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Subcommittee on Financial Services and General Government
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Good morning, Chairwoman Capito, Ranking Member Coons and members of the Subcommittee. Thank you for the opportunity to testify on the Commodity Futures Trading Commission ("Commission" or "CFTC") FY 2018 Budget Request.

I appreciate the support your Committee has shown the Commission and for understanding the critical role we play in regulating the derivatives markets. I am pleased to be here today with Securities and Exchange Commission's (SEC) Chairman Clayton, and I very much look forward to our discussion today and working collaboratively with him as we move forward.

For more than 100 years, farmers and ranchers have used listed derivatives markets to hedge their costs of production and delivery price so that Americans can always find plenty of food on grocery store shelves. But derivatives markets are not just beneficial for agricultural producers. They 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. In addition, more than 90 percent of *Fortune* 500 companies use derivatives to manage commercial or market risk in their worldwide business operations. In short, derivatives serve the needs of society to help moderate price, supply and other commercial risks to free up capital for economic growth, job creation and prosperity.

It is imperative that we get our regulation of America's derivatives markets right, and that regulation needs to be supportive of economic growth. To do that, our oversight of market participants, here and abroad, should provide a model of regulatory excellence. We need to review, and where it makes sense, reform, rewrite, and appropriately simplify our regulations to allow market participants to effectively manage risk.

It is these basic tenets that form the basis of the Commission's FY 2018 Budget Request. With this Budget Request, the Commission will be able to support regulatory excellence without sacrificing other important Commission work, such as Enforcement or Surveillance activities. In the FY 2018 request, the Commission placed importance on specific capabilities that will allow the Commission to enhance economic cost benefit analysis capabilities; strengthen Commission examinations capabilities over swaps clearing houses; and address the regulatory challenges related to market innovation.

Budget Request

The Commission is requesting $281.5 million and 739 full-time equivalents (FTE) for fiscal year 2018 operations. This is an increase of $31.5 million and 36 FTE over the FY 2017 level. The $31.5 million in additional funds is not a formulaic or superficial number, but a thorough and informed assessment of what the CFTC needs to execute its mission in FY 2018. This amount differs from the President's Budget Request of $250 million.

Under my direction, the Commission has utilized its ability to provide a budget directly to the Congress. This is the first budget submission under my leadership, and I believe it is important to articulate the needs of the Commission based on my perspective and vision for a renewed and refocused CFTC.

On January 20th, I began a process of looking at every function and every expenditure undertaken by the Commission. In the private sector, we would never simply take last year's budget number and add a percentage increase. Rather, each dollar requested had to serve a purpose. Likewise, when I sat down with our leadership team, my budget baseline was zero. We built our budget from the ground up. Drawing on my business experience, I have already identified several areas in which the agency can run more efficiently and save taxpayer dollars. For example, I reviewed the needs of the offices that provide various support services to our divisions, and I intend to gain efficiencies by instituting a central-services organizational model that is a best practice in the private sector. We also discovered areas within our current mission where we need additional investment. The $281.5 million FY 2018 budget request reflects the current needs of the CFTC based on this analysis.

The era of Dodd-Frank implementation at the CFTC is now drawing to a close. It is time for the agency to resume normalized operations and practices. That means a return to greater care and precision in rule drafting, more thorough econometric analysis, less contracted time frames for public comment and a reduced docket of new rules and regulations to be absorbed by market participants. It also means that the CFTC will embrace the Administration's directive that each federal agency minimize the costs incurred by regulation. We plan to accomplish this through the KISS initiative I launched in March, which includes both internal and external reviews of rules and processes. It is another way of looking for opportunities where we can reinvest and maximize current resources.

Normalizing operations at the CFTC also means working cooperatively with other federal market regulators, like the SEC, and where appropriate, the CFTC should look to delegate responsibility to the National Futures Association and other SROs for certain compliance matters.

In addition, we are reevaluating the focus of our enforcement efforts. The Commission's enforcement function is staffed by experienced and decorated former prosecutors, and I can proudly say is one of the premier civil law enforcement arms of the federal government. Yet, the Commission's enforcement efforts must look to benefit from cooperation, and where appropriate, defer to the civil and criminal capabilities of other federal and state regulators and enforcement agencies.

Resources for Increased Economic Cost Benefit Analysis

The additional resources requested for economic analysis will be invested in building the Commission's capacity to systematically analyze large volumes of trade data and improve our understanding of the markets.

The additional investment in economic capabilities will boost the CFTC's analytical expertise and monitoring of systemic risk in the derivatives markets, in particular with regard to central counterparty clearinghouses. It includes the expansion of sophisticated econometric and quantitative analysis devoted to risk modeling, stress tests, and other evaluations necessary for market oversight. Furthermore, such analysis will help the CFTC fulfill the Presidential Executive Order on Core Principles for Regulating the U.S. Financial System, relating to the core principle of fostering economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry.

A common criticism of the rule-making process has been the lack of quantitative assessments of costs and benefits. While there was a paucity of relevant data for Dodd-Frank implementation, we believe that market participants and the public expect the CFTC to leverage the data sources now available to inform future rulemaking. The current staff dedicated to economic analysis is inadequate to meet appropriate standards for econometric analysis required by a regulatory agency with oversight of more than 35 to 45 percent of the global derivatives markets.

Looking beyond rulemaking, the new data sets have opened up possibilities for more effective analysis of the U.S. derivatives markets. For example, Commission economists are focused on developing the capability to integrate activity and positions across futures and swaps markets, and thus gain a holistic view into the derivative exposures of market participants and the interaction between the futures and swaps markets.

There is growing awareness that just looking at the total notional size of activity in the market might not be representative of the true extent of risk transfer. We have taken some initial steps to convert notional amounts into risk-based measures; however, additional resources are necessary to develop these analytical capabilities. Without the requested increase, the CFTC will continue to rely on outdated, anachronistic models and metrics of studying our markets.

Resources for Examinations to Cover Increased DCOs

The Commission is also requesting additional resources that would strengthen the Commission's examinations capability and enable it to keep pace with the explosive growth in the number and value of swaps cleared by designated clearing organizations (DCOs), pursuant to global regulatory reform implementation. As the size and scope of DCOs has increased, so too has the complexity of the counterparty risk management oversight programs and liquidity risk management procedures of the DCOs under CFTC regulation here and abroad.

Currently, there are 16 DCOs registered with the Commission and there is one pending application for registration. The Commission projects that the number of DCOs will continue to expand in FY 2018, and volume will continue to grow at existing DCOs. Since the end of 2011, the total amount of initial margin held by registered DCOs for futures and swaps has grown by more than 168 percent from $119 billion to $320 billion. For swaps alone, the growth is even more dramatic. For example, at LCH Clearnet Ltd, the amount of initial margin held for swaps has grown by more than 600 percent since 2010.

The growth in volume has been accompanied by an increase in the complexity of products. For example, the risks posed by credit default swaps differ from those posed by interest rate swaps. Accordingly, DCOs have developed a large number of individualized margin models and other risk management tools to address these risks. This, in turn, generates a corresponding increase in the complexity of the Commission's oversight responsibilities.

The Commission is seeking to position additional resources to enable it to continue to fulfill its responsibilities relating to systemic risk. Increases in the number of DCOs, the volumes cleared, and the complexity of the products necessitate increases in the resources devoted to the oversight of clearing, through timely and thorough examinations of DCOs. These examinations cover a range of issues from the size of financial resources, to margin, to treatment of customer funds, and cyber security. In addition, the Commission will also continue to develop capabilities for conducting stress testing and back testing to assess the impact of stressful market scenarios across the clearinghouses.

Many of the DCOs are expanding their registration in other jurisdictions around the world. Those jurisdictions look to the Commission to provide insight regarding the effectiveness of the programs implemented by the DCOs. The Commission supports the expanding market participant registrations through information sharing and compliance discussions in the areas of cybersecurity, liquidity risk management, default management and other high profile risk management issues.

Resources to Further Implement FinTech

Earlier in the year, President Trump issued an Executive Order establishing an American Technology Council. The President said, "It is the policy of the United States to promote the secure, efficient, and economical use of information technology to achieve its missions. Americans deserve better digital services from their Government. To effectuate this policy, the Federal Government must transform and modernize its information technology and how it uses and delivers digital services."

I could not agree more. That is why in FY 2018, the Commission requests additional funds to increase staffing and resources to address financial technology innovation (FinTech). The Commission aims to address three fundamental issues arising from transformations in FinTech: 1) how the CFTC should leverage FinTech innovation to make it a more effective regulator; 2) how FinTech can help the CFTC identify rules and regulations that need to be updated for relevance in digital markets; and 3) the role of the Commission in supporting U.S. FinTech innovation in CFTC regulated markets. With these additional investments, I plan to execute a phased approach that will achieve these three objectives.

So much of our world today, from information to music to manufacturing to transportation to commerce, and even farming, has undergone a digital transformation. It should be no surprise to anyone that our capital, commodity and futures markets are going through the same digital transformation. The electronification of markets over the past 30 to 40 years and the advent of exponential growth in digital technologies have altered trading, markets and the entire financial landscape with far ranging implications for capital formation and risk transfer.

Other breaking digital innovations present equal regulatory challenges. These innovations include "big data" capability to enable more sophisticated data analysis and interpretation; artificial intelligence to guide highly dynamic trade execution; "smart" contracts that value themselves and calculate payments in real-time; behavioral biometrics that can detect and combat online fraud; and distributed ledger technology, more commonly known as blockchain, that will challenge orthodoxies that are foundational to today's financial market infrastructure.

The pace of investment in these technologies, and in FinTech more broadly, has accelerated in recent years. According to one measure, investment has increased at a cumulative annual growth rate of more than 45 percent from 2011 to 2016. We are seeing a powerful convergence, as the costs of launching new ventures and applying new technologies have dropped enormously, while the speed and scalability with which they can be brought to market have increased dramatically.

The world is changing. Our parents' financial markets are gone. The 21st century digital transformation is well underway, and the digital technology genie will not go back in the bottle. In order for the CFTC to remain an effective regulator, it must keep pace with these changes or our regulations will become outdated and ineffective.

Effective Use of Resources

Just as I did in the private sector, I will strive as a government official to maximize how limited resources are used. Earlier this year, I notified you of actions we took to streamline and centralize business management functions from the mission delivery divisions to administrative services, a change that will produce long-term savings. In addition, we realigned portions of the surveillance staff under the enforcement division and refocused a team on developing improved market intelligence. Each of these actions leverages existing processes, and increases the efficiency and effectiveness of the Commission's core functions. Moreover, these actions will allow us to better manage our resources while maintaining, but not increasing, our Division of Enforcement's legal resources.

The Commission has also worked to improve its administration of its leases. CFTC entered into a memorandum of understanding (MOU) with the General Services Administration (GSA) to administer all future CFTC leases. In addition, the CFTC cleared the lease accounting issues highlighted in the FY 2015 financial statements audit, received an unmodified, or "clean," opinion on its FY 2016 financial statements and earned the certificate of excellence in accountability reporting from the Association of Government Accountants.

In FY 2018, I have plans to review additional opportunities to streamline operations and further maximize the effective use of our resources. The Commission's organizational structure must evolve to support the changing times. These types of organizational reviews are critical to ensure that resources and staff are devoted to the most important priorities in the CFTC's mission to oversee the nation's derivatives markets.

Conclusion

The U.S. derivatives markets should be neither the most regulated nor the least regulated of the world—but the best regulated. This quest for superior regulatory oversight and unswerving enforcement of our laws motivates the work of the hundreds of talented men and women who serve their country at the CFTC. Only with such a commitment can all Americans experience the economic benefits that risk-transfer markets afford. This budget request ensures that the CFTC can meet such a standard for the American people. The FY 2018 budget submitted by the Commission reflects the true needs of a policy setting and civil law enforcement agency that has the duty to ensure the derivatives markets operate effectively. This budget will give the Commission the resources it needs to put in place and oversee responsible regulations that allow for innovation and enable our markets to remain competitive and safe at home and abroad.