

*Acting Chairman of the Commodity Futures Trading Commission Walter Lukken testifies before the House Committee on Agriculture on Capitol Hill in Washington, Wednesday, Oct. 15, 2008. The hearing is to review the role of credit derivatives in the U.S. economy.*

*(AP Photo/Laurence Jackson)*



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## A MESSAGE FROM THE CHAIRMAN

During the last year, the commodity futures and option markets continued their rapid growth and evolution as credit markets seized and equity markets began a steep decline. The fundamental shift in the futures and option markets is illustrated by steadily increasing volumes, the introduction of new market participants, cutting edge technological and product innovation, and increased globalization and competition. At the same time, commodity prices across the board—from metals, to agricultural, to energy—have been extremely volatile with many commodity prices reaching record highs during the year.

While our markets have evolved dramatically in recent months and years, the mission of the Commodity Futures Trading Commission (CFTC or Commission) has remained strong and constant: *We are charged with protecting market users and the public from fraud, manipulation, and abusive practices in the sale of commodity and financial futures and options, and fostering open, competitive and financially sound futures and option markets.* In working to achieve its mission, the Commission has been guided by the notion that regulatory evolution and informed responses to changing market conditions are the keys to effective market oversight, particularly in a global marketplace. This approach requires a continual review of internal regulatory processes, consistent application of those processes to the markets, and an aggressive enforcement program that prosecutes wrongdoers. I am pleased to report that in Fiscal Year (FY) 2008, the CFTC and its regulatory approach have evolved along with the futures and option markets we regulate to continue to protect our markets, market users, and the public.

A major step in the Commission's evolution came in May, after years of work and bipartisan effort, when Congress

enacted the CFTC reauthorization legislation as part of the Food, Conservation, and Energy Act of 2008 (Farm Bill), making critical improvements to the Commodity Exchange Act (CEA or the Act) and the Commission's authority. Specifically, the new legislation reauthorized the Commission through FY 2013, closed the so-called "Enron Loophole" by allowing enhanced Commission oversight of exempt commercial markets (ECMs) that trade contracts linked to regulated U.S. futures contracts, increased CFTC penalties for manipulation, clarified CFTC anti-fraud authority for off-exchange principal-to-principal energy trades, and clarified CFTC retail foreign currency fraud authority. The Commission is thankful for all the hard work that went into this legislative effort and is working diligently to implement these important new authorities.

Any assessment of the past year must acknowledge the extraordinary rise then fall of commodity prices. The CFTC recognizes that a secure, reliable, and sustainable energy future is of great importance to the American people, and is acutely aware that high commodity prices adversely affect all Americans. We have heard concerns that speculative activity has been affecting commodity prices and impacting the price discovery and risk management roles of the markets we regulate. With that in mind, and building upon the regulatory model developed as part of the Farm Bill, the CFTC has been systematically examining the various satellite markets that complement and compete with the centralized, regulated futures markets. These efforts have been designed to increase transparency and to determine whether trading on satellite markets—such as ECMs, foreign boards of trade (FBOTs) and over-the-counter (OTC) swaps—impacts the regulated futures markets.

In order to increase transparency and better inform the regulatory responses to the challenges of today's markets, the Commission conducted a number of public hearings and meetings over the last year. These included: 1) a public hearing concerning oversight of energy and other trading



*Commodity Futures Trading Commission (CFTC) Acting Chairman Walter Lukken is pictured during a break while testifying on Capitol Hill in Washington, Tuesday, June 24, 2008, before a Senate Homeland Security and Governmental Affairs Committee hearing regarding oil speculation.*

*(AP Photo/Charles Dharapak)*

on ECMs; 2) two meetings of the Commission's Agricultural Advisory Committee; 3) two meetings of the Commission's Global Markets Advisory Committee; 4) the first meeting of the newly-formed Energy Markets Advisory Committee; and 5) an Agricultural Forum (Webcast to 2,800 individuals in 38 states and 43 countries) to discuss the sudden run-up in agricultural prices in early 2008. In addition, in FY 2008, the Chairman and senior Commission staff members appeared on Capitol Hill on 14 occasions to provide testimony to various House and Senate Committees addressing issues within the Commission's regulatory purview.

As a result of these public hearings and meetings, the Commission focused on a number of critical initiatives, including: 1) providing a detailed report to Congress recommending legislative changes relating to oversight of trading on ECMs (recommendations that were enacted in large part as part of the Farm Bill); 2) announcing its national crude oil enforcement investigation and its

enforcement investigation into the February/March 2008 price run-up in the cotton futures markets; 3) entering into an agreement to receive enhanced data from IntercontinentalExchange (ICE) Futures Europe in London relating to its crude oil markets; 4) requiring production of more detailed trading information from index traders and swap dealers; 5) modifying the recognition process for FBOTs to condition direct access to U.S. customers on implementation of position and accountability limits on linked contracts; 6) reviewing whether index traders and swap dealers are properly classified for regulatory and reporting purposes; and 7) issuing an unprecedented special call for information from commodity swap dealers and index funds trading in OTC markets to quantify the amount of this trading and evaluate its potential effects on the regulated markets.

In addition to this comprehensive inward review, the Commission has continued to look outward to foster important relationships, both domestic and international, to assist us in carrying out our mandate. To that end, the CFTC formed an interagency working group with the Federal Reserve Board, U.S. Department of the Treasury (Treasury), U.S. Securities and Exchange Commission (SEC), U.S. Department of Energy, U.S. Department of Agriculture (USDA), and the Federal Trade Commission (FTC) to study investor practices, fundamental supply and demand factors, and the role of speculators and index

traders in the commodity markets. In addition, the CFTC signed a ground-breaking mutual cooperation agreement with the SEC to establish a closer working relationship between the agencies, establish a permanent regulatory liaison between the agencies, provide for enhanced information sharing, and establish several key principles guiding the agencies' consideration of novel financial products that may reflect elements of both securities and commodity futures or options. This agreement led to the expedited, coordinated approval of the trading and clearing of several novel derivative products (futures and option contracts based on shares of an exchange traded fund), an outcome expected to enhance legal and regulatory certainty for users of these novel products.

On the international front, the CFTC was tasked to co-chair the International Organization of Securities Commissions' (IOSCO) newly-created Task Force on Commodity Markets that will examine the current supervisory approaches for overseeing commodity markets worldwide. It also reached an agreement with the China Securities Regulatory Commission (CSRC) to hold regular meetings to promote enhanced cooperation and collaboration to promote investor protection, market integrity, and the supervision of derivatives trading occurring on a cross-border basis between China and the United States. In addition, the Commission hosted an International Regulators Meeting of more than 50 futures industry regulators from around the world to address concerns associated with cross-border clearing, the differences between a core principles-based regulatory regime and a rules-based regime, the development of international financial centers, and whether OTC instruments that are centrally collateralized or cleared should be subject to the same or comparable regulatory regimes as economically equivalent exchange-traded instruments.

The agency's sweeping regulatory review and regulatory outreach is complemented by the efforts of its Division of Enforcement (DOE). This year, DOE filed 40 new actions, including 13 actions against hedge funds/pool operators/trading advisors, and cases charging attempted manipulation and/or manipulation in the energy markets involving a former gasoline trader for BP Products North America Inc. and Optiver Holding BV and related companies and employees. As a result of these prosecutions, respondents and defendants were ordered to pay more than \$630 million



*Washington, D.C., March 11, 2008 — Securities and Exchange Commission Chairman Christopher Cox and Commodity Futures Trading Commission Acting Chairman Walter L. Lukken today signed a ground-breaking mutual cooperation agreement to establish a closer working relationship between their agencies. (SEC Photo)*



in civil monetary penalties, restitution, and disgorgement. In addition to its investigation and litigation efforts, DOE continued to foster relationships with global regulators by hosting two enforcement conferences with international regulators to share observations of trends in commodities markets, including on-exchange, cash, and OTC markets to enhance the ability of regulators to work cooperatively across borders as we all share the same goals of detecting and deterring misconduct affecting commodity prices.

With the credit crunch and overall market distress over the last year, the Division of Clearing and Intermediary Oversight (DCIO) has worked tirelessly to ensure the financial integrity of the futures and option clearing systems regulated by the CFTC. This required active daily monitoring of and working with exchange self-regulatory organizations (SROs) to ensure that futures firms continued to meet their customer segregation and capital requirements while allowing for the orderly functioning and stability of the markets. As part of its effort, DCIO staff were on-site in New York during the Lehman Brothers Holdings Inc. bankruptcy proceedings to safeguard customer assets and promote the orderly transfer of positions from CFTC regulated futures commission merchant subsidiary, Lehman Brothers Inc. DCIO also worked with fellow regulators and market participants to advance the development and proper oversight of a clearinghouse for credit default swaps and other over-the-counter (OTC) instruments.

The CFTC is dedicated to protecting the public and market users from manipulation, fraud, and abusive practices in order to ensure that the futures markets are working properly. Throughout the year, the agency has sought to successfully meet its important oversight mission while facing the significant challenge of operating at historically low staffing levels. At the same time, agency internal controls and accountability have remained among our highest priorities. The agency's financial statements are included in this report and we can confirm that that the financial and performance data presented in this report are fundamentally reliable and complete. Moreover, I am pleased to report that in FY 2008, the CFTC again had no material weaknesses. On behalf of our Inspector General, our auditor, the public accounting firm KPMG, LLP, has affirmed that our financial statements are presented fairly in all material respects and are in conformity with



*President Bush center, with, from left, Commodity Futures Trading Commission (CFTC) Acting Chairman Walt Lukken, Security and Exchange Commission (SEC) Chairman Christopher Cox, Vice President Dick Cheney, Treasury Secretary Henry Paulson and Federal Reserve Board Chairman Ben Bernanke are seen at the end of a meeting with members of the President's Working Group on Financial Markets, Friday, Jan. 4, 2008, in the Roosevelt Room of the White House in Washington. (AP Photo/Lawrence Jackson)*

U.S. generally accepted accounting principles (GAAP). The Financial Section of this report includes greater detail about our internal controls and highlights some key management assurances. Success in these important areas makes it possible for the Commission to operate as effectively as we do.

The year ahead will be a busy one for the Commission. In the wake of the financial crisis, Congress will likely turn to broad financial reform. Volatility in the energy and agricultural markets will continue to be the focus of policymakers as we work to ensure the proper functioning of our price discovery and risk management markets. I am confident that the Commission's dedicated staff and the flexible principles-based authority provided by Congress will help this agency to forcefully police these ever-changing markets in order to uphold the CFTC's important mission and the public's trust.

Walter Lukken  
Acting Chairman

November 17, 2008