

**TESTIMONY BY
J. CHRISTOPHER GIANCARLO
CHAIRMAN OF THE
COMMODITY FUTURES TRADING COMMISSION
BEFORE THE
SENATE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON
FINANCIAL SERVICES AND GENERAL GOVERNMENT
WASHINGTON, DC
MAY 8, 2019**

INTRODUCTION

Thank you, Chairman Kennedy, Ranking Member Coons, and Members of the subcommittee. I appreciate the opportunity to appear before you today, along with my fellow colleague from the Securities Exchange Commission (SEC), Chairman Jay Clayton.

I want to start by saying thank you to all the members of this subcommittee for supporting the work of the Commodity Futures Trading Commission (CFTC), and for the budget increase you provided with the enactment of the FY 2019 budget.¹

I would also like to acknowledge the strong working relationship that exists today between the SEC and CFTC. From the outset Chairman Clayton and I recognized the need for our agencies to work more closely together. We are doing that today in the areas of regulatory enforcement, cryptoasset regulation, Dodd-Frank rule harmonization, clearinghouse oversight, disaster recovery testing and resolution planning and so much more. It has been a privilege, a pleasure and an honor to work alongside him and the fine men and women of the SEC. I thank Chairman Clayton for being a good partner and trusted colleague in the challenging roles that we serve.

As you know, the CFTC oversees the futures, options and swaps markets. While most Americans do not actively participate in these markets, businesses of all sizes use the derivatives markets to manage commercial and market risk. These markets are one reason why American consumers enjoy stable prices, not only in the supermarket, but in all manner of consumer finance from auto loans to household purchases. Derivatives markets influence the price and availability of heating in American homes, the energy used in factories, the interest rates borrowers pay on home mortgages, and the returns workers earn on their retirement savings.

Today, American derivatives markets are the world's largest, most developed, and most influential. They are relatively unmatched in their depth and breadth, providing deep pools of trading liquidity, low transaction costs and friction and participation by a diverse array of global counterparties. They are also some of the world's fastest growing and technologically innovative.

¹ Consolidated Appropriations Act, 2019, PL 116-6 at <https://www.congress.gov/bill/116th-congress/house-joint-resolution/31>

American derivatives markets are also the world's best regulated. The United States is the only major country in the Organization for Economic Co-operation and Development to have a regulatory agency specifically dedicated to derivatives market regulation: the CFTC. There is a connection between having the world's most competitive derivatives markets and independent Federal regulation. For over forty years, the CFTC has been recognized for its principles-based regulatory framework and econometrically-driven analysis. The CFTC is respected around the world for its depth of expertise and breadth of capability.

The combination of regulatory expertise and competency is one of the reasons why derivatives markets continue to serve the global need to hedge price and supply risk safely and efficiently. It is why well-regulated U.S. derivatives markets, by allowing low-cost and effective hedging, are of great benefit to American producers and consumers and to the rest of the world.

In short, America's well-regulated derivatives markets are a national advantage in global economic competition. However, we must not take this advantage for granted. In order for U.S. derivatives markets to remain the world's best, U.S. markets must remain the world's best regulated. To be the best regulated, U.S. derivatives markets must have an adequately funded regulator. The CFTC must have adequate resources to continue to serve its mission to foster open, transparent, competitive, and financially sound U.S. derivatives markets that remain the envy of the world.

It was five years ago this month that I first testified before the Senate Agriculture Committee concerning my nomination to serve on the Commission. I knew that if confirmed, I would bridge the last years of the Obama Administration and the early years of the new Administration. In 2017, as Chairman of the Commission, I set out my agenda for moving the Agency forward. I pledged to make sure that our derivatives markets performed their essential role moderating price, supply and other commercial risks – shifting risk to those who can best bear it from those who cannot. I said that our markets should be neither the least nor the most prescriptively regulated – but the BEST regulated – balancing market oversight, health and vitality. To do that, we would follow a three-part agenda: completing unfinished business of the past, improving current operations, and preparing for the future, what I call becoming a 21st Century digital regulator.

I believe the budget request for FY 2020 supports this agenda.

BUDGET REQUEST

The Commission is requesting a total of \$315.0 million for FY 2020. This budget request consists of two separate requests, the annual Commission operational funding of \$284.0 million and a new request to support the relocation of three regional offices of \$31.0 million. The annual operational request of \$284.0 million will provide 707 FTE in FY 2020; this request is \$2.5 million above the FY 2019 President's Budget Request² and represents an

² Commodity Futures Trading Commission, FY 2019 President's Budget, February 2018, at: https://www.cftc.gov/About/CFTCReports/cftcreports_historical.html

inflationary adjustment of less than 1%. This request seeks an annual increase of \$35.0 million above the FY 2019 Continuing Resolution funding level and is in line with the FY 2019 President's Budget.

The budget request of \$284 million is the level of funding necessary to fulfill the CFTC's statutory mission.

21st CENTURY REGULATOR

I have frequently talked about transforming the CFTC into a 21st Century regulator amidst today's increasingly digital and algorithmic markets. I recently identified several factors that are challenging the work of regulators: the extraordinary pace of exponential technological change, the disintermediation of traditional actors and business models, and the need for technological literacy and big data capability.

I said that the CFTC's response to rapidly changing markets and technological developments, including blockchain technology and cryptocurrencies, is built upon the following four cornerstones:

- Adopting an "exponential growth mindset" that anticipates the rapid pace of technological innovation and the need for appropriate regulatory response;
- Becoming a "quantitative regulator" able to conduct independent market data analysis across different data sources, including decentralized blockchains and networks, without being reliant on self-regulatory organizations and market intermediaries;
- Embracing "market-based solutions" to determine the value of technological innovations, as we witnessed with the launch of crypto-asset-based futures products; and
- Establishing an internal FinTech Stakeholder to address the opportunities and challenges that FinTech presents and manage the ever-present tension between innovation and regulation.

For us, that stakeholder is LabCFTC, which was launched almost two years ago. In that time, it has had over 250 separate interactions with innovators big and small. It has offices in New York City. It conducts "lab hours" in places where innovators work: from Silicon Valley, California to Silicon Hills, Texas and from the South Bank of London to Singapore Center. LabCFTC is not a "sandbox." It does not try to pick winners from losers, nor does it exempt firms from CFTC rules.

Instead, LabCFTC provides us both an internal and external technological focus. Internally, it means explaining technology innovation to agency staff and other regulators and advocating for technology adoption. Externally, that means reaching out and learning about technological change and market evolution, while providing a dedicated liaison to innovators. It has entered into FinTech cooperation agreements with regulators in London, Singapore and Australia. It has published well-regarded technology primers and requests for comments. I am proud to say that LabCFTC has become a category leader. Every U.S. federal financial regulator

has either created or is creating a program similar to LabCFTC.

ECONOMIC MODELING AND ECONOMETRIC CAPABILITIES

The FY 2020 budget request will continue to allow the agency to expand its core economic expertise in order to conduct in-depth analytical and empirical studies of issues affecting all areas of Commission and regulatory interest. It will allow the Commission to address the large volumes of data collected as a result of the Dodd-Frank Act. The resulting work will further enhance the Commission's understanding of market risk or systemic risk and derivatives market structure and participants, including end users, intermediaries, and traders, and connections between futures, cleared swaps, and uncleared swaps.

Improved economic and econometric analysis will improve the analytical and empirical foundations of the Commission's policies and rules and better inform its cost-benefit considerations. Furthermore, this request will enable the Commission to provide more of its analysis to the public in the form of white papers on topics of current interest, as well as recurring reports on aggregate market trends, trading activity, and positions, and high-quality research papers on fundamental properties of relevant markets and sectors of market participants.

CYBER SECURITY

As market leaders and regulators, we must continue to take every step possible to thwart cyber-attacks that have become a continuous threat to U.S. financial markets. With the FY 2020 budget request, the Commission plans to strength cybersecurity and network defenses, support the LabCFTC 2.0 initiative, and invest in the agency's multi-year cloud strategy.

The Commission seeks new IT security resources to continue progress towards achieving compliance with Federal Information Security Management Act (FISMA) and related Office of Management and Budget (OMB) security mandates and ensuring the protection of sensitive market participant data.

The same vulnerabilities hold true in the case of futures commission merchants where customer accounts hold records and information that requires protection. We as an agency will work hard to ensure that regulated entities live up to their responsibility to ensure their IT systems are adequately protected from attacks and customers are protected.

AGENCY REFORM AND THE KISS PROJECT

Two years ago, I announced the launch of Project KISS. It stands for "Keep It Simple Stupid." It is an agency-wide review of CFTC rules, regulations and practices to make them simpler, less burdensome and less costly. It has resulted in a range of rule and process improvements that are reducing regulatory costs and burdens.³ Many KISS initiatives were recommended by market participants, but many were also initiated by our own agency staff that

³ Michael Gill, Chief of Staff, U.S. Comm. Fut. Trading Comm'n, Remarks at the National Press Club, CFTC KISS Policy Forum, Washington, D.C. (Feb. 12, 2018), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagill2>.

saw ways to reduce undue obligations on registrants and market participants. There are still more Project KISS initiatives in the pipeline. It is my belief that this effort should continue upon my departure and be a regular part of the agency's mission.

DODD FRANK RULEMAKING

The Commission has made progress on completion of its critical Dodd-Frank Act rule making. On November 5, 2018 a five-Member Commission voted unanimously on the threshold for swap dealer de minimis to provide the market with certainty that the threshold will not fall from \$8 billion to \$3 billion.⁴

In addition, all five Commissioners have committed to Congress to move forward with a final position limits rule. I believe the final rule must be responsive to the public comments and ensure that regulatory barriers do not stand in the way of long standing hedging practices of American farmers, ranchers, producers and manufacturers, who depend on our markets. I intend to put forth such a position limits rule proposal before I leave the Commission.

SEF REFORMS

The CFTC's implementation of its swaps trading rules has long been a concern of mine. I believe the current framework is inconsistent with the Dodd-Frank Act by being too prescriptive, too burdensome and too modeled on futures markets. The framework is also highly subjective and overly reliant on a series of no-action letters, staff interpretations and temporary regulatory forbearance that may change at any time.

That is why, last November, the Commission issued a proposed rule to amend the SEF regulations and the trade execution requirement and a request for comment on the practice of "post-trade name give-up."⁵ I believe there are two crucial reasons to improve the SEF rules: risk and opportunity. The impermanence of the current SEF rule framework poses risk for market participants. At any time staff may well change or withdraw the numerous interpretations, guidance and compliance expectations that underpin the current framework. Moreover, the current restrictions on methods of execution may turn out to be, by themselves, a source of trading risk during a liquidity crisis – when swaps counterparties need to be found through less prescriptive and more flexible means of execution.

On the other hand, improving the SEF rules presents opportunity – opportunity for service innovation by existing and new market entrants that has waned under the current framework. It is the opportunity to boldly create a regulatory framework that actually fosters innovation, entrepreneurship, competition and increased market vibrancy rather than stifle it. Improving the SEF rules also increases the chance that the SEC will draw on the new framework in whole or in part for their security-based SEF regime. It would create a common U.S. regulatory approach for all swaps products, reducing operational and compliance costs and

⁴ "Commission Approves a Final Rule on Swap Dealer De Minimis Exception", November 5, 2018, at:

<https://www.cftc.gov/PressRoom/Events/opaeventstaffmeeting110518>.

⁵ Federal Register, November 30, 2018, at: <https://www.federalregister.gov/documents/2018/11/30/2018-24643/posttrade-name-give-up-on-swap-execution-facilities>.

risks.

I do not support merely tinkering with the current SEF rules to fix their most glaring shortcomings or perpetuating the many no action letters and staff guidance on which they rely. Such a step would be unworthy of the regulator of the world's most vital derivatives markets. Instead, the agency must not be afraid to build a better and more durable regulatory framework for swaps execution that encourages the return of innovation and new service offerings and supports vibrant markets and broad-based prosperity for a generation or more.

INCREASED EXAMINATIONS OF CLEARINGHOUSES

Fully funding the CFTC at the FY 2020 levels will support the agency's oversight of clearinghouses. The agency's work to conduct regular examinations, in concert with the Commission's surveillance and other functions, is a highly effective method to maintain market integrity so that American businesses can rely on these markets. The Commission leverages resources by conducting joint examinations across Commission divisions, and through coordinated examinations with the Federal Reserve and the Securities and Exchange Commission, where possible. This effort allows the Commission to be more efficient with its limited resources and at the same time, reduce burdens for dual registrants.

In addition, examinations of DCOs help the Commission identify issues that may affect a clearinghouse's ability to control and monitor its risks. These are among the most important examinations that the Commission conducts, as clearinghouses have become critical single points of risk in the global financial system. Furthermore, the number of clearinghouses, the scope and complexity of the examination issues and the importance of these examinations to overall financial stability are all increasing.

In addition to U.S. clearinghouses, the Commission regulates six registered non-U.S. clearinghouses, and has limited oversight of four non-U.S. clearinghouses exempt from registration. The Commission anticipates new applications for DCO registration resulting from the explosion of interest in crypto currencies; an area in which protection of the crypto currencies will be one of the highest risks.

The Commission has an active, data-driven daily risk surveillance function, and expects to continue investing additional resources on human capital, data, and technology to improve our current analytical capabilities to keep up with growth in both the scale and complexity of risk transmission in the derivatives markets.

Given the emphasis of G-20 and Dodd Frank reform efforts on central clearing as a critical tool to help mitigate systemic risk in the global financial markets, the Commission expects to grow our stress testing program to help ensure that the clearing eco-system continues to be resilient to absorb both market and systemic shocks.

EFFECTIVE INTERNATIONAL ENGAGEMENT

Recently, the CFTC along with the Bank of England and the Financial Conduct Authority (FCA), with support from Her Majesty's Treasury, issued a joint statement

providing assurances to market participants on the continuity of derivatives trading and clearing activities between the UK and U.S. regardless of the outcome of the UK's withdrawal from the EU.⁶ Together, the four authorities are taking measures to avoid regulatory uncertainty about the continuation of derivatives market activity between the UK and U.S. These measures should give confidence to market participants about their ability to trade and manage risk across the Atlantic. It is a great credit to the decades-long cooperation between the CFTC and the Bank of England, FCA, and HM Treasury, that we are able to work together to take these steps.

It is critical that the CFTC continues to work positively with its overseas regulatory counterparts, not just in the UK, but in all financial centers. I am a firm believer that by working together with my regulatory counterparts across the globe, in a cooperative spirit, we can strengthen our economies while keeping our financial system resilient and stable. That is why the afternoon after the CFTC-UK announcement; I traveled to Brussels to meet with European Commission Vice President Valdis Dombrovskis and Director-General Olivier Guersent to discuss how to broaden cooperation between the CFTC and the EC.

In addition, I am proud to report that we achieved a significant milestone on March 13, 2019 as the CFTC and the Monetary Authority of Singapore announced the mutual recognition of swaps trading venues in our respective jurisdictions.⁷ In this regard, the CFTC exempted certain Singapore trading venues from the SEF registration requirements. This exemption reduces the burdens associated with duplicative and overlapping regulations, mitigates market fragmentation, enables U.S. market participants to access Singaporean markets to manage risks effectively, and enhances cross-border business opportunities for both U.S. and Singaporean firms.

Recently, EU co-legislators reached a political agreement on the new amendments to the European Market Infrastructure Regulation (EMIR 2.2) pertaining to the regulation and supervision of central counterparties (CCPs). To mark this occasion, I issued two statements: a joint statement with Valdis Dombrovskis (Dombrovskis), the Vice-President of the European Commission (EC), and a separate statement as Chair of the CFTC. The statements publically affirm that the CFTC's concerns regarding the potential adverse impact EMIR 2.2 on U.S. CCPs and the broader U.S. financial markets remain a significant issue for the U.S. and it is our expectation, that EU authorities will address our concerns during the EMIR 2.2 legislative process.

The joint statement with Dombrovskis asserts that the CFTC will continue to engage with EU authorities on EMIR 2.2 through the next phase of the legislative process, the drafting of the implementation regulations (the Level 2 process), and that the EC will consider the CFTC's concerns during this Level 2 process. It also states that it is the expectation of the EC and the CFTC that the implementation of EMIR 2.2, along with the CFTC's on-going review

⁶ "Joint Statement by UK and US Authorities on Continuity of Derivatives Trading and Clearing Post-Brexit", February 25, 2019, at <https://www.cftc.gov/PressRoom/PressReleases/7876-19>.

⁷ "Joint Statement of the CFTC and the Monetary Authority of Singapore Regarding the Mutual Recognition of Certain Derivatives Trading Venues in the United States and Singapore, March 13, 2019, at: <https://www.cftc.gov/PressRoom/PressReleases/7887-19>.

of its cross-border regime, will result in a future transatlantic relationship between the EU and the CFTC, which will be based on greater deference than there is now.

In my separate statement, I reaffirm my understanding that although the application of EMIR 2.2 to U.S. CCPs is not likely to occur until 2020 or beyond, EU authorities, including the EC and the European Securities and Markets Authority (ESMA), will work with the CFTC to address U.S. concerns during the legislative process. Further, I state that the starting point for any future recognition assessment of U.S. CCPs must be the current 2016 Equivalence Decision.

These statements taken together are meant to provide market participants who transact in both U.S. and EU markets assures that the CFTC and the EC will continue to work through our differences to mitigate the impact of unnecessary regulatory and supervisory burdens, and to foster economic growth and stability for our global CCPs.

Six months ago, I released a White Paper on cross-border swaps regulation that proposed updating the agency's current cross-border application of its swaps regime with a rule-based framework based on regulatory deference to third-country regulatory jurisdictions that have adopted the G-20 swaps reforms.⁸ As our regulatory counterparts continue to implement swaps reforms in their markets, it is critical that we make sure our rules do not conflict and fragment the global marketplace. That is why I believe the CFTC should move to a flexible, outcomes-based approach for cross-border equivalence and substituted compliance and operate on the basis of comity, not uniformity, with overseas regulators.

Before I leave the Commission, I intend to put forward a rule proposal to address the registration of non-U.S. CCPs clearing swaps for U.S. persons. I also intend to put forth a rule proposal addressing the registration and regulation of non-U.S. swap dealers and major swap participants. In particular, the proposal will address the risk that non-U.S. swap dealing activity poses to the United States, but do so in a way that does not apply the swap dealer rules extraterritorially without sufficient consideration of whether the activity truly poses a "direct and significant" risk to the U.S. financial system, as Congress intended.

ENFORCEMENT

The fiscal year 2020 budget request will allow the Commission to continue its strong record on enforcement and oversight of the derivatives markets to ensure they operate free of fraud, manipulation, and other trading abuses.

Two years ago, I issued a warning to those who may seek to cheat or manipulate our markets that they would face aggressive and assertive enforcement action by the CFTC. I pledged there would be no pause, let up or reduction in our enforcement of the law and punishment of wrongdoing.

During my watch, the CFTC has been resolute in holding market participants to the

⁸ "Chairman Giancarlo Releases Cross-Border White Paper", October 1, 2018 at: <https://www.cftc.gov/PressRoom/PressReleases/7817-18>.

highest standards of behavior. In fact, by any measure, enforcement has been among the most vigorous in the history of the CFTC, including more enforcement actions, more penalties, more large-scale matters, more accountability, more partnering with criminal law enforcement and more whistleblower awards than in prior years.⁹

The Commission has strengthened its rules and procedures to better protect whistleblowers, brought new impactful enforcement cases, and successfully resolved other important enforcement cases. In addition, enforcement resources have been enhanced through the internal realignment of the Market Surveillance Branch in 2017 to report directly to the Director of Enforcement. This is one of several actions the Commission has taken to better utilize resources across the Commission.

At the same time, I have strived to make sure CFTC enforcement staff is committed to providing incentives for companies and individuals to engage in ethical corporate behavior – to develop a true culture of compliance, to do the right thing. The cooperation and self-reporting policies issued by the Division make clear that companies and individuals could receive a recommendation for a Commission reduction in penalty if they fully cooperate with enforcement investigations, timely remediate, and, most importantly, self-report misconduct before the Commission learns about it.

To better encourage compliance, the Division recently issued an advisory on cooperation and self-reporting concerning foreign corrupt practices. As noted in remarks accompanying the advisory, James McDonald, the Commission’s enforcement director, made clear that if a company or individual not registered (or required to be registered) with the CFTC timely self-reports a violation of the CEA involving foreign corrupt practices, fully cooperates, and appropriately remediates, the Division will apply a presumption, absent aggravating circumstances, that it will not recommend a civil monetary penalty.¹⁰

Before I entered government service, I spent a decade and a half working on Wall Street. My commitment to transparent examination practices and robust regulatory enforcement derives from that experience. It is the duty of government generally and the particular mission of the CFTC to fairly enforce market regulation and prosecute bad actors. We fulfill that mission so that America’s financial markets are places for good people to fulfill their dreams, grow the economy and increase prosperity.

AGRICULTURAL COMMODITY FUTURES

Under my leadership at the Commission, we have refocused our attention on agricultural commodity futures, the agency’s traditional foundation.

⁹ See, generally, “Regulatory Enforcement & Healthy Markets: Perfect Together!”, Remarks of Chairman J. Christopher Giancarlo at Economic Club of Minnesota, October 2, 2018, Minneapolis, Minnesota, at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo56>.

¹⁰ “Speech of James McDonald, Director of the Division of Enforcement Commodity Futures Trading Commission Regarding Perspectives on Enforcement: Self-Reporting and Cooperation at the CFTC”, September 25, 2017 at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald092517>

During almost five years on the Commission, I have travelled the country and visited agriculture producers in over two dozen states from Montana, Texas, Arkansas, Louisiana and Iowa to Minnesota, Missouri, New York, Georgia, Mississippi and Oklahoma. I have walked in wheat fields and harvested soybeans, tramped through rice farms and beneath pecan groves, milked dairy cows and toured feedlots, visited grain elevators and viewed cotton gins. I have also met with our energy producers, going 900 feet underground in a Kentucky coal mine and 90 feet in the air on a North Dakota oil rig. Throughout, I have been moved by the diverse beauty of this country. I have come to love its hard-working families producing food and energy from this abundant land. These visits have been a great privilege for me.

This year in Kansas, we held the CFTC's second annual agricultural futures conference along with Kansas State University.¹¹ Panelists discussed current macro-economic trends and issues affecting our markets, such as market speculation, algorithmic trading, trade data transparency, novel hedging practices and market manipulation. Our common purpose was to hear from end users who use our markets to hedge risk and consider and address issues of emerging market structure and trading practices.

We also hosted a CFTC Agricultural Advisory Committee meeting in Kansas where panelists discussed the future of Futures Commission Merchants (FCM) and cash market innovations, as well as the evolution of electronic trading in agricultural markets, both very timely and important topics. I believe this was the first ever CFTC advisory committee meeting held outside of Washington with all five Commissioners in attendance.

CONCLUSION

Looking to the past, I will be pleased that I have furthered and confirmed much of the Dodd-Frank mandate for swaps. Where I have identified flaws in implementation, I have proposed comprehensive solutions. In my view, now is the time to create better frameworks that are more flexible, more durable and more supportive of deep and liquid markets, in good times and in bad.

As for the present, I have tried to do what my parents taught me – to leave any place I visit in a better condition than I found it: better run, better funded, more transparent, more accountable and more efficient in its vital mission overseeing American markets.

As for the future, I will be satisfied that I have raised the profile and reputation of the CFTC and set it on a course for the digital Twenty-First Century. So much is changing, and changing rapidly in our commodity derivatives markets. As market regulators, we are ready to listen, and we are working to understand. And, we will be dogged. The greater the pace of change, the greater must be our capacity to keep pace, understand and harness it.

¹¹ 2nd Annual Agriculture Commodity Futures Conference, April 11-12, 2019, at: <https://www.k-state.edu/riskmanagement/conference1.html>.

The CFTC is well along the course of that new direction set two years ago – a course that is sustainable and true.

Thank you for a privilege to speak to you today. It has been my honor to serve you, our dynamic markets and the American people.