




U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of the
Inspector General

MEMORANDUM

TO: Timothy Massad
Chairman

FROM: A. Roy Lavik 
Inspector General

DATE: November 17, 2014

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)¹ 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.² 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 Fiscal Year 2015, the most serious management challenge is:

¹ Public Law 106-531, sec 3, 114 STAT. 2537 (Nov. 22, 2000), *codified at* 31 USC § 3516(a).

² *Id.*

- For the CFTC to deliver on Congressional expectations embedded in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)³, including expansion of the CFTC’s regulatory footprint to the swaps markets, while adhering to government-wide budgetary constraints.

CFTC Financial Statement Audit Results

In accordance with the *Accountability of Tax Dollars Act*,⁴ 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.⁵ The results of the Fiscal Year 2014 financial statement audit will be discussed in the Annual Financial Report (AFR), and the financial statement audit resulted in an unmodified audit opinion.

CFTC’s Progress on Last Year’s Challenges

Last year’s OIG identified management challenge remains relevant for this year and the near future and, possibly, more acute under a government wide continuing resolution⁶; although, CFTC has significantly addressed congressional expectations embedded in the Dodd-Frank Act.⁷ Since July 21, 2010, when President Obama signed the Dodd-Frank Act into law, CFTC has completed over 80%⁸ of the rules mandated by the Dodd-Frank Act. Consequently, the agency is now focused on implementing, refining, and ensuring industry compliance with fifty new Dodd-Frank Act related rules now in place. Nonetheless, stakeholders will continue to expect the agency to meet its regulatory oversight responsibilities by continually improving its information technology infrastructure⁹ for receiving regulatory compliance related data¹⁰ as well as swap transaction data¹¹. Collecting and evaluating swaps market data will enable CFTC to

³ Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010)

⁴ Public Law 107-289, 116 STAT. 2049, Nov. 7, 2002, *codified at* 31 USC 3501 note

⁵ The IG’s authority is found at § 304 of the CFO Act, P.L. 101-576, 104 STAT.2852, Nov. 15, 1990, *codified at* 31 USC 3521(e)

⁶ See Public Law 113-164 The Continuing Appropriations Resolution provides continuing FY2015 appropriations to federal agencies until December 11, 2014, or enactment of specified appropriations legislation

⁷ See CFTC press release: PR6853-14 CFTC Announces Measures to Promote Trading on Swap Execution Facilities and Support an Orderly Transition to Mandatory Trading. Mandatory trading of swaps on Swap Execution Facilities (SEF) began for certain interest rate swaps on February 15, 2014.

⁸ OIG calculation (50 out of 60 = 80%) Dodd-Frank mandated rules. See Speech of Commissioner Sharon Bowen before the Futures Industry Association Expo 2014 November 5, 2014 paragraph 7.

⁹ Virtually all communication with industry participants is in electronic form. Therefore efficient use of information technology resources is fundamental to the operations of the CFTC. That is why OIG identified management challenges reflect this fact. See Fiscal Year 2009, 2011, and 2012 IG management challenge letter.

¹⁰ Regulation 23.600(c) (2) (ii) requires that Swap Dealers (SD) and Major Swap Participants (MSP) furnish risk exposure reports to the Commission. On March 22, 2013, the Commission implemented a web based portal to facilitate the furnishing of risk exposure reports to the Commission by SDs and MSPs.

¹¹ See Remarks of Timothy G. Massad before the Swaps Execution Facilities Conference (SEFCON V) November 12, 2014, paragraph 8 “We also have four swap data repositories provisionally registered, collecting and disseminating market data. This is a work in progress, but today we and the public have much more information regarding the swaps marketplace, enabling more competition and better oversight.”

continue to restore confidence in all aspects of the commodities and swaps derivatives markets post 2008¹² market events.

As an independent sentinel, the OIG is committed to monitoring continuously CFTC's response to stakeholders such as Congress. During the 2014 calendar year my staff completed three performance audits¹³ directly in line with congressional expectations embedded in the Dodd-Frank Act, sensitive to stakeholders' interests, and consistent with our oversight responsibilities for evaluating aspects of the CFTC's strategic plan for FY2011-FY2015. Along with our statutory responsibilities for conducting annual audits of the CFTC's financial statements the OIG audits relevant to last year's management challenges and supportive of our understanding of CFTC's operations executed during calendar year 2014 were:

1. *Performance Audit-Management's Use of Information Technology Resources in Support of its Strategic Plan and Regulatory Responsibilities.*

Starting in fiscal year 2011, Congress designated specific spending levels for information technology at the CFTC. Our audit objective for undertaking this audit was to ascertain how the agency allocated congressionally designated funds for information technology. We examined Office of Data and Technology (ODT) spending on information technology during fiscal year 2011 and 2012 and, for the first time, we were able to evaluate FY2013 ODT spending allocations and found that ODT spent 50% of funds on software licenses and staff augmentation and 50% on software modernization and surveillance enhancements. Furthermore, we examined the largest contracts entered into by ODT that accounted for 49% of ODT spending in FY2013 and found ODT monitored vendors and their deliverables under the contracts. In the coming years as additional funds are appropriate for ODT we will evaluate their spending to ensure that congress and taxpayers expectations are efficiently and effectively address.

2. Recent market disruptions by MF Global Inc. and Peregrine Financial Group Inc. exposed management control weakness at some Futures Commission Merchants (FCM). The CFTC has regulatory oversight responsibilities for FCMs. Consequently, we sought to identify and evaluate the process CFTC employs for monitoring and reviewing financial statements of FCMs and Retail Foreign Exchange Dealers (RFEDs) and assess the agency's procedures for evaluating financial information received as well as evaluating reporting firm's regulatory compliance reports to the CFTC regarding their separation of customers' funds from individual firm's capital. The audit team selected a statistical sample of firms and found that the CFTC, an oversight regulator, complied with its policies and procedures for reviewing financial information received over the

¹² See Opening Statement of Chairman Timothy G. Massad, Open Meeting on Proposed Rule on Margin Requirements for Uncleared Swaps and Final Rule on Utility Special Entities paragraph 2: "It was six years ago—September 16, 2008—when our government was required to step in and prevent the failure of AIG, which was on the brink of collapse because of excessive swap risk, a collapse that could have thrown our nation into another Great Depression."

¹³ The OIG contracted with independent public accounting (IPA) firms to conduct each audit and the OIG monitored conduct of all performance audits performed by the IPA.

three year period examined (FY2011 through FY2013). Following is a link to the final audit report¹⁴.

During FY2014 CFTC enhanced its regulatory requirements to address concerns emerging from the two FCM related events mentioned above. CFTC's regulatory footprint in this area continues to grow. Today there are 105 swap dealers¹⁵ and 2 major swap participants provisionally registered, along with 22 swap execution facilities temporarily registered with the CFTC.¹⁶ Consequently, CFTC oversight of these entities will present a challenge for the agency during this ongoing period of budgetary constraints. We will monitor the agency's effectiveness in meeting its statutory responsibilities to stakeholders during the foreseeable period of austere budgets.

3. Finally, section 748 of the Dodd Frank Act¹⁷ amended the Commodity Exchange Act to establish a consumer education and outreach program funded from CFTC collected civil monetary sanctions, greater than one million dollars, imposed by individual judiciary decisions. During FY2014 the Customer Protection Fund (CPF, Fund) acquired over \$274.9 million in budgetary resources for use in addressing twin goals of increasing Customer Protection education and awarding payments to whistleblowers¹⁸ for actionable prosecutorial information.

My office decided to undertake a performance audit of *CFTC's Consumer Outreach Program's Efforts for Enhancing Awareness of Regulatory Resources and Protections Available to Commodity Market Users Against Fraud*.¹⁹ This audit of the three year old Customer Protection Fund sought to assess management's plans for addressing its mandate as stated in the Dodd-Frank Act. For congress and stakeholders we offered several recommendations for improving consumer outreach operations-management accepted the audit recommendations. My office continues to manage the annual financial statement audit of the Fund which separately provides all financial resources for consumer outreach and may revisit this critical operation so as to ensure that it continues to operate efficiently and effectively in addressing congressional intent codified in the Dodd-Frank Act.

¹⁴ Management Controls and Procedures for Evaluating Futures Commission Merchants' (FCM) and Retail Foreign Exchange Dealers' (RFED) Compliance with CFTC Financial Reporting Requirements Mandated by the Commodity Exchange Act and the Dodd Frank Act.

http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_auditreportp05.pdf

¹⁵ Data as of 11-3-14 <http://www.cftc.gov/LawRegulation/DoddFrankAct/registerwapdealer>

¹⁶ See Remarks of Timothy G. Massad before the Swaps Execution Facilities Conference (SEFCON V) November 12, 2014, paragraph 7 and 11

¹⁷ Public Law No. 111-203, § 748, 124 Stat. 1841 (2010)

¹⁸ Section 748 of the Dodd-Frank Wall Street Reform and Consumer Protection Act amended the Commodity Exchange Act ("CEA") by adding Section 23, entitled "Commodity Whistleblower Incentives and Protection." CEA Section 23 established a whistleblower program under which the Commodity Futures Trading Commission ("Commission") will pay awards, based on collected monetary sanctions and under regulations prescribed by the Commission, to eligible whistleblowers who voluntarily provide the Commission with original information about violations of the CEA that lead either to a "covered judicial or administrative action" or a "related action."

¹⁹ See audit report at: <http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oigocoaudit2014.pdf>

Results of these three audits and awareness of CFTC operations confirm our assessment of major near term management challenges for the CFTC.

Current and Future OIG audits

In the coming year my office plans to contribute meaningful independent analyses towards aiding the agency to explore solutions to its management challenges. Toward that goal my office has underway an audit to examine the agency's process for conducting Rule Enforcement Reviews (RER) of designated contract markets. We will evaluate staffing, frequency of audit, and management controls in the program office responsible for RERs which the CFTC identified in their FY2011-2015 strategic plan as a significant component of their strategic goal #1.²⁰ As we learn more about the agency's monitoring of designated contract markets we may further evaluate how the agency reviews designated contract markets cyber security efforts-a critical infrastructure. These audits along with our two financial statement audits, other program audits, and reviews provide us with valuable data for evaluating future challenges at the CFTC

Cc: Commissioners Wetjen, Bowen, and Giancarlo

²⁰ See CFTC Strategic Plan 2011-2015 goal 1 located at:
<http://www.cftc.gov/reports/strategicplan/2015/2015strategicplan0701.html>