



CFTC MISSION

TO PROTECT MARKET USERS AND THE PUBLIC FROM FRAUD, MANIPULATION, ABUSIVE PRACTICES AND SYSTEMIC RISK RELATED TO DERIVATIVES THAT ARE SUBJECT TO THE COMMODITY EXCHANGE ACT, AND TO FOSTER OPEN, COMPETITIVE, AND FINANCIALLY SOUND MARKETS.



A MESSAGE FROM THE CHAIRMAN

I am pleased to present the Agency Financial Report for Fiscal Year 2012. It chronicles a critical time in the history of the Commodity Futures Trading Commission (CFTC or Commission), a year of transition and real progress toward ensuring that the futures and swaps markets are transparent and work for the American public.

THE NEW ERA OF SWAPS MARKET REFORM

This past year has been a very active year for the CFTC. We have made significant progress in bringing comprehensive oversight to the once opaque swaps market.

The swaps marketplace had operated without the basic transparency and common-sense reforms of the financial markets that Americans have benefitted from since the 1930s.

Those historic reforms put in place in the aftermath of the Great Depression established a foundation of transparency, competition and market integrity for the futures and securities markets. This democratization of our financial markets has led to many decades of economic growth and innovation.

The 2008 financial disaster caused great damage. Eight million American jobs were lost, millions of Americans lost their homes, and thousands of businesses closed their doors.

In response, Congress and the President borrowed from what has worked best in the futures markets in passing the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).





U.S. President Barack Obama, right, speaks in the Rose Garden of the White House with Timothy F. Geithner, U.S. treasury secretary, center, and Gary Gensler, chairman of the Commodity Futures Trading Commission (CFTC), in Washington, D.C., U.S., on Tuesday, April 17, 2012. Obama urged Congress to bolster federal supervision of oil markets, including bigger penalties for market manipulation and greater power for regulators to increase the amount of money traders must put up to back their energy bets.

(Photo by Andrew Harrer/Bloomberg via Getty Images)

The CFTC is now close to completing the Dodd-Frank rule set with 41 finalized rules of the road for the swaps market. Last month, at the start of Fiscal Year 2013, the new era of swaps market reform began.

Also of note, the CFTC finished an agency-wide reorganization in Fiscal Year 2012.

As we begin 2013, the agency is increasingly shifting to the implementation of rules, as well as the direct oversight of the swaps market. We will require the necessary resources to oversee this vast market.

Given this new era of swaps market reform, it's the natural order of things that market participants have questions and have sought further guidance. This regularly occurs as we move to market implementation from congressional legislation and agency rulemaking.

We welcome inquiries from market participants. My fellow commissioners and I, along with the CFTC staff, are all committed to sorting through issues as they arise. Fine-tuning is expected.

The CFTC also will continue to consult broadly on appropriately phasing in compliance. The Commission has included phased compliance schedules within many of our rules. Extensive information on the compliance schedule for each of the CFTC's reforms is available on our website.

I believe it's also critical that we continue our efforts to put in place aggregate position limits across futures and swaps, as Congress directed the CFTC to do.

PROMOTING TRANSPARENCY

Dodd-Frank reforms are bringing needed transparency to the swaps market.

Transparency lowers costs for investors, consumers and businesses. It increases liquidity, efficiency and competition. And it shifts some of the information advantage from swap dealers to businesses across the country that use these markets to lock in a price or rate and hedge a risk.

In 2012, the agency completed significant transparency rules and bright lights have begun to shine on the swaps market. Swaps transactions are being reported to regulators through swap data repositories. The public also will benefit from real-time reporting of the price and volume of transactions beginning in 2013, based on the CFTC's completed rules. Regulators and the public will have their first full window into the swaps marketplace.

In addition, the CFTC will initiate a new weekly report so that the public can benefit from seeing aggregate data in the swaps market. This week, the CFTC put out to public comment the first draft proposal of this report. For years, the public has benefited from the futures market data we have published in our weekly Commitment of Traders reports, and our goal is to provide similar transparency to the public for the swaps market. After reviewing the public input, we intend to issue this swaps data regularly in 2013.

In the coming months, the CFTC is working to finalize reforms that promote pre-trade transparency, including rules on minimum block sizes and trading platforms called swap execution facilities. Market participant compliance for these rules will be phased throughout 2013.

LOWERING RISK AND DEMOCRATIZING THE MARKET THROUGH CLEARING

Another significant Dodd-Frank reform is bringing swaps into central clearing, which will lower the risk of the highly interconnected financial system.

For over a century, through good times and bad, central clearing in the futures market has lowered risk to the broader public.

Central clearing also equalizes access to the market and democratizes it by eliminating the need for market participants to individually determine counterparty credit risk, as now the clearinghouse stands between buyers and sellers.

In 2012, the CFTC largely finished the clearing rule set. Clearinghouses have adopted risk management reforms, including critical customer protection enhancements. The so-called "LSOC rule" (legal segregation with operational comingling) for swaps prevents clearing organizations from using the collateral attributable to cleared swaps customers who haven't defaulted to cover losses of defaulting customers. In addition, clearinghouses have to collect margin on a gross basis.

To complete the process of bringing swaps into central clearing, the Commission is working to finalize the initial set of clearing determinations regarding which interest rate swaps and credit default swap indices should be required to be cleared. This would lead to required clearing by swap dealers and the largest hedge funds as early as February 2013. Compliance would be phased in for other market participants through the summer of 2013.

In 2013, the CFTC also will be considering possible clearing determinations for physical commodity swaps.

LOWERING RISK THROUGH SWAP DEALER OVERSIGHT

Dodd-Frank reform also means comprehensive oversight of swap dealers, which will lower their risk to the rest of the economy.

As the result of CFTC rules completed in 2012, swap dealers have begun the process of registering and, for the first time,

will come under comprehensive regulation. We anticipate many dealers will register in early 2013.

Once registered, swap dealers will report their trades to both regulators and the public. In addition, they will implement crucial back office standards that lower risk and increase efficiency. Swap dealers also will be required to implement sales practices that prohibit fraud, treat customers fairly, and improve transparency.

Moving forward, in consultation with international regulators, the CFTC will move to finalize guidance on the cross-border application of swaps market reform and an accompanying release on phased-compliance for foreign swap dealers.

The CFTC also is collaborating on a global approach to margin requirements for uncleared swaps through the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO).

I would anticipate the CFTC, in coordination with domestic prudential regulators and international regulators, would take up the final rules on margin in 2013, so as to benefit from this international work.



WASHINGTON, D.C. - JULY 18: Federal Reserve Board Chairman Ben Bernanke (2nd L) speaks as (L-R) Chairman of the Commodity Futures Trading Commission Gary Gensler, U.S. Secretary of the Treasury Timothy Geithner, and acting chairman of the Federal Deposit Insurance Corporation Martin Gruenberg listen during a meeting of the Financial Stability Oversight Council (FSOC) July 18, 2012 at the Treasury Department in Washington, D.C. Members of FSOC voted during the meeting on a report to Congress regarding a study of contingent capital required by the Dodd-Frank Act, and also voted on the Council's annual report. (Photo by Alex Wong/Getty Images)

Once these margin rules as well as related rules on capital are completed, I would envision that compliance for market participants would be phased in throughout 2013.

CUSTOMER PROTECTION

Segregation of customer funds is a core foundation of customer protection in both the futures and swaps markets.

The CFTC in Fiscal Year 2012 completed a number of important reforms to enhance the protection of customer funds. These include the completed amendments to rule 1.25 regarding the investment of customer funds, as well as the LSOC and gross margining rules.

The Commission also worked closely with market participants and self-regulatory organizations (SROs) on new rules for customer protection at the National Futures Association (NFA). These include requiring Futures Commission Merchants (FCMs) to hold sufficient funds in Part 30 secured accounts (funds held for U.S. foreign futures and options customers trading on foreign contract markets) to meet their total obligations to customers trading on foreign markets computed under the net liquidating equity method. In addition, FCMs must maintain written policies and procedures governing the maintenance of excess funds in customer segregated and Part 30 secured accounts. Withdrawals of 25 percent or more would necessitate pre-approval in writing by senior management and must be reported to the designated SRO and the CFTC.



Gary Gensler, chairman of the U.S. Commodity Futures Trading Commission (CFTC), speaks at the Securities Industry and Financial Markets Association (SIFMA) annual meeting in New York, U.S., on Tuesday, Oct. 23, 2012. Swaps market participants will have a grace period before trades are required to be cleared, settling confusion over a rule that will begin early next year, said Gensler. (Photo by Peter Foley/Bloomberg via Getty Images)

These steps were significant, but market events this year have further highlighted that the Commission must do everything within our authorities and resources to strengthen oversight programs and the protection of customers and their funds.

In the fall of 2012, the Commission sought public comment on further enhancements to protect customer funds.

This proposal is about ensuring customers have confidence that the funds they post as margin or collateral are fully segregated and protected.

It is the direct result of significant input from the public and market participants that the CFTC gathered throughout 2012, working with the Futures Industry Association, the NFA and the self-regulatory organizations.

The proposal, which the CFTC looks forward to finalizing in 2013, would strengthen the controls around customer funds at FCMs. It also would set new regulatory accounting requirements that would provide stronger protections for customer money held by FCMs and would raise minimum standards for independent public accountants who audit FCMs. And it would provide regulators with daily direct electronic access to FCMs' bank and custodial accounts for customer funds.

BENCHMARK INTEREST RATES

In 2012, the CFTC brought the most significant case in our history against Barclays for attempting to manipulate the London Interbank Offered Rate (LIBOR) and violating the Commodity Exchange Act's false reporting provision.

Looking forward to 2013, one of the most critical challenges for the markets, international regulators and the CFTC is how to best ensure benchmark rates, such as LIBOR, are honest and reliable.

As they are a key component of our financial markets, they must work for the rest of the economy. LIBOR is the reference rate for nearly half of U.S. adjustable-rate mortgages; for about 70 percent of the U.S. futures market; and for a majority of our swaps market.

I believe for a benchmark rate for any commodity or swap to be reliable and have integrity, it's best to be anchored in real, observable transactions.

When market participants submit for a benchmark rate that lacks observable underlying transactions, even if operating in

good faith, they may stray from what real transactions would reflect. When a benchmark is separated from real transactions, it is more vulnerable to misconduct.

The underlying market for interbank transactions in London, however, has largely diminished.

The CFTC is consulting with a number of international organizations with regard to next steps for benchmark rates. In particular, the UK Financial Services Authority (FSA) and the CFTC are co-chairing the IOSCO task force plans to seek public consultation hopefully starting in December 2012. This will include a public roundtable and culminate in a report and recommendations in the spring.

The IOSCO task force will be seeking public input on best practices that should apply to the benchmark process and entities that produce benchmarks, as well as possible mechanisms and protocols that would best ensure for a smooth transition to new benchmarks when and if needed.

RESOURCES

As the CFTC moves from finalizing Dodd-Frank reforms to implementing them, the agency needs additional resources consistent with the agency's expanded mission and scope.

At 703 on board staff at the start of Fiscal Year 2013, the CFTC's hardworking staff is just 10 percent more in numbers than at our peak in the 1990s. The futures market has grown more than five-fold since that time, and the swaps market is eight times larger than the futures market.

Given this reality, the President requested \$308 million to fund 1,015 full time employees and a much-needed increase in technology for Fiscal Year 2013. Under the most recent continuing resolution, the agency was funded at a rate of \$206.6 million.

With an expanded mission due to the Dodd-Frank mandate, the CFTC completed an agency reorganization in Fiscal Year 2012. This includes a new division for oversight of swap dealers and intermediaries and a reorganization of our critical technology programs.

The CFTC places a strong emphasis on being an effective steward of its operating funds. I am pleased that for the eighth consecutive year, the Commission has received an unqualified opinion on its financial statements. For the sixth consecutive



Futures Trading Commission Chairman Gary Gensler (R) answers questions from senators while testifying with Securities and Exchange Commission Chairman Mary Schapiro before the Senate Banking, Housing and Urban Affairs Committee about derivatives reform in the Dirksen Senate Office Building on Capitol Hill May 22, 2012 in Washington, D.C. The committee questioned the regulators about 'reducing systemic risk and improving market oversight' in the wake of the Dodd-Frank Act. (Photo by Chip Somodevilla/Getty Images)

year, the auditors disclosed no material instances of noncompliance with laws and regulations. I can also report that the CFTC had no material internal control weaknesses and that the financial and performance data in this report are reliable and complete under Office of Management and Budget guidance.

CONCLUSION

The 1930s reforms brought light to the securities and futures markets, helping to promote decades of economic growth and are at the core of our strong capital markets.

The swaps market reforms that are being implemented hold out similar potential. Bright lights of transparency will shine, dealers will come under comprehensive regulation and standardized swaps between financial entities will be centrally cleared.

The public will benefit and our markets will be stronger in this new era.

Gary Gensler
November 15, 2012