Implementing Dodd-Frank: A Review of the CFTC's Rulemaking Process

Testimony
of
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The Relationship of Unregulated OTC Derivatives to the Meltdown. It is now accepted wisdom that it was the non-transparent, poorly capitalized, and almost wholly unregulated over-the-counter ("OTC") derivatives market that lit the fuse that exploded the highly vulnerable worldwide economy in the fall of 2008.[1] Because tens of trillions of dollars of these financial products were pegged to the economic performance of an overheated and highly inflated housing market, the sudden collapse of that market triggered under-capitalized or non-capitalized OTC derivative guarantees of the subprime housing investments. Moreover, the many undercapitalized insurers of that collapsing market had other multi-trillion dollar OTC derivatives obligations with thousands of financial counterparties (through unregulated interest rate, currency, foreign exchange, and energy derivatives). If a financial institution failed because it could not pay off some of these obligations, trillions of dollars of interconnected transactions would have also failed, causing a cascade of collapsing banks throughout the world. It was this potential of systemic failure that required the United States taxpayer to plug the huge capital hole that a daisy chain of nonpayments by the world's largest financial institutions would have caused, thereby heading off the cratering of the world's economy.[2]

An Example of the Multi-Trillion Dollar Derivative "Bets" That Had to Be Paid by the U.S. Taxpayer. The then perfectly lawful "bets" that hedge fund manager John Paulson placed through this unregulated OTC derivatives market provide but a single example of how that market collectively misfired and – but for taxpayer bailouts – nearly imploded the world economy.[3] From 2006 to 2007, Mr. Paulson with, *inter alia*, the assistance of swaps dealers, purchased synthetic collateralized debt obligations ("CDOs"), which were nothing more than the

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[1] *See* Ben Moshinsky, *Stiglitz says Banks Should Be Banned From CDS Trading*, BLOOMBERG.COM (Oct. 12, 2009), http://noir.bloomberg.com/apps/news?pid=newsarchive&sid=a65VXsI.90hs; Paul Krugman, Op-Ed, *Looters in Loafers*, N.Y. TIMES, Apr. 18, 2010, *available at* http://www.nytimes.com/2010/04/19/opinion/19krugman.html?dbk. *See generally* Alan S. Blinder, *The Two Issues to Watch on Financial Reform — We Need an Independent Consumer Watchdog and Strong Derivatives Regulation. Industry Lobbyists are Trying to Water Them Down*, WALL ST. J., Apr. 22, 2010, *available at* http://online.wsj.com/article/SB10001424052748704133804575197852294753766.html; Henry T. C. Hu, *"Empty Creditors and the Crisis*, WALL ST. J., Apr. 10, 2009, at A13; MICHAEL LEWIS, THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE (2010) [hereinafter THE BIG SHORT]; SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN (2011) [hereinafter 13 BANKERS]; MICHAEL HIRSH, CAPITAL OFFENSE: HOW WASHINGTON'S WISE MEN TURNED AMERICA'S FUTURE OVER TO WALL STREET (2010) [hereinafter CAPITAL OFFENSE]; BETHANY MCLEAN & JOE NOCERA, ALL THE DEVILS ARE HERE: THE HIDDEN HISTORY OF THE FINANCIAL CRISIS (2010) [hereinafter ALL THE DEVILS ARE HERE]; INSIDE JOB (Sony Pictures Classics & Representational Pictures 2010); *Frontline: The Warning* (PBS television broadcast Oct. 20, 2009) [hereinafter The Warning]; FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES xxiv (Jan. 2011), *available at* http://www.fcic.gov/report [hereinafter FCIC REPORT].

[2] *See* Moshinsky, *supra* note 1; Krugman, *supra* note 1; Blinder, *supra* note 1; Hu, *supra* note 1; THE BIG SHORT, *supra* note 1.

[3] Complaint at 2, Securities and Exchange Commission v. Goldman Sachs & Co. and Fabrice Tourre, 2010 U.S. Dist. Ct. 3229 (S.D.N.Y. Apr. 16, 2010) ("Undisclosed in the marketing materials and unbeknownst to investors, a large hedge fund, Paulson & Co. Inc. ('Paulson'), with economic interests directly adverse to investors in the ABACUS 2007-AC1 CDO, played a significant role in the portfolio selection process. After participating in the selection of the reference portfolio, Paulson effectively shorted the RMBS portfolio it helped select by entering into credit default swaps ('CDS') with [Goldman] to buy protection on specific layers of the ABACUS 2007-AC1 capital structure. Given its financial short interest, Paulson had an economic incentive to choose RMBS that it expected to experience credit events in the near future.") (On July 15, 2010, Goldman Sachs entered into a settlement without admitting or denying the SEC's allegations for the amount of $550 million.)

purchase of insurance on his selection of weak tranches of subprime residential mortgage-backed securities that Mr. Paulson himself did not own.[4] In other words, through so-called "naked credit default swaps ('CDS')," Mr. Paulson effectively bought insurance on his own selection of subprime investments in which he had no ownership and for which he had no risk, but which he believed would fail. Since the dawn of the 19th century, it has not been legal to buy insurance on someone else's risk. However, because these "bets" were categorized as OTC derivatives, they were expressly deregulated as "swaps" by Congressional enactment, and insurance laws were not applied.

When subprime mortgage borrowers (*i.e.*, those with various degrees of non-creditworthiness) defaulted and could not, as common sense would have suggested, sustain their mortgages, the tranches that Mr. Paulson insured (but did not own) failed, thereby triggering highly lucrative payment obligations to Mr. Paulson pursuant to his synthetic CDOs and naked CDS. Paulson ultimately made about $15 billion on these bets.[5]

Even though the purchasers of synthetic CDOs, such as Mr. Paulson, "profited spectacularly from the housing crisis . . . they were not purchasing insurance against anything they owned. Instead, they merely made side bets on the risks undertaken by others."[6] In fact, because synthetic CDOs mimicked insurance, those who were "insured" through synthetic CDOs were only required to sustain their multi- trillion dollar bets with insurance-like "premiums," *i.e.*, they were only required to pay about two percent of the total amount insured.[7]

Moreover, as has been widely demonstrated, investors "creating" their synthetic bets that the subprime market would fail often repeatedly insured against the *same* weak subprime tranches, *i.e.*, many weak subprime tranches were "bet" to fail multiple times.[8] In essence, therefore, once a borrower defaulted on a mortgage, the loss in the real economy was exponentially multiplied by the many side bets placed on whether that borrower would default.

Mr. Paulson's investments are reflective of trillions of dollars bet on the subprime market, and the astronomical amounts owed to the holders of this unregulated "insurance" of the subprime market serve as a microcosm of the worldwide financial crisis.[9]

Most importantly, the "insurers" of the subprime market (some of the most prominent financial institutions in the world) were not required to have capital to sustain their insurance or to post collateral to ensure their payments. (Had these investments been governed by insurance or gaming laws, those betting that subprime mortgages would be paid would have been required to have adequate capital to ensure payments if the bet were lost.) And, when the "insurers" were "surprised" to find that those without creditworthiness could not pay their mortgages, they did not have the ability to pay off their indebtedness to the holders of synthetic CDOs. However, what should have been a zero-sum game was converted from a lose-lose game into a win-win

[4] *Id.*
[5] Svea Herbst-Bayliss and Kevin Lim, *Paulson reassures on Goldman role*, REUTERS (April 21, 2010), *available at* http://www.reuters.com/article/2010/04/21/us-goldman-paulson-redemptions-idUSTRE63K0C620100421?pageNumber=1.
[6] FCIC REPORT, *supra* note 1, at 195.
[7] *See* THE BIG SHORT, *supra* note 1, at 51.
[8] *See id.*
[9] *See generally* THE BIG SHORT, *supra* note 1; *see also* INSIDE JOB, *supra* note 1.

situation, *i.e.*, the Mr. Paulsons of this world only got paid because "insurers" were subsidized by the taxpayer so that the "casinos" could make payment on the bets. Unlike regular gambling, no gambler lost – except the perfectly innocent bystanders: the U.S. taxpayer.[10]

As it now stands, the world is attempting to dig itself out of the worst financial crisis since the Great Depression of the 1930's – a task now aggravated, *inter alia*, by the burden of escalating energy and food commodity prices. Dozens of studies suggest that even those escalating commodity prices may very well be aided by betting on the upward direction of those prices through passive investments originated by U.S. financial institutions using unregulated OTC derivatives.[11]

Dodd-Frank Provides the Tools to Protect the U.S. Taxpayer. Title VII of the Dodd-Frank Act[12] would make it very difficult to repeat the kind of undercapitalized, non-transparent, and economy-busting "betting" mentioned above. That statute, *if properly implemented*, (1) requires all major players to have adequate capital to enter the market to sustain their potentially huge obligations; (2) requires that *almost* all of these kinds of investments be collateralized by counterparties; (3) requires *almost* all of these investments to be guaranteed and properly margined by clearing facilities, which, in turn, are subject to strict federal regulation and oversight; (4) requires all of these transactions to be publicly recorded and, in many instances, traded on public exchanges or exchange-like environments; and (5) collectively places the CFTC, the SEC, and the members of the Financial Stability Oversight Council in a position to have full transparency of these kinds of investments with an eye to preventing the kind of systemic risk that threatened the world economy in the fall of 2008.

It must be emphasized that Title VII exempts from the clearing requirement commercial end users.[13] Moreover, the CFTC and SEC have repeatedly said that uncleared swaps used by

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[10] *See* THE BIG SHORT, *supra* note at 1, at 256.

[11] *See* Commodity Markets Oversight Coalition, EVIDENCE OF THE IMPACT OF COMMODITY SPECULATION BY ACADEMICS, ANALYSTS AND PUBLIC INSTITUTIONS (2011), *available at* http://www.nefiactioncenter.com/PDF/evidenceonimpactofcommodityspeculation.pdf; *see also* KENNETH J. SINGLETON, GRADUATE SCHOOL OF BUSINESS PROFESSOR, STANFORD UNIVERSITY, INVESTOR FLOWS AND THE 2008 BOOM/BUST IN OIL PRICES (March 23, 2011), *available at* http://www.stanford.edu/~kenneths/.

[12] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

[13] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 723(a)(3) (2010) ("Clearing Transition Rules – (A) Swaps entered into before the date of the enactment of this subsection are exempt from the clearing requirements of this subsection if reported pursuant to paragraph (5)(A); (B) Swaps entered into before application of the clearing requirement pursuant to this subsection are exempt from the clearing requirements of this subsection if reported pursuant to paragraph (5)(B).").

commercial end users will be exempt from margin requirements both for the commercial end user *and* for the swap dealer selling the hedging vehicle.[14]

Moreover, the statute expressly exempts from regulation all swaps in existence before the statute passed, as well as swaps executed before final rules are put in place.[15] That means until the CFTC acts, hundreds of millions of dollars of swaps will continue to be unregulated with no provision for capital adequacy or transparency. This latter factor, in and of itself, justifies the timetable established in Dodd-Frank for implementation of the statute, which the CFTC is diligently attempting to follow. Until final rules are adopted, the American taxpayer, consumer and retiree are exposed to the same regulatory inadequacies that caused the fall 2008 credit crisis to begin with.

One of the most important sections in Title VII of Dodd-Frank is Section 737 on Position Limits.[16] It is designed to ban excessive speculation from the derivatives market, *i.e.*, ban that speculation which exceeds the need for liquidity by commercial hedgers in the commodity markets. The CFTC, as congressionally mandated, is currently in the process of implementing Section 737 through the rulemaking process and proposed rules on position limits on January 26, 2011.[17]

However, in attempting to properly implement Section 737, the CFTC has faced massive opposition. Opponents have argued that Section 737 is not necessary to prevent volatility in commodity prices. First, as I have stated in my comment letter in response to the proposed position limits rules,[18] Section 737 does not afford the CFTC discretion regarding the implementation of position limits. Rather, it imposes the statutory obligation to set position limits with the goal of limiting excessive speculation. In drafting this section, Congress

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[14] Written Testimony of Gary Gensler, Chairman, Commodity Futures Trading Commission, *Hearing Before the U.S. House Committee on Agricultural to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Acton*, February 10, 2011, *available at* http://www.cftc.gov/pressroom/speechestestimony/opagensler-68.html ("Transactions involving non-financial entities do not present the same risk to the financial system as those solely between financial entities. Consistent with this, proposed rules on margin requirements should focus only on transactions between financial entities rather than those transactions that involve non-financial end-users.") [hereinafter "Gensler Testimony"]; Written Testimony of Mary Schapiro, Chairman, Securities and Exchange Commission, *Hearing Before the U.S. House Financial Services Committee on Implementation of Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act by the U.S. Securities and Exchange Commission*, February 15, 2011, *available at* http://www.sec.gov/news/testimony/2011/ts021511mls.htm ("in proposing margin rules, we will be mindful both of the importance of security-based swaps as hedging tools for commercial end users and also of the need to set prudent risk rules for dealers in these instruments.") [hereinafter "Schapiro Testimony"].

[15] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 739 (2010) ("Unless specifically reserved in the applicable swap, neither the enactment of the Wall Street Transparency and Accountability Act of 2010, nor any requirement under that Act or an amendment made by that Act, shall constitute a termination event, force majeure, illegality, increased costs, regulatory change, or similar event under a swap (including any related credit support arrangement) that would permit a party to terminate, renegotiate, modify, amend, or supplement 1 or more transactions under the swap.").

[16] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 737 (2010).

[17] Position Limits for Derivatives, 76 Fed. Reg. 4752 (January 26, 2011).

[18] *See* Comment Letter by Michael Greenberger, Professor, University of Maryland School of Law, Director, Center for Health and Homeland Security, to David Stawick, Secretary, Commodity Futures Trading Commission, *Position Limits for Derivatives* (March 28, 2011), *available at* http://www.michaelgreenberger.com/files/Greenberger_PL_comment_letter.pdf.

purposefully replace the word "may" in the House version of the Dodd-Frank Act[19] with "shall,"[20] to "strengthen confidence in trader position limits on physically deliverable commodities as a way to prevent excessive speculative trading."[21]

Those who oppose position limits argue that there is a lack of empirical data demonstrating that excessive speculation has unnecessarily and dramatically increased the price of energy and agricultural commodities. For example, Terry Duffy of the CME Group stated during the March 3, 2011 hearing before the Senate Committee on Agriculture, Nutrition and Forestry that "there's been absolutely no evidence that [speculators] have anything to do with the effect of price whether it comes from an academic, whether it comes from a government study or anything else. So just want to put that clear."[22] This is simply incorrect. Even if, for argument's sake, the imposition of position limits is discretionary, many company/commercial end-users, including, *inter alia*, Starbucks, Hershey, Lindt & Spruengli, and Delta Airlines, have now come forward demonstrating that the futures market is in complete disarray because of excessive speculation.[23] The Commodity Markets Oversight Coalition, an independent, non-partisan and non-profit alliance of groups that represents commodity-dependent industries, businesses and

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[19] The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (2009).

[20] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 737 (2010).

[21] Official website of House Committee on Agriculture, House Passes Peterson-Frank Amendment to Strengthen Regulation of Over-the-Counter Derivatives, December 10, 2009, *available at* http://democrats.agriculture.house.gov/press/PRArticle.aspx?NewsID=207.

[22] *See Transcript of Implementation of Title VII of the Wall Street Reform and Consumer Protection Act, Hearing Before the Senate Committee on Agriculture, Nutrition & Forestry*, 112th Cong. (March 3, 2011) (Statement of Terry Duffy, Executive Chairman, CME Group); *see also e.g.*, in the comment letter submitted by SIFMA Asset Management Group, which is comprised primarily of Chief Operating Officers and other senior executives at asset management firms, argued: "The CFTC should delay adoption of position limits until an 'appropriateness' determination can be made. *Currently, there lacks insufficient evidence to suggest that speculation is affecting commodities markets*." Comment Letter by Timothy W. Cameron, Esq., Managing Director, Asset Management Group of Securities Industry and Financial Markets Association (SIFMA) to David Stawick, Secretary, Commodity Futures Trading Commission, *Notice of Proposed Rulemaking – Position Limits for Derivatives*, March 28, 2011, *available at* http://www.sifma.org/issues/item.aspx?id=24137 (emphasis added).

[23] *See* e.*g.*, Howard Schultz, Chief Executive Officer of Starbucks, Inc., recently stated: "I've been in this business for 30 years. I can tell you unequivocally with every coffee farmer and resource that we talk to in which we have decades of relationships, we cannot identify a supply problem in the world where we're buying coffee. So one question is, 'why are coffee prices going up?' and in addition to that, 'why is every commodity price going up at the same time?' Why is cotton, corn, wheat, why? And I think what's going on is financial engineering; that financial speculators have come into the commodity markets and drove these prices up to historic levels and as a result of that the consumer is suffering." Josh Garrett, *Starbucks CEO Points to Speculation as Cause of Rising Commodity Prices*, HEATINGOIL.COM (April 6, 2011), *available at* http://www.heatingoil.com/blog/starbucks-ceo-points-to-speculation-as-cause-of-rising-commodity-prices0406/; *see also e.g.,* The world's largest chocolate maker, Hershey Co. have announced that they have increased the price to "offset the higher costs of ingredients such as cocoa and sugar which has doubled in cost over the last year." Moreover, Lindt & Spruengli, the Swiss chocolate maker, said that "they may well increase their prices to consumers in the second half of the year to offset the higher costs of Cocoa prices that the company have incurred *after Cocoa costs rose following financial speculation* and post-election violence in the Ivory Coast." Edward Buckley, *Hershey's Raise Their Prices By Nearly 10% To Offset Rising Costs*, NEWSDAILYBRIEF.COM (April 1, 2011), *available at* http://newsdailybrief.com/hersheys-raise-their-prices-by-nearly-10-percent-to-offset-rising-costs/353628/ (emphasis added); Jim Spencer and Dee DePass, *As we pay more at the pump, oil trading curbs still on hold*, STAR TRIBUNE (March 20, 2011) (quoting Ben Hirst, Chief Counsel, Delta Air Lines: "[S]peculators try to anticipate what other speculators are going to do, and the market overreacts. It's not as though there's a shortage of product that caused the price to move up. It's a casino process with financial players betting on where the price is going to go. But it has an effect on [current] prices.").

end-users, has also adopted the position that commodity prices defy market fundamentals due to excessive speculation.

Notably, during the March 31, 2011 hearing before the House Committee on Natural Resources, three out of the four panelists (Bill Graves, CEO and President of American Trucking Association and former Republican Governor of Kansas, Don Shawcroft, President of Colorado Farm Bureau, and Michael J.Fox, Executive Director of Gasoline & Automotive Service Dealers of America, Inc.) supported the need to regulate *excessive* speculation with strict aggregate position limits as required by Section 737 across all derivatives markets and to provide necessary funding to the CFTC to implement that strict anti-speculative regime.[24] In particular, Mr. Fox told the Committee: "The fastest way to six dollar retail gasoline price is to not fully fund the CFTC and not impose the Dodd/Frank regulations. That's the fastest way to get to six dollar gasoline."[25]

Overbroad exemptions from speculative position limits are wholly unjustified, as it has been repeatedly proven that the swap dealer exemptions have allowed those Too Big to Fail banks to enter into excessive speculative transactions in the commodities market. Specifically, the bi-partisan Senate Permanent Subcommittee on Investigations Report on Excessive Speculation in the Wheat Market, which was released on July 24, 2009, found that "four swap dealers selling index-related swaps currently operate with hedge exemptions that allow them to hold much larger positions on the Chicago wheat futures market than would otherwise apply under the CFTC's speculative position limits."[26] Allowing these kinds of exemptions to continue would drive excessive speculation in all commodity markets, which is why we are in an inflationary food and energy bubble at this time.

We Are Not Home Free Yet. There is now a substantial question whether Title VII of Dodd-Frank will be properly implemented because of resistance by big banks and other financial institutions. According to the Comptroller of the Currency, five big Wall Street banks have controlled 98% of the existing (pre-Dodd-Frank) OTC derivatives market, thereby necessitating, for example, the Antitrust Division of the Department of Justice to intervene in one of the critically important CFTC and SEC proposed rulemakings concerning ownership of the major new financial institutions created by Dodd-Frank. The big banks want to keep these institutions within their control. Needless to say, if properly implemented, the huge profits of these and other banks will be diminished by the competition that a transparent market brings, in the words of Dodd-Frank, "free and open access" to what would be highly competitive derivatives markets.

While each argument advanced by swaps dealers must be analyzed on its own merits, there can be no mistake that a unifying rationale for minimizing the impact of Dodd-Frank, either implicitly or explicitly, is that we are now out of the financial crisis and there is no need for change. Therefore, it is suggested that as much of the status quo ante as can be preserved should now be left in place.

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[24] *See Harnessing American Resources to Create Job and Addressing Gasoline Prices: Impacts on Business and Families Hearing Before the H. Comm. on Natural Resources*, 112th Cong. (March 31, 2011).
[25] *Id*.
[26] PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, EXCESSIVE SPECULATION IN THE WHEAT MARKET 37 (June 24, 2009) [hereinafter "Wheat Report"].

A subsidiary argument is that if Dodd-Frank is fully enforced, it will be a job killer. However, as shown above, the undercapitalized casino that unregulated derivatives fostered in the subprime housing market was the ultimate job and pension killer. The misery created by that unregulated market often gets lost in Wall Street talking points. Moreover, the economic gambling infrastructure built before Dodd-Frank around subprime mortgages exists, *e.g.*, for prime mortgages, commercial mortgages, student loans, auto and credit card debt.

We are presently in a jobless "recovery." Moreover, the shock of rapidly escalating energy and food prices, as well as threatened defaults by municipalities and European Union sovereign states, can either individually or collectively create economic dislocations akin to that experienced in the fall of 2008. For example, there is almost certainly an untold number of grossly undercapitalized naked CDS on municipal and sovereign obligations. If there are widespread defaults in those areas, an untold number of undercapitalized "insurance" guarantees will be triggered.

The loss of profits of "Too Big to Fail" financial institutions, which have fully recovered and may be stronger and bigger now than before the meltdown, must be balanced against the well being of the American consumer, worker and taxpayer.[27] Rejecting Dodd-Frank on the assumption that all is now well is a dangerous strategy to follow legislatively or at the regulatory level.

There is another concern that the implementation of Dodd-Frank would add significant operation costs to commercial end users. However, as shown above, the Act contains a statutory "end-user" exception to ease the burden on businesses using swaps to mitigate risk associated with their commercial activities.[28] The legislative intent shows that the drafters of the Act unequivocally share this goal as well.[29] Furthermore Chairman Gensler and Chairwoman Shapiro have said repeatedly that end users will not have to post margin for uncleared swaps and that the swaps dealer counterparty will not have to post margin.[30] Simply, this is a case of commercial end-users not taking "yes" for an answer to their worries about having to post collateral for uncleared swaps.

Whatever new costs Dodd-Frank imposes (and those costs are greatly exaggerated by those seeking to deflate regulation) are minimal compared to the dire economic havoc that might be caused by under-regulation, especially when Congress is now almost devoid of "stimulus bullets" to repair future economic ills.

Funding for the CFTC and SEC. Severely hampering the CFTC's and SEC's ability to implement Title VII of Dodd-Frank are their challenging financial and staffing conditions. With

[27] Karen Weise, *Banks 'Too Big to Fail' Could Get Bigger: Federal agencies putting mortgage and derivative reforms into force are writing rules that seem to have a big-bank bias*, BLOOMBERG BUSINESSWEEK (April 7, 2011), *available at* http://www.businessweek.com/magazine/content/11_16/b4224025246331.htm.
[28] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 723 (2010).
[29] *See* Letter from Christopher Dodd, Chairman, Senate Committee on Banking, Housing, and Urban Affairs & Blanche Lincoln, Chairman, Senate Committee on Agriculture, Nutrition, and Forestry, to Barney Frank, Chairman, Financial Services Committee & Colin Peterson, Chairman, Committee on Agriculture, (June 30, 2010), *available at* http://www.wilmerhale.com/files/upload/June%2030%202010%20Dodd_Lincoln_Letter.pdf (explaining that the end-user exception is "for those entities that are using the swaps market to hedge or mitigate commercial risk.").
[30] *See* Gensler Testimony, *supra* note 14; *see also* Schapiro Testimony, *supra* note 14.

regard to the CFTC, that agency's gross underfunding makes performing its new and complex functions under Dodd-Frank "a herculean task."[31] Under the new regulations, the CFTC must examine a voluminous amount of data and information encompassing transactions that number in the millions.[32] An $11 million slash in the technology budget has forced the agency to cease developing a new program that would scan the overwhelming number of trades to detect suspicious trading. Moreover, the potential long-term effects of insufficient funding is severe; operating under its current budget will mean that applications, findings, and enforcement required by the new law would languish.[33] As Commissioner Bart Chilton aptly warns, "Without the funding, we could once again risk another calamitous disintegration."[34] Lack of funds not only shortchanges the Commission, but it also risks another widespread financial crisis.

In this regard, the CFTC lacks an adequate number of personnel to perform its increased regulatory duties. From 1999 to 2007, the agency shrunk from 567 full-time equivalents ("FTEs") to 437. By 2010, the number of FTEs had risen to 650, only a 30% increase in the number of personnel since the agency's establishment in 1975. Chairman Gary Gensler estimates that he needs an additional 400 people to meet the challenges of regulating the multi-trillion dollar derivatives markets.[35] As Barbara Roper of the Consumer Federation of America has noted, for example, the "draconian cuts" of the House of Representatives' proposed budget would "decimate that tiny agency without making any meaningful inroads in the federal deficit."[36] Even the relatively fiscally conservative *Financial Times* has recently editorialized that the SEC and CFTC deserve the funding levels that were promised to prevent a future meltdown through proper implementation of Dodd-Frank.

It is one thing to attack Dodd-Frank frontally by seeking deregulatory action either through legislation or weakened rules. There can be little doubt, however, that starving financial regulatory agencies dependent upon appropriations is a *de facto* rescission of Dodd-Frank. It asks Americans to face yet another crisis under the guise of budget cuts – a crisis that may "the next time" drag the United States and the world into the next Great Depression.

In making this point, I also want to commend the CFTC for its heroic work in meeting the necessarily rigorous deadlines imposed by Dodd-Frank for well over 60 new rules. I spent 25 years in a private law practice heavily devoted to rulemaking advocacy, and then involvement in the judicial review of those rules in virtually every federal circuit court of appeals in the country

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[31] Ben Protess, *Regulators Decry Proposed Cuts in C.F.T.C. Budget*, N.Y. TIMES (February 24, 2011) (quoting CFTC Commissioner Michael Dunn), *available at* http://dealbook.nytimes.com/2011/02/24/regulators-decry-proposed-c-f-t-c-budget-cuts/?ref=todayspaper.

[32] Jean Eaglesham and Victoria McGrane, *Budget Rift Hinders CFTC*, WALL ST. J. (Feb. 25, 2011).

[33] *See* Transcript of the Congressional Hearing to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act before the H. Comm. on Agriculture (Feb. 15, 2011) (statement of Terry Duffy, Executive Chairman, CEM Group).

[34] *See* Statement of Bart Chilton, Commissioner, Commodity Futures Trading Commission, Risky Business (February 24, 2011), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement022411.html.

[35] Ben Protess and Mac William Bishop, *At Center of Derivatives Debate, a Gung-Ho Regulator*, N.Y. TIMES (Feb. 10, 2011), *available at* http://dealbook.nytimes.com/2011/02/10/at-center-of-debate-over-derivatives-a-gung-ho-regulator/.

[36] *See* Statement of Barbara Roper, Director of Investment Protection, Consumer Federation of America, Feb. 14, 2011.

and in the United States Supreme Court. I was also very proud of the many rules that were promulgated by the CFTC while I was the Director of the Division of Trading and Markets. However, the hard and productive work performed by the CFTC in implementing Dodd-Frank, especially with its small staff, is extraordinary. The quality of that work also meets the highest standards of public service. This subcommittee as one of the key oversight bodies for the CFTC should be very proud of this effort. The agency has more than demonstrated that it will be a vigilant protector of the important markets it now oversees if it receives the financial support it needs from this Congress.

This testimony is further supported in detail by my March 3, 2011 written testimony before the Senate Committee on Agriculture, Nutrition and Forestry at pp. 6 to 25;[37] my March 28, 2011 comment letter to the CFTC on Position Limits for Derivatives;[38] my published article in the University of Maryland School of Law's *Journal of Business and Technology Law*;[39] and a series of my previously published articles and testimony delivered to Congress and to the Financial Crisis Inquiry Commission.[40] Links to those documents may be found in the margin.

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[37] Written Testimony of Michael Greenberger, *Hearing Before the U.S. Senate Committee on Agriculture, Nutrition and Forestry Regarding the Implementation of Title VII of the Wall Street Reform and Consumer Protection Act* (March 3, 2011), *available at* http://www.michaelgreenberger.com/files/110303-Greenberger_Senate_Ag_Testimony2.pdf.

[38] Comment Letter by Michael Greenberger, Professor, University of Maryland School of Law, Director, Center for Health and Homeland Security, to David Stawick, Secretary, Commodity Futures Trading Commission, *Position Limits for Derivatives* (March 28, 2011), *available at* http://www.michaelgreenberger.com/files/Greenberger_PL_comment_letter.pdf.

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MICHAEL GREENBERGER
BRIEF BIOGRAPHY

After 25 years in private legal practice, Michael Greenberger served under Chairperson Brooksley Born as the Director of the Division of Trading and Markets ("T&M") at the Commodity Futures Trading Commission ("CFTC") from September 1997 to September 1999. In that capacity, he supervised approximately 135 CFTC personnel in CFTC offices in DC, New York, Chicago, and Minneapolis. During his tenure at the CFTC, he worked extensively on, *inter alia*, regulatory issues concerning exchange traded energy derivatives, the legal status of over-the-counter ("OTC") energy derivatives, and the CFTC's authorization of trading foreign exchange derivative products on computer terminals in the United States.

While at the CFTC, Professor Greenberger also served on the Steering Committee of the PWG. In that capacity, he drafted portions of the April 1999 PWG Report entitled "Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management." The report enumerated regulatory recommendations to Congress in the wake of the near collapse of the Long Term Capital Management ("LTCM") hedge fund. Further, as a member of the International Organization of Securities Commissions' ("IOSCO") Hedge Fund Task Force, he participated in the drafting of the November 1999 report of IOSCO's Technical Committee relating to the LTCM episode: "Hedge Funds and Other Highly Leveraged Institutions."

After a two-year stint between 1999 and 2001 as the Principal Deputy Associate Attorney General in the U.S. Department of Justice, Greenberger began his service as a Professor at the University of Maryland School of Law. At the law school, he has continued to focus on OTC derivatives. He currently teaches a course entitled "Futures, Options, and Derivatives."

Professor Greenberger served in 2009 as the Technical Advisor to the United Nations Commission of Experts on Reforms of the International Monetary and Financial System and in 2009-2010 as a member of the International Energy Forum's Independent Expert Group on reducing worldwide energy price volatility.

During Congress' consideration of the Dodd-Frank legislation, Professor Greenberger served as a volunteer technical advisor to Americans for Financial Reform and the Commodities Market Oversight Coalition, and he is now working with those groups on the implementation of the Dodd-Frank Act. To date, he has filed comments on 18 Dodd-Frank proposed rules.

Professor Greenberger is also the Founder and Director of the University of Maryland Center for Health and Homeland Security, an academic consulting center of nearly 65 professionals working at the local, state, federal, and international level providing legal and operational guidance on crisis management.