

STATEMENT OF GARY GENSLER
CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION
BEFORE THE
HOUSE COMMITTEE ON AGRICULTURE
SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND RISK MANAGEMENT
December 15, 2010

Good afternoon Chairman Boswell, Ranking Member Moran and members of the Subcommittee. I thank you for inviting me to today's hearing on behalf of the Commodity Futures Trading Commission (CFTC).¹ I am pleased to testify alongside my fellow Commissioner, Bart Chilton.

Implementing the Dodd-Frank Act

Before I discuss the CFTC's rule-writing process with regard to position limits, I will update the Subcommittee on the CFTC's implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Dodd-Frank Act is very detailed, addressing all of the key policy issues regarding regulation of the swaps marketplace. This Subcommittee's work on the Act should be commended. The Act reduces risk while promoting transparency in the swaps markets.

¹ Commissioner Bart Chilton did not participate in the approval of this testimony.

To implement the Dodd-Frank Act, we have organized our effort around 31 teams who have been actively at work. Two principles are guiding us throughout the rule-writing process. First is the statute itself. We intend to comply with the statute's provisions and Congressional intent to lower risk and bring transparency to these markets.

Second, we are consulting extensively with both other regulators and the broader public. We are working very closely with the SEC, the Federal Reserve, other prudential regulators and international regulators. To date, we have had more than 304 meetings with other regulators at the staff or Chairman's level.

We also are soliciting broad public input into the rules. This began the day the President signed the Dodd-Frank Act when we listed the rule-writing teams and set up mailboxes for the public to submit their views directly.

We also have organized seven public roundtables to hear on particular subjects. Last week we held a joint roundtable with the SEC and prudential regulators on issues related to capital and margin requirements for swaps. Additionally, many individuals have asked for meetings with the CFTC to discuss swaps regulation. As of Monday morning, we have had more than 466 such meetings. Just as Congress brought transparency to the swaps markets, the CFTC has added additional transparency to our rule-writing efforts. We are now posting on our website

a list of all of our meetings, as well as the participants, issues discussed and all materials given to us.

We are in the process of publishing proposed rules, using open Commission meetings for this purpose. So far, we have had seven public meetings. We have another meeting scheduled tomorrow during which the Commission will consider rules related to position limits, swap execution facilities, derivatives clearing organizations and business conduct standards.

Thus far the Commission has approved 30 proposed rules, one final rule, two interim final rules and four advanced notices of proposed rulemaking. That does not include the four proposed rulemakings that the Commission will consider tomorrow.

The Dodd-Frank Act requires the CFTC and the SEC to write rules generally within 360 days after the date of enactment. This means we have 213 days left for the majority of the rulemakings. In the case of position limit mandates, Congress had directed a more ambitious schedule.

Position Limits Rulemaking

Legislative and Regulatory History

Since 1936, the Commodity Exchange Act has prescribed position limits to protect against the burdens of excessive speculation, including those caused by large concentrated positions. Between the CFTC and the futures exchanges, there are currently position limits in the spot month on physical delivery contracts in the agricultural, energy and metals markets. There also are position limits in a number of financial contracts. In addition to these spot month limits, between Federally-set position limits and those set by exchanges, there also are a number of agricultural contracts that have single-month and all-months-combined position limits. The exchanges had set all-months-combined limits in energy markets until 2001 and in metals markets earlier, after which the limits were replaced with position accountability regimes.

The debate on the position limits provisions included in the Dodd-Frank Act began with actions taken by the House Agriculture Committee in the summer of 2008. According to the Committee report, the Agriculture Committee and this Subcommittee held six hearings with 44 witnesses on issues related to position limits. The House later passed H.R. 6604 in September 2008.

The CFTC itself held three public meetings in the summer of July 2009 to gather further input from the public and Members of Congress regarding position limits for energy markets. In January 2010, the Commission published a proposed rule to set position limits on four energy contracts. In response to the proposal, the CFTC received more than 8,200 comments from the public. The CFTC announced the withdrawal of that proposal in August

with plans to re-propose pursuant to the Dodd-Frank requirements. To be properly informed during the current rule-writing process, the Commission and staff are reviewing the comments received in response to the January rulemaking. The CFTC is scheduled to consider a new position limits rulemaking tomorrow.

In March 2010, the Commission held an additional public meeting to consider the appropriateness of position limits in the metals markets. The public's views from that meeting and the comments that were later submitted also will be helpful as the Commission considers a proposed rulemaking on position limits in the metals markets.

The CFTC does not set or regulate prices. Rather, the Commission is directed to ensure that commodity markets are fair and orderly. The January position limits proposal was intended to meet Congress's mandate and to promote market integrity. The CFTC is directed by statute to act in this regard to protect the American public.

When the CFTC set position limits in the past, the agency sought to ensure that the markets were made up of a broad group of market participants with a diversity of views. At the core of our obligations is promoting market integrity, which the agency has historically interpreted to include ensuring markets do not become too concentrated.

Position limits help to protect the markets both in times of clear skies and when there is a storm on the horizon. In 1981, the Commission said that “the capacity of any contract market to absorb the establishment and liquidation of large speculative positions in an orderly manner is related to the relative size of such positions, i.e., the capacity of the market is not unlimited.”

Dodd-Frank Requirements

The Dodd-Frank Act requires the CFTC to set position limits for the following classes of contracts:

- futures;
- options on futures; and
- swaps that are economically equivalent to such futures or options.

The Dodd-Frank Act also directs the Commission to set aggregate position limits for the following:

- contracts listed for trading on designated contract markets,

- contracts traded on a foreign board of trade providing persons in the U.S. with direct access that settle against the price of one or more contracts traded on a futures exchange or swap execution facility; and
- any other swap contracts that perform or affect a significant price discovery function with respect to regulated entities.

The Act requires that the CFTC set the first set of position limits within 180 days of enactment for exempt commodities and within 270 days for agricultural commodities. The Commission has some additional flexibility with respect to the timing of the rulemaking for the aggregate limits.

The Commodity Exchange Act exempts positions that are held as bona fide hedges from position limits. The Dodd-Frank Act provided further detail on the types of positions that fall in that category. End users and other persons with physical holdings in the energy and metals markets will not be limited in the amount or size of their positions that are entered into to hedge their physical purchases, holdings or sales.

In establishing the limits for energy and agricultural commodities, the CFTC is required to set spot-month, single month and all-months-combined position limits to achieve the following goals:

1. diminish, eliminate or prevent excessive speculation;
2. deter and prevent market manipulation, squeezes and corners;
3. ensure sufficient market liquidity for bona fide hedgers; and
4. ensure that the price discovery function of the underlying market is not disrupted.

Data Requirements

The Commission is working to meet each of the deadlines included in the Dodd-Frank Act. Setting position limits in the swaps markets poses a unique challenge because of the market's opacity. Prior to the Dodd-Frank Act, the Commission had only limited authority to obtain data regarding the swaps market. The Dodd-Frank Act includes essential provisions to bring transparency in the markets to both regulators and the public. At this point, however, the Commission does not have the same comprehensive data for the swaps markets, including economically equivalent swaps, as it has for the futures markets. The Commission also currently has limited access to data on linked contracts traded on FBOTs through direct access by U.S. participants. The Commission has collected some data from swaps dealers since 2008, using special call authority to do so. However, additional data is required on the swaps markets to determine the size of the overall market in particular commodities, as well as the nature of the positions in this market. In particular, the Commission lacks data that would identify the extent to which positions are held for hedging or speculative purposes.

On October 19, the Commission approved a proposed rulemaking on large trader reporting for physical commodity swaps. The proposal would require position reports on

economically equivalent swaps from clearing organizations, their members and swap dealers. This would enable the CFTC to receive such data until swap data repositories are in operation and capable of fulfilling the Commission's need for this information. The comment period on the proposed rulemaking closed on December 2.

In addition, large trader reporting will allow the Commission to gather data that could be used to determine appropriate position limits. The rule builds on the Commission's ongoing special call for data from swap dealers.

Options for Position Limits Rulemakings

CFTC staff is considering options to phase in implementation of the position limits rules as the agency obtains the necessary data regarding the swaps market. Staff is examining whether certain elements of the rule for which the Commission has substantial data can proceed on a more expedited timeframe, while leaving those aspects of the rule that depend upon additional data for later implementation. Staff is considering whether it would be possible to implement spot month limits sooner than the single-month or all-months-combined limits.

The Commission could consider proposing single-month and all-months-combined position limits based on the open interest for futures, options and economically equivalent swaps. This is similar to the approach taken in the rulemaking that the Commission proposed in January.

Open interest is currently used to establish position limits in the futures markets. Staff is reviewing an option that use data regarding open interest in the swaps markets to set hard aggregate limits. This approach would allow the Commission to hear from the public on the appropriate methodology for setting position limits while also allowing the Commission to collect additional swaps data through the large trader reporting regime. The actual hard limits would be applied when sufficient data becomes available.

Currently, spot month limits for physically-settled futures contracts are generally set as some percentage of deliverable supply to prevent someone with a large position from cornering or squeezing the market as contracts move to expiration. In contrast, single-month and all-months-combined position limits have historically been set as a function of the overall size of the markets to guard against the burdens of excessive speculation.

Resources

Before I close, I will briefly address the resource needs of the CFTC. The futures marketplace that the CFTC oversees is approximately \$40 trillion in notional amount. The swaps market that the Dodd-Frank Act tasks the CFTC with regulating has a far larger notional amount as well as more complexity. Based upon figures compiled by the Office of the Comptroller of the Currency, the largest 25 bank holding companies currently have \$277 trillion notional amount of swaps.

The CFTC's current funding is far less than what is required to properly fulfill our significantly expanded role. The CFTC requires additional resources to enhance its surveillance program, prevent market disruptions similar to those experienced on May 6 and implement the Dodd-Frank Act.

The President requested \$261 million for the CFTC in his fiscal year 2011 budget. This included \$216 million and 745 full-time employees for pre-Dodd-Frank authorities and \$45 million to provide half of the staff estimated at that time needed to implement Dodd-Frank. The House of Representatives matched the President's request in the continuing resolution it passed last week. We are currently operating under a continuing resolution that provides funding at an annualized level of \$169 million. To fully implement the Dodd-Frank reforms, the Commission will require approximately 400 additional staff over the level needed to fulfill our pre-Dodd-Frank mission.

I again thank you for inviting me to testify today. I look forward to your questions.