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Office of the
Inspector General

MEMORANDUM

TO: Gary Gensler
Chairman

FROM: A. Roy Lavik ARL
Inspector General

DATE: November 10, 2010

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 more meaningful and useful format for Congress, the President, and the public, through publication of the Performance and Accountability Report (PAR). 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, all for inclusion in the PAR. 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 have relied on data contained in the CFTC financial statement audit and PAR, as well as 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:

- Implementation of the Dodd-Frank Act

- Human Resource Expansion and Management

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 2010 financial statement audit are discussed in the PAR, and the financial statement audit resulted in an unqualified audit opinion.

CFTC's Progress on Last Year's Challenges

Last year, we identified three most serious management challenges:

- Harmonization of CFTC and Securities and Exchange Commission (SEC) Overlapping Regulations;

- CFTC's Regulatory Model for the Swaps Derivatives Market; and,

- CFTC's Regulatory Responsibilities over the Potential Carbon Emission Trading Markets.

CFTC made progress on all three challenges.

Harmonization of CFTC and Securities and Exchange Commission (SEC) Overlapping Regulations. On June 17, 2009, the White House released a White Paper on Financial Regulatory Reform calling on the SEC and CFTC to 'make recommendations to Congress for changes to statutes and regulations that would harmonize regulation of futures and securities.' Specifically, the White House recommended 'that the CFTC and SEC complete a report to Congress by September 30, 2009, that identifies all existing conflicts in statutes and regulations with respect to similar types of financial instruments and either explains why those differences are essential to achieve underlying policy objectives with respect to investor protection, market integrity, and price transparency or makes recommendations for changes to statutes and regulations that would eliminate the differences.

The CFTC jointly with SEC issued a substantial Harmonization Report in October 2009, identifying areas where the respective regulatory regimes for futures and securities could be better aligned to streamline the regulation of novel derivative products and to avoid duplicative regulation. In November 2009, CFTC and SEC issued two joint orders to clarify their respective jurisdiction with respect to certain security index products and to allow additional products to underlie security futures products. Most of the statutory recommendations set forth in the October 2009 Report were included in the Dodd-Frank Act, and the agencies are now proceeding to implement those new authorities.

CFTC's Regulatory Model for the Swaps Derivatives Market. In 2009, we believed that both the intricacies of any forthcoming derivatives regulation and the acquisition of human capital to carry out the regulatory tasks would challenge the CFTC in the coming year. The Commission employed 605 FTE in FY 2010, up from 498 FTE in FY 2009. The Commission requested in the President's FY 2011 Budget, 745 FTE for pre-Dodd-Frank Authorities and 119 FTE to implement Dodd-Frank authorities, for a total of 864 FTE. The Commission states in order to be as timely and substantively prepared as possible to meet the needs of the Human Capital requirements of the Dodd-Frank Act, it has:

- Engaged all offices to identify and implement business process changes that will shorten the time to hire new staff;
- Granted Divisions and Offices FTE ceilings that allow them to identify priority hires and make selections according to their greatest needs;
- Considered recruitment alternatives, such as combining vacancy announcements and making multiple selections if applicants are of high quality;
- Built on past cooperative efforts to target underrepresented groups, to continue and enhance diversity recruiting for its workforce; and,
- Developed a process to ensure it identifies detailed job requirements as quickly as possible as it implements financial reform legislation to guide the content and tactics of the recruiting actions.

CFTC's Regulatory Responsibilities over the Potential Carbon Emission Trading Markets. Anticipated legislation regulating carbon emission trading and assigning regulatory duties to the Commission did not materialize. On June 26, 2009, the House passed the American Clean Energy and Security Act—H.R. 2454—that set forth new legislation to regulate carbon emission trading; however, the Senate did not act on this proposed legislation. The Dodd-Frank Act requires the Commission to lead an interagency working group tasked with organization and completion of a study of regulatory oversight of potential carbon markets, with a report due to Congress in January 2011. Staff convened the interagency group and began work on the study. This forthcoming study may also address issues identified by the Government Accountability Office (GAO) in their report issued on August 19, 2010 regarding *Carbon Trading: Current Situation and Oversight Considerations for Policymakers,* GAO-10-851R.

Most Serious Management Challenges

Two issues that are likely to challenge the CFTC in the coming year are:

Implementation of the Dodd-Frank Act

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub. L. 111-203, 124 Stat. 1376 (2010). Title VII of the Dodd-Frank Act amended the Commodity Exchange Act (CEA) to establish a comprehensive new regulatory framework for swaps and security-based swaps. In order to enact the Dodd-Frank Act, the Commission has identified 30 areas where rules will be necessary. Many of these rules will require or result in cooperative efforts with the Securities and Exchange Commission or other federal agencies. In addition, the Dodd-Frank Act calls for numerous studies and other undertakings by the Commission, some also with cooperation from other agencies. The Commission recognizes that many of the new rules required under Dodd-Frank must be adopted within 180 days. The magnitude of this undertaking under a compressed timeline during FY 2011 presents a serious management challenge.

Human Resource Expansion and Management

The Commission's new responsibilities under Dodd-Frank significantly increased its workload. By the end of fiscal year 2010, the Commission had on-board 687 employees, which is 58 below the 745 FTE CFTC requested to carry out our pre-Dodd-Frank authorities. To fully implement the Dodd-Frank reforms, the Commission states it requires an additional 398 FTEs. Rather than 398, the President's FY 2011 Budget provided for hiring only 238 additional positions. CFTC is requesting an additional 160 FTEs for FY 2012 to staff areas of critical need. However, the current budgetary limits imposed by the government-wide continuing resolution will significantly impact the CFTC's ability to hire any additional employees during FY2011. Should Congress lift the continuing resolution, the CFTC will need to dramatically expand its Human Resource function to meet and manage the CFTC's need for additional staff and training to address the requirements of Dodd-Frank Act. We view the possibility of a rapid and dramatic increase (35% staff increase in FY11) in new employees to address new rules over newly regulated markets, such as swaps, a significant management challenge during Fiscal Year 2011.