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BEFORE THE

SENATE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

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Good morning Chairman Stabenow, Ranking Member Roberts and members of the Committee. I am Dan Berkovitz and I am privileged to serve as the General Counsel at the Commodity Futures Trading Commission (CFTC or Commission). I appreciate the opportunity to testify today regarding the CFTC's regulation of derivatives markets.

CFTC Mission

The mission of the CFTC is to ensure the integrity and transparency of derivatives markets so that market participants may use these markets with confidence. Derivatives serve as tools that allow producers and merchants to be certain of the prices of commodities that they plan to use or sell in the future. Derivatives markets are used to hedge risk and discover prices, and the CFTC strives to ensure that the markets within its jurisdiction are transparent and free from fraud, manipulation, and abusive trading practices. The CFTC also seeks to ensure the financial integrity of all transactions that are within its jurisdiction and the avoidance of systemic risk.

Since the 1920s, the CFTC and its predecessors have been charged with overseeing the futures and commodity options markets. While the first futures markets traded only contracts for future delivery of certain agricultural commodities, such as wheat, corn, and other grains, these markets have evolved to include futures contracts and options on futures contracts on energy and metals commodities, such as crude oil, heating oil, gasoline, copper, gold, and silver, as well as futures and options on futures on financial products, such as interest rates, broad-based security indexes, and foreign currencies.

These markets are but one part of a much broader derivatives marketplace, which includes futures, options, and swaps. With the passage of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), the CFTC's mission now includes the regulation of the swaps market. Like futures, swaps can include physical commodities and financial instruments. Firms use both futures and swaps markets to hedge their risks and for price discovery.

The CFTC fulfills its statutory mandate to ensure that trading is fair and free from abuse through market surveillance, industry oversight, and enforcement. The Commission oversees futures exchanges and clearinghouses, including the processing of designation and registration applications, as well as the review of exchange and clearinghouse rules and their enforcement. Since the 1930s, the Commission and its predecessors have had the authority to set speculative position limits on traders in order to prevent the undue burdens on commerce that arise from excessive speculation. In carrying out its responsibilities, the Commission relies upon industry self-regulatory organizations, such as the futures exchanges themselves, to monitor trading and enforce compliance with trading rules and position limits. Ultimately, however, it is the

Commission that is responsible for enforcing our regulations and the provisions of the Commodity Exchange Act (CEA).

As a part of its surveillance function, the Commission’s Division of Market Oversight routinely collects and analyzes position reports that are required of large traders in the futures markets. These reports and other surveillance data allow the Commission staff to see accumulating positions that may be disruptive to fair and orderly trading, to act to prevent such disruptions, and, where appropriate, to refer matters to the Division of Enforcement to take enforcement action if there is a violation of the CEA or the Commission’s regulations.

The Commission’s enforcement program is designed to deter, prevent, and punish fraud, manipulation—including attempted manipulation—and other statutory and regulatory violations. Overall, since the beginning of fiscal year 2008, the Commission has collected more than $236 million in civil penalties imposed in enforcement actions. In recent years, the Commission has seen a significant increase in the number of fraud cases, including Ponzi schemes. Since October 2008, the Commission has filed 100 enforcement cases for fraud.

CFTC Expanded Authorities and Responsibilities

The Dodd-Frank Act significantly expanded the CFTC’s authorities by expanding its oversight, for the first time, to include the swaps markets in addition to the futures markets. The Act specifically repeals provisions of the CEA that, prior to the Dodd-Frank Act, restricted the Commission’s authority to regulate the swaps markets – including provisions that related specifically to energy markets. The CFTC will have access to information about trading and positions and full authority to guard against fraud and manipulation and take enforcement action to prosecute violations in both markets. As required by the Act, trading in both markets will be transparent to the CFTC and to the public. The statute directs the CFTC to apply position limits in markets for both agricultural commodities and exempt commodities (primarily energy and metals), as appropriate, and to the market as a whole. Additionally, the Dodd-Frank Act enhanced the CFTC's basic enforcement authorities to prevent fraud and manipulation. The Securities and Exchange Commission (SEC) will have similar jurisdiction over the security-based swaps markets.

The Dodd-Frank Act

Specific new authorities provided by Dodd-Frank to the CFTC with respect to the swaps market include:

-- **Comprehensive oversight of the swaps market.** The Dodd-Frank Act calls for comprehensive regulation of the entire swaps market. Swap dealers and major swap participants are required to register and are subject to capital and margin requirements, recordkeeping and reporting requirements, and business conduct standards. The Act provides for regulation of trading venues and clearinghouses as well. The CFTC is directed to determine which swaps should be required to be cleared, and swaps that are required to be cleared also must be traded transparently on swap execution facilities or on designated contract markets if they are made available for trading. Non-financial end-users hedging or mitigating commercial risk are exempt from the clearing and trading requirements.

-- **Price transparency of swaps transactions**. The Dodd-Frank Act generally requires the real-time public reporting of price and volume data for transactions in swaps with exceptions for large (block) trades and trades that would reveal the identities of the counterparties.

-- **Comprehensive reporting of swaps transaction data.** The Dodd-Frank Act requires the reporting of basic data about each swap transaction to either a swap data repository or, if there is no repository for that data, the CFTC. This comprehensive transaction data will expand the CFTC's view of the market for surveillance purposes.

-- **Position limits on speculation in swaps.** The Dodd-Frank Act directs the Commission to establish position limits for both futures and swaps in a very specific manner. First, the Act directs the Commission to establish speculative position limits, as appropriate, for futures contracts for agricultural commodities and exempt commodities. Second, the Act directs that the Commission concurrently establish, as appropriate, speculative position limits on swaps that are economically equivalent to those futures contracts. Third, the Act requires the Commission to establish aggregate limits across the futures and swaps markets. On January 26, the Commission published a proposed rule to implement these statutory directives. The comment period closed on March 28. The Commission will evaluate the comments received before proceeding to a final rulemaking.

In connection with this new authority to establish speculative position limits in the swaps market, the Commission has issued a proposed rule to require data on large trader positions in the swaps market. The CFTC currently obtains comprehensive data with respect to positions of large traders in the futures markets. Prior to Dodd-Frank, the CFTC could issue special calls to swap dealers for particular swaps position data, but the information obtained through this special call authority is limited to the swap positions of the reportable traders in the futures markets. Under the Commission's proposed large swap trader reporting rule, which would apply to swap dealers and cleared swaps, this new data would be used to calculate the appropriate position limits under the proposed position limits rule, as well as permit the Commission to begin to monitor all large positions in this market.

Over the past several years the Commission has taken a number of steps to increase the transparency of the futures market. For several decades, the Commission has published what is now the weekly *Commitments of Traders* (COT) report. The COT reports provide a breakdown of each Tuesday's open interest between commercial and non-commercial traders for markets in which 20 or more traders hold positions equal to or above the reporting levels established by the CFTC. In September 2009, the Commission began publishing a weekly Disaggregated COT report for physical commodity markets. It takes the Commercial category in the COT report and splits it into two groups—the "producer/merchant/processor/user" category and the "swap dealer" category. It also splits the Noncommercial category into two groups—the "managed money" traders and the "other reportables" category.

Also in September 2009, the CFTC began publishing a quarterly report of Index Investment in the physical commodity markets. This quarterly Index Investment report was converted to a monthly report beginning with the July 31, 2010, data.

In July 2010, the CFTC began publishing the *Traders in Financial Futures* report to add transparency to financial futures markets (comparable to that for physical commodity markets) through a weekly COT-type report using new classifications of large traders, into essentially the "buy side" and the "sell side." The "sell side" is reflected in the category "Dealer/Intermediary," while the buy side is subdivided into 3 groups: "Asset Manager/Institutional," "Leveraged Funds," and "Other Reportables."

Once the data regarding swap trader positions is available, the Commission will be able to provide the public with similar transparency into the swaps market.

-- **Enhanced enforcement authorities.** The Dodd-Frank Act enhanced the Commission's enforcement authorities in both the futures and swaps markets. It specifically extended the Commission's anti-manipulation authority to cover swaps. The Act further provides the Commission with new anti-fraud authority, as well as new anti-manipulation authority based upon similar anti-manipulation authority that the SEC, the Federal Energy Regulatory Commission, and the Federal Trade Commission have for securities and certain commodities in the cash market.

The Dodd-Frank Act prohibits certain specific disruptive trading practices, including the submission of bids or offers when a trader has no intent of making a trade and the intentional or reckless disregard of orderly trading during the settlement period. The CFTC was given authority to issue rules to prohibit other types of practices that disrupt fair and orderly trading.

The Act contains a number of additional new enforcement authorities. It provides new protections for whistleblowers and allows whistleblowers to recover up to 30 percent of any monetary sanctions recovered in enforcement actions resulting from original information they provide that leads to such sanctions, in cases where the recovery is in excess of $1 million. It prohibits trading on the basis of non-public information obtained from the Federal government. It gives the CFTC specific authority to issue regulations to prevent evasions of various requirements in the Act. It also makes it illegal to enter into a swap knowingly or in reckless disregard of the fact that the counterparty will use the swap as part of a device or scheme to defraud a third party.

-- **Registration of Foreign Boards of Trade.** The Dodd-Frank Act provides the CFTC with new authority to register foreign boards of trade that provide direct access to traders in the United States. The Act specifies that a foreign board of trade seeking registration must meet a number of identified conditions if it intends to provide direct access to traders in the U.S. to trade in its market contracts whose settlement price is based upon the price of a commodity listed for trading in the U.S. These conditions include the establishment of position limits for that contract, emergency authority to liquidate positions, the sharing of data on large traders with the Commission, and publication of aggregate reports on trader positions. This new authority is designed to ensure that U.S. traders cannot avoid speculative position limits on U.S. futures contracts or transparency requirements by directly trading economically equivalent contracts on a foreign board of trade.

The CFTC is in the midst of the rulemaking process with respect to these authorities. The CFTC has encouraged public comment on all of its rulemakings, and is evaluating the comments it has received so far.

FY 2012 Budget Request

The President's Budget proposes that $308 million be appropriated for the CFTC for fiscal year (FY) 2012 to remain available until expended through FY 2013. This funding level is the estimated amount the agency needs to perform its responsibilities to continue overseeing the futures and options markets and to begin overseeing the swaps markets.

The CFTC's resources are used primarily on staff and technology. The agency currently has 676 personnel on staff. The President's budget would provide funding for 983 employees. The additional staff will be necessary for the Commission to fulfill its responsibilities in the futures and swaps markets.

The FY 2012 budget requests $66 million for technology. This level of funding is necessary for the CFTC to be able to upgrade and expand its technology capabilities to handle its new data and market surveillance responsibilities under Dodd-Frank.

Conclusion

Thank you for the opportunity to address the Committee. I'd be happy to answer any questions you may have.