Summary Report* of the Commodity Futures Trading Commission on the Futures Industry Response to September 11th

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** Full report available at www.cftc.gov*

Three of the commodity futures exchanges regulated by the Commodity Futures Trading Commission -- the Cantor Financial Futures Exchange (Cantor)[1], the New York Board of Trade (NYBOT) and the New York Mercantile Exchange, Inc. (NYMEX) -- were located in Lower Manhattan on September 11th. These exchanges were drastically impacted by the terrorist attacks, the lives of friends and colleagues were lost, and trading was interrupted. Other futures exchanges, in Chicago and elsewhere, were also impacted by events in New York, particularly by the closing of the stock markets, and also experienced interruptions in trading.

But in its preparedness and by its responses to this unprecedented disaster, the futures industry demonstrated foresight, resilience, and determination. Steady leadership, the ingenuity of technical staffs, and the courage and tenacity of everyone in the industry, made possible a remarkably fast and effective resumption of trading and restored to the United States economy rapid access to the risk-management tools and price-discovery mechanisms that are uniquely provided by the futures industry. The Commission, in cooperation with other federal financial regulators, Congress, and the White House, strove in the days and weeks after the attacks to assist the industry in restoring operation of these important markets. The Commission now hopes that its report on responses to this situation will assist in efforts to enhance preparedness.

The Role of the Futures Markets

Futures markets exist primarily to provide a mechanism for managing risk, principally price risk. Producers, distributors, and users of physical commodities -- as well as those exposed to fluctuation in financials such as currencies, interest rates, and stock index values --

[1] Cantor trades various U.S. Treasury futures products and is owned by members of NYBOT and the New York Cotton Exchange. NYBOT provides regulatory services for Cantor.

use futures contracts to manage (or “hedge”) their exposure to risk. Thus, disruption of a futures market can cause significant economic hardship for the users of these hedging tools.

Futures markets also perform a second function: they enable other markets to discover appropriate prices for commodities (and the products or services derived from commodities) by referencing quoted futures markets transactions. Businesses, investors, and even government entities throughout the economy depend upon these important price discovery mechanisms. Thus, disruption of a futures market can cause widespread economic hardship for those who look to it for price discovery information. For example, observers have noted that had the New York Mercantile Exchange, Inc. not succeeded in restoring operation of its market for futures contracts based on crude oil so quickly and smoothly after the attacks, then the domestic and global stock markets might have suffered drastically.

There are 16 domestic futures exchanges designated by the Commission as contract markets. Approximately 65,000 persons are registered as floor brokers, floor traders, introducing brokers, associated persons, futures commission merchants, and commodity trading advisors. Although contracts for agricultural commodities have been traded in the U.S. for almost 150 years, the industry has in recent years expanded rapidly into many new markets. Futures and option contracts are now offered in a vast array of financial instruments, including foreign currencies, domestic and foreign government securities, and domestic and foreign stock indices.

There are more than 240 contracts actively traded on U.S. futures exchanges, twice as many as a decade ago, and the volume of trading has also doubled in the last ten years. The four largest exchanges are the Chicago Board of Trade (CBT), Chicago Mercantile Exchange (CME), NYMEX, and NYBOT but there are other futures exchanges, regional and electronic, that also play important roles.

The Role of the CFTC

Congress created the Commission in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States. The CFTC consists of five Commissioners who are appointed by the President and confirmed by the Senate, one of whom is designated by the President to serve as Chairman. The CFTC headquarter offices are located in Washington, D.C. The Commission also maintains large regional offices in Chicago and New York, and smaller regional offices in Kansas City, Los Angeles, and Minneapolis.

The CFTC is charged under the Commodity Exchange Act with deterring and preventing price manipulation and other disruptions to market integrity, ensuring the financial integrity of transactions in the commodity futures and option markets so as to avoid systemic risk, promoting responsible innovation and fair competition in these markets, and protecting all market participants against fraudulent or other abusive sales practices and from misuse of customer assets. Through oversight regulation, the CFTC enables futures markets to better serve their two key functions in the economy: a mechanism for managing risk and a means of price discovery.

The CFTC has three operational divisions: Economic Analysis (DEA), Trading and Markets (T&M), and Enforcement (DOE). DEA helps the Commission -- through market surveillance, market analysis, and market research -- to fulfill its responsibility to promote competitive markets free of manipulation or congestion. T&M develops, implements, and interprets regulations that protect customers, prevent trading and sales practice abuses, and assure the financial integrity of firms that hold customer funds. DOE investigates and prosecutes alleged violations of the Commodity Exchange Act and the Commission's rules.[2]

[2] The CFTC recently announced plans to combine elements of DEA and T&M into a single market oversight function and will use other elements of T&M to oversee intermediaries. A separate office of chief economist will also be established.

Impact of the Terrorist Attacks

The futures industry demonstrated preparedness, resilience, and flexibility in the aftermath of the attacks. NYMEX and NYBOT, despite being directly and severely impacted by the September 11th attacks, successfully responded by following established contingency plans and/or by skillfully adapting to unforeseen challenges and new operational realities. NYMEX initially resumed trading on Friday, September 14th, using internet access to its electronic trading platform. It resumed open outcry trading on Monday, September 17th, after remarkable efforts to restore the functionality of its floor trading facility located only one block from the World Trade Center. NYBOT, whose facilities in 4 World Trade Center were destroyed, moved quickly into a well-conceived, well-resourced backup facility in Queens, complete with trading rings, and resumed its open-outcry trading operations on Monday, September 17th.

The Chicago exchanges were not physically impacted and, after closing their markets to observe an industrywide day of recognition on September 12th, resumed trading in all but their equity-based contracts on September 13th. Trading by all exchanges in contracts based on U.S. equities was suspended until the reopening of the underlying stock markets.

All clearing organizations for the futures exchanges and the banks that they utilize were prepared to function as soon as the exchanges reopened. Clearing operations were fully successful upon this resumption of trading. Virtually all reporting firms (futures commission merchants, clearing members, and foreign brokers) that are required to submit large trader data to the CFTC were able to do so as soon as trading activities resumed. This was accomplished through either their main computing facilities or backup locations. The CFTC’s market surveillance large trader automated computer system was not disabled in any way.

Preparedness Efforts

The firms, clearinghouses, exchanges, and industry associations that make up this important industry had in place prior to the terrorist attacks a variety of preparedness measures and contingency plans for disaster recovery and business continuity. This catastrophic event produced an unprecedented opportunity for those plans and preparations to be tested and, as it turned out, some organizations were better able to withstand and recover from the disruption. Those plans and measures that proved most effective in preparing certain market participants to better handle this disaster can and should be held up as benchmarks and guidance for others as the industry seeks to prepare itself, as it must, for disasters that it hopes never to face.

The CFTC, like other institutions, learned much about the adequacy of its own contingency plans on September 11th. The Commission had in place a Market Disruption Contingency Plan setting forth procedures to implement and relevant information to collect in the event of extreme market volatility, financial emergency, or disruption to physical or electronic facilities. During a period of such disruption, designated staff were responsible for: (i) collecting and analyzing information from various markets, market participants, and different self-regulatory organizations; (ii) communicating information to the Commission concerning market events and conditions and possible regulatory responses; and (iii) disseminating information and regulatory responses to markets, market participants, regulatory and self-regulatory organizations, other federal financial regulators, Congress, and the public.

The appropriate regulatory responses under the Plan vary from one market event to another but fall broadly into the categories of: identification and oversight of market moves, “first day” responses, subsequent follow-up and intensified oversight, and responses to particular market-related emergencies (such as the distress of a financial institution, physical emergencies, and major system malfunctions). In addition, the Commission prepared itself for potential problems connected with the Year 2000 date rollover by developing contingency plans focused on failures in building infrastructure services and mission-critical information systems.

It is fair to say, however, that neither the Market Disruption Contingency Plan nor the Commission's Y2K contingency plan contemplated the scope of disaster experienced on September 11th, which included the destruction or dislocation of two major exchanges and numerous trading firms combined with the destruction of a regional office of the Commission itself. Accordingly, the Commission, like many market participants, must now undertake a strategic review of every facet of its preparedness and contingency plans, both in terms of disaster recovery and business continuity. From instituting better backups of data and more complete archiving of institutional knowledge, to enhancing organizational flexibility and responsiveness in times of crisis, the Commission faces the challenge of ensuring the effective survival of its abilities to fulfill its core mission and accomplish its public policy goals.

Moving Forward … What's the Next Step?

The Commission believes that it is appropriate to continue to solicit the views of market participants, both individually and through their associations, to determine whether and how to best encourage the development of guidance, standards, or best practices in the areas of disaster preparedness, disaster recovery, and business continuity. Invaluable insights have been gained in the Commission's initial outreach efforts through the DRBC surveys and the November 2001 Technology Advisory Committee meeting. In addition to those discussed above, these insights have included the following observations, many of which were received from market participants directly involved in the New York recovery efforts:

- Every single aspect of operational needs (including, without limitation, electricity, water, natural gas, fuel oil, telecommunications, personnel transport, food and drinking water provision) must be considered in emergency planning efforts or critical dependencies will be missed (e.g. having electricity for computers but not being able to run air conditioning systems to maintain safe computer operating temperatures);
- Feasibility of backup operations should be confirmed in advance to avoid legal or regulatory impediments (e.g. special air quality permits that might be required for the sustained operation of diesel generators);
- Communication protocols among staff, with regulators and other government authorities, with other organizations on whom an organization depends for mission critical functions, and even the media must be planned and tested exhaustively;
- It is not enough for key staff to understand the organization's own contingency plans, they must also understand the contingency plans of other organizations with whom important business relationships exist;
- People are an organization's most valuable asset and contingency plans must include providing staff (and relevant market participants such as traders) with the means to reach the organization, giving them the tools they need, and making sure they are safe, secure, and comfortable (for example, staff and market participants expected to use a backup trading facility should have phone numbers, driving directions, mass transit options, parking alternatives, restaurant recommendations, and so forth);

- Regular testing is essential to successful implementation of contingency plans when needed (for example, NYBOT conducted quarterly tests up to July 2001);
- Regular backups should mirror every aspect of an organization's systems; and
- Telecommunications dependencies must be scrutinized for single points of vulnerability.

As one possible avenue for continued cooperation, the Institute for Financial Markets (IFM) has offered to evaluate issues surrounding the promulgation of guidance on coordinating disaster recovery plans among different institutions, an area of preparedness whose importance was emphasized by the ripple effect of the attacks across institutions that routinely rely on one another in the performance of mission-critical functions. Such an effort -- led by the IFM, for example, in cooperation with other market participants -- could take whatever form those participants believe will be most effective in identifying challenges, approaches, and solutions.

Some of the areas in which such efforts may yield substantial benefits include:

- communications, both telephonic and internet-based;
- backup facilities, both for computers and key operations such as trading;
- protocols and up-to-date information to support communications within and across institutions, firms, and regulators during a crisis;
- support services, such as access to power and water needed to sustain operations; and
- effective access to government authorities (at local, state, and federal levels).

The relative priority of each area, appropriate participants in such efforts, and suggestion of other areas of fruitful cooperation will be the subject of intra-industry and industry-regulator dialogue.

It is also important to emphasize that the scope of analysis undertaken in consideration of these preparedness issues should not be limited only to terrorist threats. Other types of catastrophe could threaten the stability of the futures and option markets. Thus, the scope of analysis should include, at a minimum, consideration of:

- natural disasters, such as floods and earthquakes that affect multiple entities;
- failures in the telecommunications infrastructure;
- other types of infrastructure failure, such as massive or prolonged power outages;
- the bankruptcy or other collapse of a key institution, particularly one that creates a ripple or "domino" effect on other market participants; and
- fraud or other malfeasance on a sufficiently large scale to undermine the credibility of one or more key markets or market participants.

In all such analyses, two overriding factors should be kept in mind: the continuing globalization of the markets and, again, the critically important but not always obvious interconnections among entities that present the threat of network failures in mission-critical functions.

The Commission hopes that its report (*full version available at www.cftc.gov)* will be helpful, both as an analysis of the events on and after September 11th and in planning for the future. The Commission looks forward to working, both internally and with market participants, to build upon the successes witnessed last year as contingency plans were put into action. We must all realize that these measures can and should be continuously improved and the lessons learned thus far will improve our ability to do so. Though we hope never to again face such a tragedy, it is nonetheless incumbent upon each of us to do our very best to prepare this sector of the financial system to recover promptly from adversity and to continue to perform its critically important role in the economy.