TESTIMONY OF GARY GENSLER

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BEFORE THE

U.S. HOUSE COMMITTEE ON AGRICULTURE

WASHINGTON, DC

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Good morning Chairman Lucas, Ranking Member Peterson and members of the Committee. I thank you for inviting me to today's hearing on oversight of the swaps and futures markets. I will review the Commodity Futures Trading Commission's (CFTC) implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), as well as the recent events related to the London Interbank Offered Rate (LIBOR) and Peregrine Financial Group.

I also thank my fellow Commissioners and CFTC staff for their hard work and commitment.

The 2008 crisis – caused in part by swaps – was the worst economic crisis Americans have experienced since the Great Depression. Eight million Americans lost their jobs, millions of families lost their homes and thousands of businesses shuttered.

Following the crisis, the President and the G-20 leaders convened in Pittsburgh in September 2009 and agreed that swaps, which were basically not regulated in the United States, Asia or Europe, should now be brought into the light of regulation.

In 2010, Congress and the President came together and passed the historic Dodd-Frank Act.

The goal of the law's swaps market reforms is to:

- Bring public market transparency and the benefits of competition to the swaps marketplace;
- Lower the risk of the interconnected financial system by bringing standardized swaps into centralized clearing; and
- Ensure that swap dealers and major swap participants are specifically regulated for their swaps activity.

The Commission has made significant progress in implementing Congress' direction to ensure that common-sense standards are established for the swaps market.

Turning Point: Implementation of Swaps Market Reforms

Throughout the rule-writing process, we have benefitted from significant public input. CFTC Commissioners and staff have met nearly 1,800 times with the public, and we have held

18 public roundtables on important issues related to Dodd-Frank reform. The agency has received more than 35,000 comment letters related to Dodd-Frank rules.

Last summer, we turned the corner and started finalizing rules. To date, we've completed 36 rules and now have fewer than 20 to go (see attachment).

This month, we reached another major turning point in the swaps market reform process. The CFTC and the Securities and Exchange Commission (SEC) completed the rule to further define the terms "swap" and "security-based swap." These further product definitions mean many other critical swaps market reforms already completed by the Commission will come to life. We also finalized this month the rule on the end-user exception to clearing. With the completion of these foundational rules, we are increasingly moving from the rule-writing process to the implementation of reforms that bring transparency to the swaps marketplace and lower its risks to the public.

Swap dealers, for the first time, will register and begin to come under comprehensive regulation. This includes implementing already completed external and internal business conduct standards that will lower swap dealers' risk to the economy and promote confidence in their integrity.

Two months after the rule further defining the term "swap" is published in the Federal Register, light will begin to shine on the swaps market. Initially, likely by October, swaps price and volume information will be reported in real time to the public for interest rate and credit default swap (CDS) indices. Three months later, such real-time reporting will begin for energy and other physical commodity swaps.

Swap data repositories (SDRs) will receive data on all swaps transactions, giving regulators their first full window into these markets. One SDR has already successfully registered with the Commission, and we have at least four other parties working on their applications.

The rule further defining "swap" is especially meaningful for the implementation of position limits. For the first time, limits will apply to the aggregate spot-month positions, including both futures and swaps. Spot-month limits protect the markets against corners, squeezes and the burdens that may come from excessive speculation.

I will now go into further detail on the Commission's swaps market reform efforts.

Transparency

Transparency is critical to both lowering the risk of the financial system, as well as to reducing costs to end-users. The more transparent a marketplace is to the public, the more efficient it is, the more liquid it is, and the more competitive it is.

We have completed the bulk of the congressionally mandated transparency reforms for the swaps market. This fall real-time reporting to the public and to regulators will begin for swaps market transactions.

Second, detailed and up-to-date reporting by large traders in the physical commodity swaps markets began last fall. This reporting allows regulators to better police for fraud, manipulation and other abuses.

Third, the CFTC also plans to begin publishing aggregated swaps market data. The public has benefited for years from the Commitment of Traders futures data we publish. Our goal is to provide similar public transparency for the swaps market.

Fourth, in May we completed rules, guidance and acceptable practices for designated contract markets (DCMs). DCMs will be able to list and trade swaps, helping to bring the benefit of pre-trade transparency to the swaps marketplace.

Looking forward, we have two important transparency rules to complete related to block sizes and swap execution facilities (SEFs). These critical Dodd-Frank reforms will bring pre-trade transparency to the swaps market for the benefit of all the end-users that use swaps.

Central Clearing

For over a century, through good times and bad, central clearing in the futures market has lowered risk to the broader public. Dodd-Frank financial reform brings this effective model to the swaps market. Standard swaps between financial firms will move into central clearing, which will significantly lower the risks of the highly interconnected financial system.

The CFTC has made significant progress on central clearing for the swaps market. We have completed rules establishing new derivatives clearing organization risk management requirements.

Second, to further facilitate broad market access, we completed rules on client clearing documentation, risk management, and so-called "straight-through processing," or sending transactions immediately to the clearinghouse upon execution.

Third, we completed the rule on the end-user exception to clearing. Consistent with congressional intent, this rule ensures that end-users using swaps to hedge or mitigate commercial risk will not be required to bring swaps into central clearing.

Fourth, the CFTC this month also proposed a rule that would permit certain cooperatives to choose not to clear member-related swaps. Cooperatives act on behalf of and are an extension of their members. Thus, I believe it is appropriate that in certain circumstances, those cooperatives made up entirely of members that could individually qualify for the end-user exception should qualify as end-users.

Fifth, yesterday the Commission adopted the final rule for phased implementation of compliance with the clearing requirement for various groups of financial entities.

Sixth, the Commission also yesterday approved proposed clearing requirement determinations based upon clearinghouse submissions on swaps they already clear. The clearing determinations begin with standard interest rate swaps in U.S. dollars, Euros, British pounds and Japanese yen, as well as a number of CDS indices, including North American and European corporate names.

In addition, the Commission has adopted four important customer protection enhancements: the amendments to rule 1.25, the gross margin rule, the LSOC rule for swaps and rules on the minimum requirements for SROs regarding their financial surveillance of FCMs.

Based upon the Dodd-Frank 90-day clock for making clearing determinations, the first clearing determinations may be finalized in October just before the gross margin and LSOC rules go into effect November 8.

The CFTC also has received substantial public input on the clearing of swaps among affiliates of the same financial entity. The staff recommendation, which would exempt certain affiliate swaps from the clearing requirement, is under review by commissioners.

Swap Dealers

Regulating banks and other firms that deal in swaps is central to financial reform. Prior to 2008, it was claimed that swap dealers did not need to be specifically regulated for their swaps activity, as they or their affiliates already were generally regulated as banks, investment banks, or insurance companies. The crisis revealed the inadequacy of relying on this claim. While banks were regulated for safety and soundness, including their lending activities, there was no comprehensive regulation of their swap dealing activity. Similarly, bank affiliates dealing in swaps, and subsidiaries of insurance and investment bank holding companies dealing in swaps, were not subject to specific regulation of their swap dealing activities. AIG, Lehman Brothers and other failures of 2008 demonstrate what happens with such limited oversight.

The CFTC is well on the way to implementing reforms Congress mandated in Dodd-Frank to regulate dealers and help prevent another AIG. The Commission has finished sales practice rules requiring swap dealers to interact fairly with customers, provide balanced communications and disclose conflicts of interest before entering into a swap. In addition, the Commission has finalized internal business conduct rules to require swap dealers to establish policies to manage risk, as well as put in place firewalls between a dealer's trading, and clearing and research operations. Staff recently provided to commissioners recommendations on a final rule on swap relationship documentation, confirmations and portfolio compression.

We completed in April a joint rule with the SEC further defining the terms "swap dealer" and "security-based swap dealer."

Based upon completed registration rules and the recently completed joint rule further defining the term "swap," we anticipate dealers will begin registering with the National Futures Association (NFA) in the early fall.

The CFTC has been working with the Federal Reserve, the other U.S. banking regulators, the SEC, and international regulators and policymakers to align margin requirements for uncleared swaps. It is essential that we align these requirements globally, particularly between the major market jurisdictions. The international approach to margin requirements in the consultative paper (sponsored by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions) released this month is consistent with the approach the CFTC laid out in its margin proposal last year. It would lower the risk of financial entities, promote clearing and help avoid regulatory arbitrage. Consistent with the CFTC's proposal, it also excludes non-financial end-users from margin requirements for uncleared swaps.

The CFTC reopened the comment period on our margin proposal so that we can hear further from market participants and the public in light of the work being done to internationally harmonize margin rules. As we work with international regulators on this coordinated approach, I would anticipate that the Commission would only take up the final margin rules toward the end of this year.

Following Congress' mandate, the CFTC also is working with our fellow financial regulators to finalize the rulemaking to implement the Volcker Rule. In adopting the Volcker Rule, Congress prohibited banking entities from engaging in proprietary trading, an activity that may put taxpayers at risk. At the same time, Congress permitted banking entities to engage in certain activities, such as market making and risk mitigating hedging. One of the challenges in finalizing a rule is achieving these multiple objectives.

Staff also has provided to commissioners recommendations in two other areas. The first relates to proposed exemptions for certain transactions in the electricity markets. In particular, this includes possible exemptive orders for certain transactions executed on regional transmission organizations, as well as between and among rural electric cooperatives and municipal public power providers. Second, now that the Commission made significant progress on swaps market reforms, we will consider completing a number of conforming rules.

Market Integrity/Position Limits

Financial reform also means investors, consumers, retirees and businesses in America will benefit from enhanced market integrity. Congress provided the Commission with new tools in Dodd-Frank to ensure the public has confidence in U.S. swaps markets.

Rules the CFTC completed last summer close a significant gap in the agency's enforcement authorities. The rules implement important Dodd-Frank provisions extending our enforcement authority to swaps and prohibiting the reckless use of manipulative or deceptive schemes. Thus, for example, the CFTC has clear anti-fraud and anti-manipulation authority regarding the trading of credit default swaps indices.

Also, the CFTC now can reward whistleblowers for their help in catching market misconduct.

Congress also directed the CFTC to establish aggregate position limits for both futures and swaps in energy, agricultural and other physical commodities. In October 2011, the Commission completed final rules to ensure no single speculator is able to obtain an overly concentrated aggregate position in the futures and swaps markets. With the recently completed joint rule further defining "swap," compliance for all spot-month limits will go into effect in approximately two months.

The Commission approved a proposed rule in May that would modify the CFTC's aggregation provisions for limits on speculative positions. The proposal would permit any person with a 10 to 50 percent ownership or equity interest in an entity to disaggregate the owned entity's positions, provided there are protections and firewalls in place to ensure trading decisions are made independently of one another.

Two associations representing the financial industry are challenging the agency's final rule establishing position limits in court. The Commission is vigorously defending the Congressional mandate to implement position limits in court.

Cross-border Application of Dodd-Frank's Swaps Market Reforms

The nature of modern finance is that large financial institutions set up hundreds, if not thousands, of "legal entities" around the globe. Many of these far-flung legal entities, however, are still highly connected back to their U.S. affiliates.

The lessons of the 2008 crisis and earlier have demonstrated that time and again financial transactions executed offshore by U.S. financial institutions can send risk straight back to our shores. It was true with the London and Cayman Islands affiliates of AIG, Lehman Brothers, Citigroup and Bear Stearns. A decade earlier, it was true, as well, with the collapse of the hedge fund Long-Term Capital Management.

During a default or crisis, the risk that builds up offshore inevitably comes crashing back onto U.S. shores. The recent events of JPMorgan Chase, where it executed swaps through its London branch, are a stark reminder of this reality of modern finance.

Section 722(d) of the Dodd-Frank Act states that swaps reforms shall not apply to activities outside the United States unless those activities have "a direct and significant connection with activities in, or effect on, commerce of the United States." Congress included this provision for swaps, but included a different provision with regard to the SEC's oversight of the security-based swaps market.

The Commission, consulting closely with the SEC, the Federal Reserve and the Treasury Department, recently proposed guidance interpreting this section of the law. The Commission also proposed in a separate release phased compliance for foreign swap dealers (including overseas affiliates of U.S. swap dealers) of certain requirements of Dodd-Frank swaps market reform. Such phased compliance would enable market participants to comply with the Dodd-Frank Act in an orderly fashion and allow time for the CFTC to receive public comment on the cross-border interpretive guidance.

The proposed guidance interpreting Section 722(d) includes the following key elements:

First, it provides the guidance that when a foreign entity transacts in more than a de minimis level of U.S. facing swap dealing activity, the entity would register under the Dodd-Frank Act swap dealer registration requirements.

Second, it includes a tiered approach for foreign swap dealer requirements. Some requirements would be considered entity-level, such as for capital, chief compliance officer, risk management, swap data recordkeeping, reporting to swap data repositories and large trader reporting. Some requirements would be considered transaction-level, such as clearing, margin, real-time public reporting, trade execution, trading documentation and sales practices.

Third, entity-level requirements would apply to all registered swap dealers, but in certain circumstances, foreign swap dealers could meet these requirements by complying with comparable and comprehensive foreign regulatory requirements, or what we call “substituted compliance.”

Fourth, transaction-level requirements would apply to all U.S. facing transactions. For these requirements, U.S. facing transactions would include not only transactions with persons or entities operating or incorporated in the United States, but also transactions with their overseas branches. Likewise, this would include transactions with foreign affiliates that are guaranteed by a U.S. entity, as well as the foreign affiliates operating as conduits for a U.S. entity’s swap activity. Foreign swap dealers, as well as overseas branches of U.S. swap dealers, in certain circumstances, may rely on substituted compliance when transacting with foreign affiliates guaranteed by or operating as conduits of U.S. entities.

Fifth, for certain transactions between a foreign swap dealer (including an overseas affiliate of a U.S. person) and foreign counterparties not guaranteed by or operating as conduits for U.S. entities, Dodd-Frank transaction-level requirements may not apply. For example, this would be the case for a transaction between a foreign swap dealer and a foreign insurance company not guaranteed by a U.S. person.

LIBOR

I’d like now to review the CFTC’s recent order against Barclays concerning the benchmarks LIBOR and Euribor.

People taking out small business loans, credit cards and mortgages, as well as big companies involved in complex transactions, all depend upon the honesty of benchmark rates like LIBOR for the cost of their borrowings. Banks must not attempt to influence LIBOR, Euribor or other indices based upon concerns about their reputation or the profitability of their trading positions.

LIBOR and Euribor are indices at the center of the capital markets for both borrowings and derivatives contracts. LIBOR is the reference index for the largest open interest of contracts in both the U.S. futures markets and swaps markets. As of the end of June, the three-month Eurodollar futures contracts that settle to U.S. Dollar LIBOR make up about 70 percent of the notional value of all futures contracts traded on the CME Group exchanges. U.S. Dollar LIBOR's traded volume in 2011 on the CME was a notional value exceeding $564 trillion. According to the British Bankers Association, swaps with a total notional value of approximately $350 trillion and loans amounting to $10 trillion are indexed to LIBOR.

The CFTC initiated in April of 2008 a review of LIBOR after media reports raised questions about the integrity of the index. Thereafter, we began coordinating with the United Kingdom's Financial Services Authority (FSA), which helped us facilitate information requests. The FSA and the U.S. Department of Justice subsequently joined the CFTC with regard to the Barclays matter, and it has been a collaborative effort throughout.

To conduct such a complicated case, the CFTC enforcement staff had to sift through a voluminous number of documents and audio recordings that spanned many years.

The CFTC's Order found that Barclays traders and employees responsible for determining the bank's LIBOR and Euribor submissions attempted to manipulate and made false reports concerning both benchmark interest rates to benefit the bank's derivatives trading positions. The conduct occurred regularly and was pervasive. Barclays' traders located at least in New York, London and Tokyo asked Barclays' submitters to submit particular rates to benefit their derivatives trading positions. In addition, certain Barclays Euro swap traders coordinated with and aided and abetted traders at other banks in each other's attempts to manipulate Euribor.

The Order also found that throughout the financial crisis, as a result of instructions from Barclays' senior management, the bank routinely made artificially low LIBOR submissions. Submitters were told not to submit at levels where Barclays was "sticking its head above the parapet." The senior management directive was intended to fend off negative public perception about Barclays' financial condition.

The CFTC's Order required Barclays to pay a $200 million civil monetary penalty for attempted manipulation of and false reporting concerning LIBOR and Euribor. In addition, Barclays is required to implement measures to ensure its future submissions are honest.

Among other things, these requirements included:

- Making submissions based on a transaction-focused methodology;

- Implementing firewalls to prevent improper communications, including between traders and submitters;
- Preparing and retaining documents concerning submissions and certain relevant communications; and
- Implementing auditing, monitoring and training measures concerning submissions and related processes, including making regular reports to the CFTC.

The CFTC has and will continue vigorously to use our enforcement and regulatory authorities to protect the public, promote market integrity, and ensure that these benchmarks and other indices are free of manipulative conduct and false information. The Commodity Exchange Act (CEA) is clear in its prohibitions against attempted and actual manipulation of futures, swaps and commodity prices**.** Further, the CEA's Section 9(a)(2) prohibits knowingly making false reports of market information that affects or tends to affect the price of a commodity.

The FSA is reviewing the LIBOR benchmark, and will be making suggestions as to how to improve it. Moving forward, the CFTC stands ready to assist the FSA on its review of LIBOR and how to best assure that LIBOR, or any alternative benchmark that might emerge, is not susceptible to attempted manipulation or false reporting. We look forward to working with regulators and market participants here and abroad to ensure that benchmarks for interest rates that touch borrowers and lenders around the globe are reliable and honest.

If these key benchmarks are based on observable transactions, borrowers, lenders and derivatives users around the globe all benefit. If these key benchmarks are not based on observable transactions, I believe their integrity will continue to be subject to question. And if these key benchmarks are not based on honest submissions, we all lose.

Peregrine Financial Group, Inc.

Background

On July 10, the CFTC filed a complaint in federal court against Peregrine and its sole owner, Russell Wasendorf, Sr., alleging that they misappropriated customer funds from an account held at US Bank.

Criminal authorities arrested Mr. Wasendorf for lying to the CFTC, and they advised the court that they intended to file more criminal charges in the future.

The CFTC's complaint, along with the criminal charges, tells a story of deliberate dishonesty and deception. In a written statement found when he attempted suicide, as quoted in the criminal charges, Mr. Wasendorf said he committed fraud, manufactured phony bank documents, and forged bank signatures. In short, the charges against him are that he took customers' funds right out of the bank, and lied about it for years.

The System of FCM Oversight

Peregrine is a CFTC-registered FCM. The NFA, a futures industry SRO, is responsible for the firm's front-line oversight. The way our oversight system has been set up for decades, SROs are the primary regulators of FCMs, introducing brokers, commodity pool operators, and commodity trading advisors. In 2000, Congress affirmed the Commission's reliance on self-regulatory organizations by amending Section 3 of the CEA to state: "It is the purpose of this Act to serve the public interests . . . through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission." Further, based on this system and the realities of limited CFTC resources, in the wake of Dodd-Frank, the NFA also will take on additional examination and registration duties with regard to swap dealers.

As part of its oversight responsibility, the NFA is required to conduct periodic audits of non-clearing member FCMs' customer funds in segregated and secured accounts. The CFTC oversees the NFA, examining them for the performance of their duties. We review the NFA's work papers only on a limited number of FCMs each year. In addition, the CFTC also does limited-scope reviews of FCMs in a "for cause" situation that are sometimes referred to as "audits," but they are not full-scale audits as accountants commonly use that term.

Under CFTC rules, FCMs must have their annual financial statements audited by an independent CPA using Generally Accepted Auditing Standards. As part of this certified annual report, the independent accountant also must conduct appropriate reviews and tests to identify any material inadequacies in systems and controls that could violate the Commission's segregation or secured amount requirements. Any such inadequacies are also to be reported to the SRO and the Commission.

The Oversight of Peregrine

The NFA last completed an audit of Peregrine in May 2011, and was in the process of conducting another periodic audit over the last several weeks. Peregrine's financials for the year ending December 31, 2011, were reviewed and certified by its independent CPA expressing a clean opinion on both the financial statements and internal controls report.

In 2000, the CFTC brought an enforcement action against Peregrine, finding in an Order that the firm had violated net capital rules. At the time, Peregrine was much smaller than it was in 2012, with roughly $800,000 in net capital requirements and $23 million in customer segregation requirements. The firm was ordered to pay a civil penalty and to take steps to improve its financial controls, including retaining a second independent public accounting firm to perform reviews of certain financial accounts and to report its findings to the CFTC. The firm retained PricewaterhouseCoopers.

The CFTC's Order in 2000, resolving the enforcement investigation, was the culmination of a process that began with limited-scope reviews conducted by the CFTC examinations staff in the 1990s. During these reviews, the staff noted a number of problems at Peregrine regarding, among other things, net capital, infusions of capital to avoid net capital violations, internal financial controls, and records of segregated and secured customer assets and liabilities. Other issues related to accounting for receivables and payables; transactions and agreements with affiliates; differences between journal entries on the company's books and the statements of one of its banks, Harris Bank; accuracy of books and records; the abilities of the firm's auditor; and providing customers with timely trade confirmations and monthly statements. In addition, CFTC staff questioned whether Peregrine had tried to mislead them concerning some of these accounting issues. The staff also noted issues regarding the sufficiency of NFA audits.

Subsequently, in 2007 and 2008, the CFTC examinations staff reviewed Peregrine's classification and reporting of customer-owned securities and the investment of customer funds for compliance with CFTC Regulations. The limited reviews identified improperly titled segregation bank accounts, which were corrected during the examination. In addition, the staff in 2010 performed a limited, two-day review of Peregrine's anti-money laundering compliance.

Although we do not yet know the full facts of what happened in this matter, it is clear that the system failed to protect the customers of Peregrine. The NFA and CFTC staff over the years did not detect Mr. Wasendorf's alleged stealing of customer funds, which came to light only a few weeks ago. Though the local police cannot prevent every bank robbery and market regulators cannot prevent every financial fraud, we all must do better. We must do everything within our authorities and resources to strengthen oversight programs and the protection of customer funds.

Customer Protection

CFTC Customer Protection Reforms To Date

The Commission has been actively working to improve protections for customer funds. This includes:

- The completed amendments to rule 1.25 regarding the investment of funds bring customers back to protections they had prior to exemptions the Commission granted between 2000 and 2005. Importantly, this prevents use of customer funds for in-house lending through repurchase agreements;
- Clearinghouses will have to collect margin on a gross basis and futures commission merchants (FCMs) will no longer be able to offset one customer's collateral against another and then send only the net to the clearinghouse;
- The so-called "LSOC rule" (legal segregation with operational comingling) for swaps ensures customer money is protected individually all the way to the clearinghouse; and
- The Commission included customer protection enhancements in the final rule for DCMs. These provisions codify into rules staff guidance on minimum requirements for self-regulatory organization (SROs) regarding their financial surveillance of FCMs.

In addition, this month, we approved an NFA proposal that stemmed from a coordinated effort by the CFTC, the SROs, and market participants, including from the CFTC's two-day roundtable earlier this year on customer protection.

The three key areas of reform included in the NFA rules are:

- First, FCMs must hold sufficient funds in Part 30 secured accounts (funds held for U.S. foreign futures and options customers trading on foreign contract markets) to meet their total obligations to customers trading on foreign markets computed under the net liquidating equity method. FCMs will no longer be allowed to use the alternative method, which had allowed them to hold a lower amount of funds representing the margin on their foreign futures;
- Second, FCMs must maintain written policies and procedures governing the maintenance of excess funds in customer segregated and Part 30 secured accounts. Withdrawals of 25 percent or more of excess funds in these accounts (that are not for the benefit of customers) must be pre-approved in writing by senior management and reported to the NFA; and
- Third, FCMs must make additional reports available to the NFA, including daily computations of segregated and Part 30 secured amounts, as well as twice monthly detailed information regarding the cash deposits and investments of customer funds.

CFTC Restructuring and Enforcement

The CFTC also has implemented a significant restructuring, based on a new strategic plan, regarding our oversight of SROs and intermediaries.

The CFTC last year established a new division dedicated solely to the oversight of the SROs and intermediaries. We created a branch within the division to specifically oversee examinations. We were able to attract talented individuals from the private sector with many years of relevant experience to lead this new division and branch. We have begun the process of strengthening our examination program, including adding risk and control elements. Separately, we also recently created a Consumer Outreach Office to help consumers get information about avoiding fraud.

In addition, the CFTC's enforcement arm aggressively pursues bad actors in the markets. In the last two years, the Division of Enforcement has been filing cases and opening investigations at the highest rate in the CFTC's history. Roughly half of the cases involve fraud against customers.

Since October 2009, the CFTC has brought 22 cases against registered FCMs, 13 of which involved supervision failures and one of which involved a failure to maintain customer secured funds properly. In the same period, the CFTC brought two cases in federal court against FCMs, one for violating segregation rules and the other for failing to be properly capitalized and to maintain books and records.

The Commission in April charged JPMorgan Chase Bank, N.A. for unlawful handling of Lehman Brothers, Inc.'s customer segregated funds and imposed a $20 million civil monetary penalty. In another case against a public accounting firm and a CPA partner of the firm, the Commission imposed sanctions for failing to conduct proper audits of a registered FCM. In one of our supervision failure cases, a registered FCM was sanctioned for failing to follow its own compliance procedures regarding “know your customer” requirements.

Customer Protection Reforms Ahead

While the Commission’s enhanced customer protection rules, staff reorganization and enforcement efforts to date have been significant, I believe we must do more. I believe we need to further enhance the agency’s rules for customer protection. As outlined below, staff recommendations, based on substantial commissioner and market participant feedback, are now drafted and in front of commissioners.

First, we must incorporate the NFA rules approved last week into the Commission’s regulations so that the CFTC can directly enforce these important reforms.

Second, I believe it is critical that we bring the regulators’ view of customer accounts into the 21st century. We must give the SROs and the CFTC direct electronic access to FCMs’ bank and custodial accounts for customer funds, without asking the FCMs’ permission. Further, acknowledgement letters (letters acknowledging that accounts contain segregated customer funds) and confirmation letters must come directly to regulators from banks and custodians.

Third, I believe we need more transparency to customers about their funds. Futures customers, if they wish, should have access to information about how their assets are held and with whom, similar to that which is available to mutual fund and securities customers.

Fourth, I believe we need to consider enhanced controls at FCMs regarding how customer accounts are handled.

In addition, I believe we need to carefully consider additional rules laying out the SROs' requirements for conducting examinations and audits.

Regarding the Commission's oversight of SROs and intermediaries, though we're making progress through our reorganization and new rules, the recent events at Peregrine highlight the necessity of looking at the decades-old system of SROs and the Commission's role in overseeing SROs.

I have directed the CFTC's staff to do a full review of how the agency conducts oversight of the SROs, as well as limited-scope reviews of FCMs, to determine what improvements can and should be made. As part of this review, we have reached out to the Public Company Accounting Oversight Board (PCAOB), which oversees the audits of public companies and regularly inspects the people who audit securities brokers and dealers that are registered with the SEC. The PCAOB's role is somewhat similar to that of the CFTC in overseeing the NFA. The PCAOB has agreed to give us the benefit of its insights and expertise.

Building on the customer protection public roundtable earlier this year, I also have asked CFTC staff to hold another public roundtable discussion on customer protection issues, including examination techniques and procedures, which will take place during the 2nd week of August.

Resources

Confidence in the futures and swaps markets is dependent upon a well-funded regulator. The CFTC is a good investment of taxpayer dollars. This hardworking staff of 710 is just 10 percent more than what we had at our peak in the 1990s though the futures market has grown fivefold. The CFTC also will soon be responsible for the swaps market – eight times bigger than the futures market.

The Commission's limited resources have historically not allowed for direct oversight of FCMs. There are 46 staff members, including 35 audit staff, on the CFTC's examinations team who oversee four SROs, which in turn have responsibilities for more than 4,341 registered persons. On top of the current lack of staff for examinations, our responsibilities are expanding to include reviews of many new market participants. For instance, there are currently 115 FCMs, and staff estimates a similar number of swap dealers will ultimately register. More frequent and in-depth risk-based, control-oriented examinations are necessary to assure the public that firms have adequate capital, as well as systems and procedures in place to protect customer money. Greater coverage by regulators – like having more cops on a beat – will improve the integrity and heighten the deterrent effect of the review process.

The President's FY2013 budget, following a similar request in 2012, asked for $308 million, investing in our technology and human resources, to better protect the public.

Market participants depend on the credibility and transparency of well-regulated U.S. futures and swaps markets. Without sufficient funding for the CFTC, the nation cannot be assured that the agency can adequately oversee these markets.

Conclusion

Nearly four years after the financial crisis and two years since the passage of Dodd-Frank, the CFTC has made significant progress in implementing Congress' common-sense reforms for the swaps market.

With the foundational rules in place, it is critical that we complete the remaining reforms that will bring transparency and competition to the swaps market, lower costs for companies and their customers, and protect the public.

It is also crucial that the CFTC, working with SROs and market participants, continues its efforts to enhance protections for the funds of both futures and swaps customers.

Thank you and I look forward to your questions.

CFTC Dodd-Frank Update

Final Rules & Guidance

- Agricultural Commodity Definition
- Agricultural Swaps
- Anti-Manipulation
- Business Affiliate Marketing and Disposal of Consumer Information
- Client Clearing Documentation, Straight Through Processing, Clearing Member Risk Management
- Commodity Options
- Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations
- Derivatives Clearing Organization - General Provisions and Core Principles
- Designated Contract Markets – Core Principles
- End-User Exception
- External Business Conduct Standards
- Foreign Boards of Trade - Registration
- Implementation Phasing for Clearing
- Internal Business Conduct Standards (Risk Management, Recordkeeping, & CCOs)
- Investment Advisor Reporting on Form PF (Jt. with SEC)
- Investment of Customer Funds (Regulation 1.25)
- Large Trader Reporting for Physical Commodity Swaps
- Position Limits for Futures and Swaps
- Privacy of Consumer Financial Information
- Process for Review of Swaps for Mandatory Clearing
- Process for Rule Certifications for Registered Entities (Part 40)
- Real-Time Reporting for Swaps
- Removal of References to or Reliance on Credit Ratings
- Reporting Certain Post-Enactment Swap Transactions (IFR)
- Reporting of Historical Swaps
- Reporting Pre-Enactment Swap Transactions (IFR)
- Retail Commodity Transactions – Interpretive Guidance on "Actual Delivery"
- Retail Foreign Exchange Intermediaries – Regulations & Registration
- Retail Foreign Exchange Transactions – Conforming Amendments
- Segregation for Cleared Swaps
- Swap, Security-Based Swap, Security-Based Swap Agreement -- Further Definitions (Jt. with SEC)
- Swap Data Recordkeeping and Reporting Requirements
- Swap Data Repositories – Core Principles, Duties & Registration
- Swap Dealers and Major Swap Participants - Registration
- Swap Dealers, Major Swap Participants, and Eligible Contract Participants - Further Definitions (Jt. with SEC)
- Whistleblowers

Proposed Rules & Guidance

- Block Rule
- Capital for Swap Dealers & Major Swap Participants
- Clearing Exemption for Cooperatives
- Clearing Requirement Determinations
- Conforming Rules
- Cross-Border Application
- DCMs – Core Principle 9
- Disruptive Trade Practices
- Governance and Conflict of Interest (DCM, DCO, & SEF)
- Identify Theft (Jt. with SEC)
- Internal Business Conduct (Documentation, Confirmation, & Portfolio Reconciliation)
- Margin for Uncleared Swaps
- Segregation for Uncleared Swaps
- Swap Data Repository Indemnification Interpretation
- Swap Execution Facilities – Core Principles, Registration, and Process for "Made Available to Trade" Determinations
- Systemically Important Clearing Organizations – Additional Provisions
- Volcker Rule

Yet to be Proposed Rules & Guidance

- Inter-Affiliate Clearing for Financial Entities
- RTO/ISO Exemptive Relief
- 201(f) Exemptive Relief
- Stress Testing under Section 165

Final Orders

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

Studies & Reports

- Feasibility of Requiring Use of Standardized Algorithmic Descriptions for Financial Derivatives (Jt. with SEC)
- International Swap Regulation (Jt. with SEC)
- Risk Management Supervision of Designated Clearing Entities (Jt. With Board of Governors of the Federal Reserve System and the SEC)
  Study on Oversight of Carbon Markets (Jt. with various other Ag