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Office of the
Inspector General

MEMORANDUM

TO: Gary Gensler
Chairman

FROM: A. Roy Lavik
Inspector General

DATE: November 14, 2012

SUBJECT: Inspector General's Assessment of The Most Serious Management Challenges Facing the Commodity Futures Trading Commission (CFTC)

Introduction

The Reports Consolidation Act of 2000 (RCA) authorizes the CFTC to provide financial and performance information in a meaningful and useful format for Congress, the President, and the public. The RCA requires the Inspector General to summarize the "most serious" management and performance challenges facing the Agency and to assess the Agency's progress in addressing those challenges. This memorandum fulfills our duties under the RCA.

In order to identify and describe the most serious management challenges, as well as the Agency's progress in addressing them, we relied on data contained in the CFTC financial statement audit and Annual Financial Report, representations by agency management, and our knowledge of industry trends and CFTC operations. Since Congress left the determination and threshold of what constitutes a most serious challenge to the discretion of the Inspector General, we applied the following definition in preparing this statement:

> Serious management challenges are mission critical areas or programs that have the potential for a perennial weakness or vulnerability that, without substantial management attention, would seriously impact Agency operations or strategic goals.

This memorandum summarizes the results of the CFTC's current financial statement audit, describes the Agency's progress on last year's management challenges, and finally discusses the most serious management challenges that we have identified. For the second year in a row, we identified the most serious management challenges as:

- Efficient Deployment of Information Technology Resources
- Expanding Delivery of Customer Protection Resources and Consumer Education.

CFTC Financial Statement Audit Results

In accordance with the *Accountability of Tax Dollars Act*, CFTC, along with numerous other federal entities, is required to submit to an annual independent financial statement audit by the Inspector General, or by an independent external auditor as determined by the Inspector General. The results of the Fiscal Year 2012 financial statement audit will be discussed in the Annual Financial Report, and the financial statement audit is expected to result in an unqualified audit opinion.

CFTC's Progress on Last Year's Challenges

Last year, we identified two of the most serious management challenges:

- Efficient Deployment of Information Technology Resources; and,
- Expanding Delivery of Customer Protection Resources and Consumer Education.

CFTC made progress on both challenges, but these challenges remain significant due to ongoing implementation of the Dodd-Frank Act.

Most Serious Management Challenges for the coming year

The two issues that we identified last year will continue to challenge CFTC management in the coming year:

Efficient Deployment of Information Technology Resources

Last year we stated that over eighty percent of futures and options trading on the Chicago Mercantile Exchange are transacted electronically. Since then electronic trading continued its inexorable march and now over eighty-five percent of futures and options occurs electronically.

Last year we also expressed a concern that the agency's additional regulatory responsibilities mandated by the Dodd-Frank Act would challenge management's ability to adequately regulate the sizeable volume of swaps transactions--currently estimated to exceed $600 trillion in notional value worldwide. On October 12, 2012 CFTC regulations required reporting on certain cleared interest rate and credit default swaps transactions to Swap Data Repositories (SDR); the agency has access to the data received by the SDRs. In order to properly analyze the data and scan for trade anomalies the agency is in the process of specifying a standard data structure for swap information submitted to SDRs and it is our understanding that the industry and the CFTC are working though this new Dodd-Frank Act regulatory mandate. In January 2013 the CFTC will receive real time swap transaction data, placing additional regulatory demand on the agency. These challenges--electronic trading vs. declining on-exchange floor trading, and expanded jurisdiction over the swaps market--remain on the horizon. Both require the efficient deployment of effective information technology resources.

In fiscal year 2012, Congress appropriated $55 million dollars in multi-year funds for information technology to address the structural shift in derivatives trading regulated by the agency. Under a period of government-wide fiscal austerity, we anticipate that the agency will be challenged during the coming year to adequately conduct surveillance over these complex markets, and equally challenged to sift through voluminous transaction data to thwart wrongdoing. Reliance on technological solutions may be the agency's best tool to regulate the formerly unregulated swaps markets, and time will reveal the agency's success in meeting this challenge. We will monitor the agency's use of appropriated funds for information technology in light of these challenges.

Expanding Delivery of Customer Protection Resources and Consumer Education

Section of 748(g) of the Dodd-Frank Act added section 23(g) to the Commodity Exchange Act to establish within the Treasury of the United States a revolving fund that will be available to the Agency for the payment of whistleblower awards and education initiatives. The new Customer Protection Fund is funded by civil monetary penalties collected through the Commission's enforcement program that are not otherwise distributed to victims. At the end of FY2012 the Customer Protection Fund held over $100 million dollars, a significant increase from the $23 million dollar balance held last fiscal year. On October 25, 2012 the Office of the Inspector General issued the financial statement audit of the Customer Protection Fund, which for the second year in a row resulted in an unqualified opinion on the financial statements.

Increasingly, the Customer Protection Fund's expanding resources and commitments will demand significant management attention. We are encouraged that the agency has staffed the fund with new management, refined its policy for issuing awards to whistleblowers, and initiated Consumer Education outreach programs. However the recent financial scandals at MF Global, Inc., and Peregrine Financial, Inc., both generating reports of misappropriated customer funds, underscore the need to strengthen consumer protections in the financial system through consumer education. The increased commitment to whistleblower protection and customer education will challenge the agency to effectively manage decisions regarding additions to and awards from the Customer Protection Fund, to develop its organizational structure, and to prudently manage significant additional resources.