise would be easily corrected, due to certain commission rules the trades are rejected from clearing. Relatedly, because trades are required to be submitted for clearing immediately after execution, counterparties may not have an opportunity to attempt to correct an error until after the transaction has cleared. Re-submitting these same trades again correctly could conflict with the CFTC's rules against pre-arranged trading. The commission has been granting and extending no-action relief since 2013 to address these issues.

SEFs should be permitted to determine whether there are actual errors, and to correct such errors, or to execute an offsetting or pre-arranged swap that reflects the correct parties and terms. The policy goals of submitting trades immediately for clearing are obviously important, but in some instances they should be balanced against the goals of fixing errors and allowing counterparties who want to maintain the swap to do so. Although the commission has been responsive by granting no-action relief, in order to provide certainty to the market and participants, the commission should consider revising our rules to find a more lasting solution.

Financial Resources. SEF Core Principle 13 requires a SEF to have financial resources in an amount that exceeds the total amount that would enable the SEF to cover the operating costs of the SEF for a one year period, as calculated on a rolling basis. As we have become more familiar with the role of SEFs, it has become clearer that unlike other registered entities, SEFs do not hold or carry the risks of positions and trades executed on it, and do not own the products traded on them (i.e., swaps are fungible and can be traded on other SEFs). As such, a SEF does not need as much time or capital to wind-down as a DCM or clearinghouse. In addition, this core principle disproportionately affects SEFs that offer voice-based execution methods as compared to purely electronic SEFs.

In light of these facts, Congress could consider reducing the one-year period to provide more flexibility to SEFs. In the meantime, the commission should consider whether there are ways to interpret this core principle and revise its regulations to provide a more reasonable and execution-method-neutral way for SEFs to comply. One such way to do so would be to re-consider commenters' requests to interpret operating costs to mean the costs of an orderly wind-down.

4. CLEARING AND FCM RISK MANAGEMENT

A hallmark of Dodd-Frank is the clearing mandate for liquid swaps. A cleared marketplace relies on clearinghouses as well as FCMs to manage risks associated with positions taken by participants. To improve this market structure further and minimize risks to customers in particular, the following steps should be considered.

Individual Segregation. Customers and end-users have repeatedly approached the commission seeking greater protection for their funds in the event their FCM becomes insolvent. These concerns have been amplified by the failures of MF Global and Peregrine, and by the market impact of the Swiss central bank's decision to abolish its three-year-old policy of capping the Swiss franc against the euro. The commission has spent considerable resources enhancing protections for customer funds, but there is more that could be done.

Currently, section 766(h) of the U.S. Bankruptcy Code continues to subject customers to mutualized risk by requiring that customer property be distributed "ratably to customers on the basis and to the extent of such customers' allowed net equity claims." With respect to cleared swaps, this requirement limits the commission's flexibility in designing a model for the protection of customer funds that allows for individual segregation. This means that even if a customer's funds are held in a completely separate account from the funds of other customers, if the customer's FCM becomes insolvent and there is a shortfall in the FCM's customer omnibus account that customer only will get back his or her pro rata share.

For customers who believe they can better protect their funds in the OTC marketplace, this potential result is unsatisfactory. It would aid the commission's work if Congress were to amend the Bankruptcy Code to permit greater flexibility with respect to the protection of customer funds.

Futures Commission Merchant Risk Management. Regulation 1.73(a)(2) provides that an FCM must screen trades against its risk-based limits. The method and timing of the FCM's screening obligation, however, is dependent upon the nature of the trade, recognizing that not all types of screens are possible on certain types of transaction. As discussed above, there exists in the marketplace some uncertainty with respect to how 1.73 applies to block trades. The commission should address this uncertainty and clarify how the FCMs can comply with rule 1.73 with respect to block trades.

5. SWAP REPORTING AND DATA

The following steps should be considered to improve the commission's swap-reporting regime.

Rulemaking on Reporting of Cleared Swaps. Dodd-Frank added to the CEA section 2(a)(13)(G), which requires all swaps – whether cleared or uncleared – to be reported to SDRs. Notwithstanding the harmonization effort between the CFTC and the SDRs to make swap data more consistent, and therefore more usable for regulatory purposes, there remain challenges to the usability of the cleared-swap data being reported. For example, reporting of cleared swaps is complicated by the so-called alpha swap being reported to one SDR, and the beta and gamma swaps being reported to another SDR. Alpha swaps remain open in SDR data and appear to be bilateral, but are in fact subject to the clearing requirement.

The result is that swaps that appear to be subject to the clearing requirement are appearing in the SDR as bilateral, uncleared "open swaps", when in fact they have been accepted for clearing by a clearinghouse. This outcome impedes the commission's ability to quickly and accurately review compliance with the clearing and trade-execution requirements, assess the size and scope of a given product's market, and assess the impact of uncleared swaps trades on the risk profile of clearing members and their customers. Staff is preparing a recommendation to the commission on how to address this matter, and the commission should act on that recommendation as soon as practicable.

Indemnification Provision related to Swap Data Repositories. As indicated, Dodd-Frank required that all swaps be reported to SDRs. Separately, CEA section 21 requires SDRs to make data available to certain domestic and foreign regulators so long as they have agreed in writing to abide by specified confidentiality requirements, and to indemnify the SDR and the commission for any expenses arising from litigation relating to the delivered data or information. In 2012, the commission issued guidance that clarified that the confidentiality and indemnification provisions do not apply to a registered SDR if it also is registered (or otherwise authorized) in a foreign jurisdiction, and the data sought to be accessed by the foreign regulator had been reported to the registered SDR pursuant to the foreign jurisdiction's rules. Notwithstanding this helpful interpretation, issues remain.

First, other U.S. regulators may need access to this information to fulfill their responsibilities and mandates, but they would be prohibited from obtaining the information from an SDR without executing an indemnification agreement. Second, these requirements continue to cause concern among foreign regulators, some of which have expressed unwillingness to register or recognize an SDR unless they have access to necessary information. The CFTC continues to work toward ensuring that both domestic and international regulators have access to swap data to support their regulatory mandates. But it would be useful to the commission's regulatory mission if Congress were to revise the CEA to remove the indemnification requirement from these information sharing provisions.

6. DEVELOPING TRENDS IN THE GLOBAL DERIVATIVES MARKETS

Finally, the committee should be aware of the following developments, as they could re-shape the derivatives markets and potentially provoke future policy responses from the Congress and the commission.

Liquidity Fragmentation in the Global Swaps Markets. As indicated in the discussion above on SEFs, today, some swap-trading decisions are being made to comply with or avoid rules and mandates imposed by law, and are no longer driven solely by the liquidity profile of, or expertise in, a given marketplace. Consequently, separate pools of liquidity have formed in distinct parts of the world largely based upon the legal status of counterparties. To be sure, differences in the timing and content of global reforms are part of the reason, as mentioned.

Avoiding fragmentation is desirable because (i) consolidated liquidity pools translate to reduced costs for end-users through tighter bid-ask spreads and improvements to other market-quality factors; (ii) centralized liquidity not only increases transparency for the broadest cross-section of price-takers, but reduces informational and trading advantages that accrue only to those able to navigate the complexities of a fragmented market structure; and (iii) from a systemic-risk standpoint, fragmentation can lead to increased operational risks as entities react to and structure around the rules. The steps identified in the cross-border section of this testimony could make significant strides towards limiting market fragmentation.

Apart from those refinements to existing commission policy, a revamp of the commission's overall cross-border guidance for swaps is not necessary at this time. The better policymaking course would include waiting until more of the other G20 nations with significant swap markets – namely, the European Union, Japan, Canada and Australia – implement their clearing and trading mandates pursuant to their respective reforms, and then analyze how those reforms compare as well as their market impacts. Only then will U.S. policymakers be able to make informed and thoughtful decisions about additional steps they should take.

Disruptive Technologies. Some relatively recent technological advancements have the potential to further reduce risk in our markets if those technologies become more widely embraced. Bitcoin-like protocols or distributed public ledger technologies could provide and enhance various settlement and other trustee-like services provided by registered entities in the derivatives markets, where monies and collateral are frequently transferred and settled throughout a trading day. These technologies work to provide a record of transactions and changes of ownership, and can be used to validate any type of transaction – including the more familiar concept of exchanging cash or currencies, as well as other types of assets or collateral, such as stocks, bonds, and securities. With these technologies, this can be done without the use of banks or other intermediaries.

Whereas now settlement may take days or occur intra-day depending on the market, this technology potentially could be used to facilitate settlement close to, or in, real-time. Reducing the time for transfers and the need to use an intermediary in the settlement process could further reduce risk to end-users and other market participants. This technology, moreover, has the potential to be used to display transaction information in close to real-time, and to maintain records of those transactions.

These are just a few of the obvious use cases for this technology, which, if deployed in commission-regulated markets, would present new policy questions for the agency and this committee. These questions include, among others, how new technologies will challenge or fit into current regulatory frameworks, potential regulatory barriers for new technologies, the impact on incumbents, and whether their use necessitates additional customer protections. Both the commission and this committee should continue to think about these questions and challenges. The subcommittee also might consider directing the commission to undertake a study to examine how these technologies could assist with compliance or otherwise reduce risk in the markets it oversees.

FCM Concentration. Policymakers should continue monitoring the number of FCMs actively involved in the derivatives markets as time continues. The number of registered FCMs has decreased since the financial crisis, which may make it more difficult for customers to manage their risk by limiting their ability to access the markets, or by making it more difficult for them to allocate funds among multiple FCMs to minimize concentration risk.

The overall framework of regulatory requirements that registered FCMs must comply with is substantially different today than it was before the crisis. FCMs are now subject to an enhanced customer-protection framework enforced by the commission, with the result that the risks posed to customers funds stewarded by FCMs have been significantly reduced. This is a positive development.

During this same timeframe, the prudential regulators have enhanced their capital requirements for global financial institutions, resulting in more capital being held by FCMs that are affiliated with a bank holding company. While the commission's and prudential regulators' measures are intended to safeguard the markets in times of stress, the consequences resulting from the costs associated with this framework remain to be seen. For instance, clearinghouses and FCMs have begun more serious discussions about facilitating more self-clearing arrangements for customers, a development that could raise a host of policy issues and considerations. Meanwhile, there are more reports in the media of additional fees being imposed on customers by FCMs resulting from the new capital-requirements framework.

This committee should monitor these developments and could play a role in ensuring that market regulators such as the CFTC on the one hand, and prudential supervisors on the other – which separately enforce different types of regulatory regimes with different policy objectives – do not pursue goals that are at cross purposes with each other. The G20, and subsequently the U.S. Congress and regulatory community, agreed to reforms that (i) promote the clearing of derivatives, as well as (ii) raise capital standards for global banks. Policymakers should take care to avoid unnecessarily thwarting the former in pursuit of the latter. It also is worth pointing out, however, that if market regulators and prudential supervisors pursue conflicting agendas as it relates to clearing, it could further incentivize the deployment of novel legal and technological solutions to compliance.

Central Counterparty Risk. Clearinghouses play an increasingly important role in the wake of implementation of G20 financial reforms related to the clearing of derivatives contracts. Consequently, the CFTC has been hard at work putting in place a framework for effective oversight and regulation of clearinghouses. Nonetheless, it is appropriate that at this stage of the overall financial-reform effort, regulators and the Congress consider what, if any, additional measures should be taken.

Additional authority from Congress is not needed for the commission to responsibly undertake this process of review. The areas related to clearinghouse risk management worth analyzing include: enhancing transparency with respect to clearinghouse stress tests, and reviewing how much of a clearinghouse's own capital – and under what circumstances – should become part of their plans for determining who pays in the case of a major clearing member default. Market regulators such as the CFTC also should assess clearinghouses' recovery and wind-down plans, and, to the extent a settlement or custodian bank failure impacts the ability of a clearing member (or group of clearing members) to timely meet its payment obligations to a clearinghouse, the ability of a clearinghouse to timely meet its payment obligations to its clearing members.

Cybersecurity. DCMs, SEFs, SDRs, and clearinghouses are required by the CEA and commission regulations to establish and maintain "system safeguards," which include, among other things, a program to identify and minimize sources of operational risk, emergency procedures, backup facilities, a business continuity and disaster recovery (BCDR) plan, and to conduct periodic BCDR plan testing. These entities are also required to promptly notify Commission staff of certain cyber security incidents or targeted threats. Commission staff conducts systems safeguards testing that examines whether these standards are being adhered to; however, staff does not conduct independent testing. Other registered entities are also required to have BCDR plans and periodically test them.

Commission staff recently conducted a public roundtable on cybersecurity and system safeguards testing in March where we heard from registered entities, market participants, and other government agencies that have developed best practices. End-users and participants rely on our markets to hedge their risks, and any disruption by way of a cyberattack could have an adverse effect on those users, such as the theft of personal information or a market disruption or outage.

The commission is considering potential enhancements to our systems safeguards rules and testing to further strengthen the security and resilience of our markets to cyberattacks. As part of this effort the commission should evaluate what types of system safeguards or testing are appropriate for other registered entities. In addition, the commission can consider changes to the current rules, such as making the notifications to the commission of cyberattacks confidential, in order to foster transparent and prompt disclosure to the commission. Finally, the commission should assess whether entities that provide services to our registered entities, such as the National Futures Association, or third-party vendors like Markit, should be subject to systems safeguards rules or testing.

In addition to making changes to our rules, in order to develop and test more effective cybersecurity and systems safeguards, it is critical to have the participation of all interested parties – financial regulators, the private sector, and the intelligence/law enforcement community. We should be considering innovative ways to foster this testing and participation, such as the voluntary CBEST program conducted by the Bank of England which brings regulators and the intelligence/law enforcement community together to assess cybersecurity risks to the financial system.

Automated Trading. Automated trading systems are becoming more omnipresent in the derivatives markets, and are often used by both traditional and non-traditional liquidity-providing firms. Automated trading can sometimes be seen in a negative light, but there are academic studies that support the views that such trading can be detrimental to a market, or benefit liquidity, or both. For example, a recent report on the rapid Swiss franc currency swings highlighted how automated trading might have contributed to sharp price movements, but also enabled the market to stabilize faster than otherwise expected. As the trend towards automated trading continues, and especially if the commission encourages it by adopting policies that facilitate the use of automated systems in swap execution, the commission must be vigilant in ensuring those systems have adequate risk controls, and operate in an appropriate regulatory framework to enable the commission to achieve its overall mission.

On September 12, 2013, the commission published a Concept Release on Risk Controls and Systems Safeguards for Automated Trading Environments. The commission is considering the next steps for regulatory action in this area with respect to pre-trade risk controls, post-trade measures, and other protections to reduce the risks arising from a malfunctioning automated trading system, and to promote the safety and transparency of automated-trading environments. To pursue these measures, the commission sought comment on the role of a registration requirement for firms that deploy automated trading systems. Recently, the U.S. Securities and Exchange Commission took a similar approach and proposed a rule that requires such firms operating in the equities markets to become members of the Financial Industry Regulatory Authority.

Thank you again for inviting me today. I would be happy to answer any questions from the panel.