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Testimony

Written Testimony of

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Committee on Agriculture
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Thank you, Mr. Chairman and members of the Committee. I am pleased to testify on behalf of the Commodity Futures Trading Commission (CFTC or Commission), and I appreciate the opportunity to discuss the CFTC and our role with respect to energy derivatives trading.

The CFTC continues to pay close attention to futures and options trading in energy commodities because of the importance of energy prices and supplies to our nation's consumers, producers, and its economy in general. Our agency is also well aware of the reliance of the agricultural sector on various sources of energy that provide fuel for field implements, feedstock for fertilizer and power for grain-drying equipment, to name a few uses. Based on our surveillance efforts to date, we believe that energy futures markets have been reflecting the underlying fundamentals of these markets.

Futures and options markets play a critically important role in the U.S. economy. They provide risk management tools that producers, distributors, and commercial users of commodities use to protect themselves from unpredictable price changes. The futures and options markets also play a price discovery role as participants in related cash and over-the-counter markets look to futures markets to discover prices that accurately reflect information on supply, demand, and other factors. Both functions would be harmed by manipulation of prices.

Overview of Energy Trading

Trading in energy commodities takes place principally in three different ways: (1) on designated contract markets (DCMs), such as the New York Mercantile Exchange (NYMEX); (2) on exempt commercial markets (ECMs), such as the Intercontinental Exchange (ICE); and (3) in over-the-counter bilateral transactions.

On-exchange trading of energy commodities takes place on DCMs, which operate as price discovery and risk management facilities. Off-exchange trading of energy commodities can take place on electronic trading facilities known as ECMs, which operate without being designated as contract markets by the CFTC. Transactions on ECMs are entered into on a principal-to-principal basis only between "eligible commercial entities" as defined by the Commodity Exchange Act (CEA). Finally, off-exchange trading of energy commodities among wealthy, sophisticated participants, "eligible contract participants" as defined by the CEA, can also occur in bilateral transactions that do not take place on a trading facility. Each of these three ways of trading energy commodities is subject to varying levels of CFTC regulation under the CEA.

CFTC Mission

The CFTC's mission is two-fold: to protect the public and market users from manipulation, fraud, and abusive practices; and to promote open, competitive and financially sound markets for commodity futures and options.

Congress created the CFTC in 1974 as an independent agency with the mandate to regulate commodity futures markets, and later option markets, in the United States. To do this, the Commission employs a highly-skilled and dedicated staff who work within three major programs – Market Oversight, Clearing and Intermediary Oversight, and Enforcement. These divisions have distinct and separate charges and standards to meet, while working in conjunction to ensure market integrity and economic opportunity. The three major Commission programs are complemented by other offices, including the Office of the Chief Economist, Office of the General Counsel, Office of International Affairs and Office of Proceedings. The Chairman and Commissioners' offices provide agency direction, and stewardship over CFTC's human capital, financial management, and information technology resources.

CFTC Division of Market Oversight

The CEA provides that the Commission has exclusive jurisdiction with respect to accounts, agreements, and transactions involving commodity futures and options contracts that are required to be traded or executed on a designated contract market, also known as a DCM or an exchange. One of the purposes of the CEA is "to serve the public interests . . . through a system of effective self-regulation of trading facilities . . . under the oversight of the Commission."[1] DCMs are regulated entities that are self-regulatory organizations (SROs) subject to comprehensive oversight by the CFTC. DCMs can list for trading any type of contract, they can permit intermediation, and all types of traders (including retail traders) are permitted to participate in their markets. The CFTC's Division of Market Oversight (DMO) is responsible for monitoring and evaluating a DCM's operations and it conducts surveillance of all activity on DCMs, as described below.

DCMs must comply with a number of designation criteria and core principles as a condition for initial CFTC approval and continuing operation. Once operational, DCMs, as SROs, must establish and devote resources toward an effective oversight program, which includes surveillance of all activity on their markets to detect and deter manipulation and trading abuses. That responsibility includes, among other things, ensuring that listed contracts are not readily susceptible to manipulation, addressing conflict of interest situations, ensuring fair trading, providing for the financial integrity of contracts, utilizing effective rules to deal with market emergencies, and complying with comprehensive reporting and recordkeeping requirements. DMO staff review all exchange new product and rule filings to ensure that they comply with the core principles set forth in the Act and the Commission's regulatory requirements.

DMO's market surveillance mission regarding DCM activity is to ensure market integrity and customer protection in the futures markets. Traders establishing positions on DCMs are subject to reporting requirements so that DMO staff and the DCM can evaluate position sizes to detect and deter manipulation. In addition, trade practice surveillance involves compilation and monitoring of transactional-level data by the Commission and the DCM to detect and deter abusive trading such as wash sales, money laundering and trading ahead of customers (trade practice surveillance). The surveillance staff conducts active market and trade practice surveillance of all futures and options trading activity that occurs on DCMs.

Under the CEA, the primary mission of market surveillance is to identify situations that could pose a threat of manipulation and to initiate appropriate preventive actions. Each day, for the estimated 1,400 active futures and option contracts in the U.S., DMO market surveillance staff monitors the activities of large traders, key price relationships, and relevant supply and demand factors to ensure market integrity.

The market surveillance staff focuses, for example, on looking for large positions, especially in comparison to potential deliverable supply of the commodity. Such a dominant position might provide a trader an opportunity to cause a price manipulation, such as in a "squeeze," in which, for example, a single trader might hold a large long (buy-side) position and demand delivery of more of a commodity than is available for delivery. In such a situation, traders holding short (sell-side) positions may have no alternative but to buy back their positions at artificially high prices dictated by the dominant long trader.

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[1] CEA Section 3(b), 7 U.S.C. § 5(b).

The market surveillance program uses many sources of daily market information. Some of this information is publicly available, including data on: the overall supply, demand, and marketing of the underlying commodity; futures, option and cash prices; and data on trading volume and open contracts. Some of the information is highly confidential, including position and trading data that the Commission regularly receives from DCMs, intermediaries, and large traders.

DCMs report to the Commission the daily positions and transactions of each of their clearing members. The data are transmitted electronically during the morning after the "as of" trade date. They show separately, for proprietary and customer accounts, the aggregate position and trading volume of each clearing member in each futures and option contract. The data are useful for quickly identifying the firms that clear the largest buy or sell volumes or hold the biggest positions in a particular market. The clearing member data, however, do not identify the beneficial owners of the positions.

To address this limitation, DMO uses a large-trader reporting system. Under this system, clearing members, futures commission merchants (FCMs), and foreign brokers (collectively called "reporting firms") electronically file daily reports with the Commission. These reports contain the futures and option positions of individual traders that hold positions above specific reporting levels set by Commission regulations, and allow DMO staff to review the beneficial owners of futures positions. If, at the daily market close, a reporting firm has a trader holding a position at or above the Commission's reporting level in any single futures month or option expiration, it reports that trader's entire position in all futures and options expiration months in that commodity, regardless of size.

Since traders frequently carry futures positions through more than one FCM, and since individuals sometimes control or have a financial interest in more than one account, the Commission routinely collects information that enables its surveillance staff to aggregate related accounts. Reporting firms file information with the CFTC to identify each new account that acquires a reportable position. In addition, once an account reaches a reportable size, the account owner periodically is required to file a more detailed report to further identify accounts and reveal any relationships that may exist with other accounts or traders.

Surveillance economists prepare weekly summary reports for futures and option contracts that are approaching their expiration periods. Regional surveillance supervisors immediately review these reports. Surveillance staff advises the Commissioners and senior staff of significant market developments at weekly surveillance meetings (which are non-public, closed meetings) so they will be prepared to take action if necessary.

Typically, the Commission gives the DCM, as the front-line regulator, the first opportunity to resolve any issue arising in its markets. If a DCM fails to take actions that the Commission deems appropriate, the Commission has broad emergency powers under the CEA to order the DCM to take specific actions. Such actions could include limiting trading, imposing or reducing limits on positions, requiring the liquidation of positions, extending a delivery period, or closing a market. Fortunately, most issues are resolved without the need to use the Commission's emergency powers. The fact that the Commission has had to take emergency action only four times in its history demonstrates its commitment to refrain from intervening in the futures markets unless all other efforts have been unsuccessful.

In addition to market surveillance, DMO staff monitors trading activity on DCMs in order to detect and prevent possible trading violations. To help accomplish this mission, staff engages in various analyses to profile trading activity and conducts trade practice investigations. These functions require the collection of trade data and the ability to process those in various ways for further analysis. In this regard, DMO currently operates the Electronic Database System (EDBS), a system developed in the mid-1980s, to process and maintain information concerning trading activity on DCMs. EDBS is an older system with limited capabilities, especially with respect to trading data collected from electronically traded markets. The Commission is in the process of replacing EDBS with a more robust tool, the Trade Surveillance System (TSS). The primary function of TSS is to collect and make all trade data accessible to staff so they can retrieve, organize, and analyze trade data to assess DCM compliance with the Act and Commission regulations. TSS will assist staff in conducting timely, customized analyses of all trading activity; examining side-by-side trading (same contract trading simultaneously on an exchange floor and an electronic trading platform) and cross-market activity (similar or identical contracts trading on different exchanges); and detecting novel and complex patterns of potential trading violations involving electronic trading. TSS also will allow DMO staff to respond to fast-moving market events, which is crucial to effective trade practice surveillance. The identification of potential trading violations results in referrals to relevant DCMs and to the Commission's Division of Enforcement.

It should be noted that surveillance of DCM trading is not conducted exclusively by the Commission. As SROs, DCMs have significant statutory surveillance responsibilities.[2] Typically, however, surveillance issues are handled jointly by Commission staff and the relevant DCM. Surveillance information is shared and, when appropriate, corrective actions are coordinated. Situations of particular surveillance interest are jointly monitored and, if necessary, verbal contacts are made with the brokers or traders who are significant participants in the market in question. These contacts may be for the purpose of asking questions, confirming reported positions, alerting the brokers or traders to the regulatory concern regarding the situation, or warning them to conduct their trading responsibly. Throughout its history, the Commission, together with the DCMs, has been quite effective in using these methods to resolve issues at an early stage.

Another key DMO oversight role involves staff oversight and assessment of the regulatory and oversight activities of DCMs. This involves periodic examinations of DCMs' self-regulatory programs on an ongoing, routine basis to evaluate their compliance with applicable core principles under the Act and the Commission's

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[2] *See, e.g.,* Sections 5(b)(2) and 5(d)(4) of the CEA, 7 U.S.C. §§ 7(b)(2), 7(d)(4).

regulations. These examinations, known as “Rule Enforcement Reviews,” result in reports that evaluate a DCM’s compliance and surveillance capabilities. The reports set forth recommendations for improvement, where appropriate, with respect to a DCM’s trade practice surveillance, market surveillance, disciplinary, audit trail, and dispute resolution programs. These reviews promote and enhance continuing, effective self-regulation and ensure that exchanges rigorously enforce compliance with their rules. The reports are made public and are posted on the Commission’s Website.

In conclusion, the Commission has a comprehensive market oversight program to detect and prevent disruption of the economic functions of all the commodity futures and option markets that it regulates.

CFTC Division of Clearing and Intermediary Oversight

The Commission’s Division of Clearing and Intermediary Oversight (DCIO) is responsible for and plays an integral role in ensuring the financial integrity of all transactions on the markets that the CFTC regulates.

DCIO meets these responsibilities through an oversight program that includes the following elements: (1) conducting risk-based oversight and examinations of industry SROs responsible for overseeing FCMs, commodity trading advisors, commodity pool operators, and introducing brokers, to evaluate their compliance programs with respect to requirements concerning fitness, net capital, segregation of customer funds, disclosure, sales practices, and related reporting and recordkeeping; (2) conducting risk-based oversight and examinations of all Commission-registered derivatives clearing organizations (DCOs) to evaluate their compliance with core principles, including their financial resources, risk management, default procedures, protections for customer funds, and system safeguards; (3) conducting financial and risk surveillance oversight of market intermediaries to monitor compliance with the provisions of the CEA and Commission regulations; (4) monitoring market events and conditions to evaluate their potential impact on DCOs and the clearing and settlement system and to follow-up on indications of financial instability; and (5) developing regulations, orders, guidelines, and other regulatory approaches applicable to DCOs, market intermediaries, and their SROs. Collectively, these functions serve to protect market users, the general public and producers, to govern the activities of market participants, and to enhance the efficiency and effectiveness of the futures markets as risk management mechanisms. DCIO’s most important function is to prevent systemic risk and ensure the safety of customer funds.

The DCOs that the Commission currently regulates are located in New York, Chicago, Kansas City, Minneapolis and London, England. The intermediaries overseen by the Commission are located throughout the United States and in various other countries.

CFTC Division of Enforcement

At any one time, the Division of Enforcement (Enforcement) is investigating and litigating with approximately 700 to 1000 individuals and corporations for alleged fraud, manipulation, and other illegal conduct. Working closely with the President's Corporate Fraud Task Force, Enforcement is staffed with skilled professionals who prosecute cases involving complex over-the-counter and on-exchange transactions. Enforcement also routinely assists in related criminal prosecutions by domestic and international law enforcement bodies.

During the last five years, Enforcement has maintained a record level of investigations and prosecutions in nearly all market areas, including attempted manipulation, manipulation, market squeezes and corners, false reporting, hedge fund fraud, off-exchange foreign currency fraud, brokerage compliance and supervisory violations, wash trading, trade practice misconduct, and registration issues.

In the energy sector alone, Enforcement investigated Enron and dozens of national and international energy companies, as well as hundreds of energy traders and hedge funds around the country. As a result of those efforts, the Commission prosecuted numerous traders and corporate entities. At the same time, in other market sectors, Enforcement prosecuted more than 50 hedge funds and commodity pool operators for various violations, and filed actions against more than 360 individuals and companies for off-exchange foreign currency fraud and misconduct.

Enforcement receives referrals from several sources: the CFTC's own market surveillance staff; the compliance staff at exchanges; market participants and members of the public; and other State, Federal, and international regulatory authorities. During an investigation, the CFTC may grant formal administrative subpoena authority, which enables Enforcement to obtain relevant materials (for example, audio recordings, e-mail and trade data) and testimony from witnesses.

If warranted, at the conclusion of its investigation, Enforcement will recommend to the Commissioners that the CFTC initiate a civil injunctive action in Federal district court or an administrative proceeding. The CFTC may obtain temporary statutory restraining orders and preliminary and permanent injunctions in Federal court to halt ongoing violations, as well as civil monetary penalties, appointment of a receiver, the freezing of assets, restitution to customers, and disgorgement of unlawfully acquired gains. Administrative sanctions may include orders suspending, denying, revoking, or restricting registration; prohibiting trading; and imposing civil monetary penalties, cease and desist orders, and orders of restitution.

The CFTC also refers enforcement matters to the Department of Justice. Criminal activity involving commodity-related instruments can result in prosecution for criminal violations of the CEA and for violations of Federal criminal statutes, such as mail fraud or wire fraud.

Oversight of Exempt Commercial Markets

Congress included a provision in the Commodity Futures Modernization Act of 2000 (CFMA) to govern a new type of trading facility known as an ECM.[3] As outlined in Section 2(h)(5)(F) of the CEA, ECMs are not "registered with, or designated, recognized, licensed or approved by the Commission." ECMs, as well as transactions executed on ECMs, are statutorily exempt from most provisions of the CEA. Trading on an ECM such as ICE is not subject to regular, ongoing market surveillance oversight by the Commission. Under current law, the Commission does not have the legal authority to limit the size of a trader's position on an ECM. Nor are ECMs required to comply with the self-regulatory obligations required of DCMs, such as adopting position limitations or position accountablility rules. The Commission does retain fraud and manipulation authority over ECMs. To assist the Commission in carrying out its fraud and manipulation authority, ECMs are required to maintain a record of allegations or complaints received by the trading facility concerning instances of suspected fraud or manipulation and to forward them to the Commission.[4]

ECMs are also subject to certain limited reporting requirements that are authorized under Section 2(h)(5)(B)(i) of the CEA and spelled out in Commission Regulation 36.3(b).[5] Pursuant to these provisions, an ECM is required to identify those transactions conducted on the facility with respect to which the ECM intends to rely on the statutory Section 2(h)(3) exemption, and which averaged five trades per day or more over the most recent calendar quarter. With respect to such transactions, the ECM is required to transmit weekly to the Commission certain basic trade information, including "the commodity, the [delivery or price-basing] location, the maturity date, whether it is a financially settled or physically delivered instrument, the date of execution, the time of execution, the price, [and] the quantity."[6] The reports filed pursuant to Regulation 36.3(b) can provide Commission surveillance staff with information regarding price spikes or unusual divergence between the price of a commodity traded on an ECM and the price of a related commodity traded on a DCM. The Regulation 36.3(b) reports, however, do not require ECMs to identify the individual traders holding positions on the ECM.

In addition, an ECM must maintain for five years, and make available for inspection upon request by the Commission, records of its activities related to its business as an electronic trading facility, including audit trail information sufficient to enable the Commission to reconstruct trading activity, and the name and address of each participant authorized to enter into transactions on the facility.[7] Should the Regulation 36.3(b) reports, or other information obtained by surveillance staff (including information from futures market large trader reports), indicate a need for further information from an ECM, Section

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[3] CEA Sections 2(h)(3)-(5), 7 U.S.C. §§ 2(h)(3)-(5).
[4] Commission Regulation 36.3(b)(iii), (iv), 17 C.F.R. § 36.3(b)(iii), (iv).
[5] 17 C.F.R. § 36.3(b).
[6] ICE has been submitting such trade data for natural gas transactions meeting the regulatory reporting threshold since January 1, 2005.
[7] CEA Section 2(h)(5)(B)(ii), 7 U.S.C. § 2(h)(5)(B)(ii).

2(h)(5)(B)(iii) of the CEA and Commission Regulation 36.3(b)(3) give the Commission authority to issue what is known as a "special call." Under the CEA, the Commission can obtain from an ECM "such information related to its business as an electronic trading facility exempt under paragraph [2(h)](3) . . . as the Commission may deem appropriate." The issuance of a special call to an ECM is simply an indication that the Commission's staff is seeking additional information. A special call, in and of itself, is not evidence of improper or illegal market behavior.

Finally, if the Commission determines that an ECM performs a significant price discovery function for transactions in the cash market for the commodity underlying any agreement, contract, or transaction traded on the facility, the ECM must publicly disseminate, on a daily basis, information such as contract terms and conditions, trading volume, open interest, opening and closing prices or price ranges, or other price information approved by the Commission.[8] To date, the Commission has not made such a determination.

Since the fall of 2006, the CFTC has been regularly utilizing its special call authority to request information from ICE. This information assists us in the regulation of activities on DCMs, and we believe it helps us to get a more comprehensive picture of the marketplace, given the similarity of ICE's natural gas contracts to those traded on NYMEX. On September 28 and December 1, 2006, respectively, the Commission issued two special calls to ICE that required ICE to provide position data to the Commission, on an ongoing basis, related to transactions in ICE's most heavily traded natural gas swap contracts. Specifically, these separately-issued special calls required that ICE provide the Commission with clearing member position data and individual trader position data in the various ICE natural gas contracts that are cash-settled based on NYMEX natural gas contracts.

The special call for clearing member position data was issued by the Commission on September 28, 2006, and the Commission has been receiving responsive data from ICE, on a daily basis, since October 10, 2006. The individual trader position data special call was issued on December 1, 2006. ICE found it necessary to make various technical adjustments to its systems in order to produce the requested materials, which it has done. Those adjustments are now in place, and the Commission received the first batch of individual trader daily position data on February 16 (showing positions as of February 15) and continues to receive that information on an ongoing basis.

These two special calls were issued primarily in order to assist Commission staff in its surveillance of the related NYMEX natural gas contracts. Compliance with special calls is not voluntary, but mandatory. The special calls were not issued as part of an investigation of any particular market participant or trading activity on either ICE or NYMEX. Nor were they issued in order to conduct regular market surveillance of ICE contracts themselves. The information provided by ICE through the special calls is

[8] CEA Section 2(h)(4)(D), 7 U.S.C. § 2(h)(4)(D); Commission Regulation 36.3(c)(2), 17 C.F.R. § 36.3(c)(2).

comprehensive, but it does not duplicate the information that the Commission collects through its DCM surveillance programs.

Despite the difference in regulatory authorities over DCMs and ECMs, the Commission is aware that when markets trade similar products or products that can be arbitraged, information regarding activity in one market tends to be incorporated into the other. This is almost certainly the case when large numbers of traders operate in both markets, as is the case between NYMEX and ICE.

CFTC Coordination with the Federal Energy Regulatory Commission

The Energy Policy Act of 2005 (EPAct) marked an important milestone in the on-going debate over the appropriate policy for regulating trading activities in our nation's energy markets. The EPAct established the Federal Energy Regulatory Commission's (FERC) anti-fraud and anti-manipulation authority in the natural gas and electricity cash markets. At the same time the EPAct initiated this upgrade in FERC's authority, it also maintained the CFTC's longstanding anti-manipulation authority in these cash markets. Recognizing the CFTC's successes in combating abusive trading practices, the EPAct preserved the CFTC's exclusive jurisdiction over commodity futures and options transactions, and accordingly its enforcement authority to proceed against abusive energy trading and false reporting under the CEA.

As called for by the EPAct, the CFTC and FERC in October 2005 entered into a Memorandum of Understanding (MOU) to coordinate their activities. Accordingly, the respective staffs of the Commission and FERC are authorized to efficiently share information concerning various issues in the energy markets without the need for cumbersome access requests for each particular matter. To that end, designated Commission staff remain in regular contact with counterparts at FERC, and FERC staff is routinely invited to attend Commission enforcement briefings and surveillance meetings. The Commission's Enforcement staff also meets with FERC counterparts on a quarterly basis to share information on issues and matters of mutual interest.

While this inter-agency MOU has helped bridge some of the day-to-day matters that have arisen, certain issues remain. For instance, since the EPAct was enacted, the CFTC and FERC now have different legal standards required to prove a violation of their respective anti-manipulation provisions. The FERC anti-manipulation language parallels the language in Section 10(b) of the Securities Exchange Act of 1934. As a result, the elements of a manipulation case for FERC differ significantly from the elements of a manipulation action brought by the CFTC pursuant to the CEA and related judicial precedent. Under the FERC legal standard, the language contemplates that in order to prove a violation, FERC must prove that a defendant intentionally or knowingly engaged in the proscribed conduct. It appears that the courts could interpret "reckless conduct" as an acceptable standard for FERC's "intent" requirement. In contrast, for manipulation cases under the CEA, the CFTC must prove specific intent, arguably a higher standard than "recklessness." The CFTC must also show that the defendant had the ability to influence market prices, that artificial prices existed, and that the defendant caused the artificial prices. [9]

We continue to work to resolve how each agency should enforce its mandate in the absence of a bright-line delineation of the boundaries of the respective agencies' authorities. These issues affect the agencies' regulatory efforts in the energy markets, and possibly undermine the effectiveness of Congress's intent to end those types of trading abuses that hurt energy consumers and undercut public confidence in fair and orderly energy markets. The CFTC will continue to monitor the ongoing interactions between our agencies in this area and will report to Congress as to whether it may be appropriate to harmonize FERC's and the CFTC's manipulation authorities.

CFTC Budget

The current budget that funds the divisions, the technology and surveillance operations, and other support staff, is approximately $98 million for the current Fiscal Year (FY). The FY 2008 President's Budget request for the CFTC is for an appropriation of $116 million and 475 staff – an increase of approximately $18 million and 17 staff over the FY 2007 continuing resolution appropriation which supports a level of 458 staff.

We are grateful for the Administration's recognition of the need for increased funding for our agency. The FY 2008 Budget request is a good down payment in an effort to reverse a recent downward trend in resources at the Commission, but it is, in perspective, a small recognition of the challenge we face.

Since the CFMA was enacted, there has been a seven-fold increase in the rate of new product listings by U.S. exchanges. Nine new DCMs and nine new DCOs have been approved by the CFTC. Electronic trading has soared to approximately 60 percent of total volume this year, and that percentage is steadily increasing. The competition, product innovation, and increasing use of technology fostered by the CFMA meant exponential growth in the futures and option markets, especially during the last few years. It has also meant continuing evolution of these markets in the form of new trading venues, new trading strategies, new risk management tools, and new customers.

The CFMA replaced the prior "one size fits all" regulatory model with a flexible, practical, principles-based model for exchanges. U.S. exchanges also were given the authority to approve new products and rules through a self-certification process without prior CFTC approval, which encouraged innovation and enabled exchanges to act quickly in response to fast-changing market conditions. The CFMA also permitted the establishment of non-intermediated trading platforms such as ECMs, the growth of which has rapidly matured in recent years.

During this period of unprecedented growth for the futures industry, however, the CFTC's resources have been steadily diminishing. The CFTC needs additional staff

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[9] *See In re Cox,* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) 23,786 at 34,061 (CFTC July 15, 1987.

resources in almost every program area. Currently, the Commission operates with a staff of 436 – an historic low at a time when the industry we regulate is at an all-time high by almost any measure: more volume, more trading platforms, more products, more complexity and a more global marketplace. Commission employees work hard, work smart, and use technology effectively, but given the complexity of the markets we oversee, they are stretched. We have the resources to carry out the Commission's mission on a daily basis – by asking more of staff and putting off some technological needs and other programs – but it is clear that the agency can continue at this funding level only for the short-term.

With regard to the adequacy of our surveillance resources, it is useful to consider that the number of actively traded contracts trading on U.S. exchanges has more than quintupled in the last decade, with most of that growth seen in the last five years. Staff devoted to surveillance today is 46; ten years ago, it was 58.

As for Enforcement, staff has fallen from 154 to 110 during the same ten-year period. The CFTC prides itself on its vigorous enforcement efforts. However, in derivatives markets that are exploding in size and complexity, coupled with its reduced staffing, the CFTC's enforcement professionals are struggling to keep up with the volume and size of its cases. For comparison purposes, the enforcement division at the Securities and Exchange Commission is funded with a budget that is more than twenty times larger than that for the CFTC's enforcement operations. We are forced to make hard choices every day on how to prioritize our investigative and litigation efforts.

Technology is critical to enable our professional staff to adequately oversee the markets. However, budget constraints have required the Commission to put new systems development initiatives and hardware and software purchases on hold. For example, Commission investment in technology, as a percentage of total budget, has fallen from approximately 10 percent to around 7 percent. This trend is unsustainable given that so much of the growth in the futures industry is directly attributable to investments in technology. It is important that the Commission not be overwhelmed by the technologically innovative industry we regulate.

Conclusion

The CFTC's last reauthorization expired in 2005, and Congress has worked hard during the past two years to try to reauthorize the CFTC and update our statutory mandate. We appreciate the efforts of this Subcommittee, the Full Committee and your Senate counterparts, as you continue those efforts.

In order to clarify the CFTC's anti-fraud authority with respect to transactions in energy commodities, it is important that Congress clarify that the CFTC's primary anti-fraud provision in CEA Section 4b[10] applies to principal-to-principal transactions. We appreciate that such a clarification was included in H.R. 4473, the CFTC reauthorization

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[10] 7 U.S.C. § 6b

legislation reported out of the House Agriculture Committee and adopted by the House of Representatives in December 2005.

Apart from enforcement, another part of the reauthorization debate has been about regulation of energy markets. It is a complicated policy decision that encompasses consideration of a number of issues, including: economic opportunity and competition at home and abroad; ensuring customer protections and market integrity; promoting growth and innovation of U.S. exchanges; and ensuring a level playing field for competitors. Congress, regulators and industry participants have varied opinions on the topic and the debate continues. It is important to hear all sides to strike the right balance in this complex economic and policy discussion.

This is truly a dynamic time in the futures markets, given the growth in trading volume, product innovation and complexity, and globalization – in all commodities, including energy. The Commission will continue to work to promote competition and innovation by proactively taking down unnecessary barriers to trading in our markets, while at the same time, fulfilling our mandate under the CEA to protect the public interest and to enhance the integrity of, and public confidence in, U.S. futures markets.

In closing, I appreciate the Committee's inquiries into this complex and important area as well as the opportunity to testify. I look forward to answering any questions you might have.

Thank you.