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United States General Accounting Office
Washington, D.C. 20548

FOR RELEASE ON DELIVERY
Expected at 9:30 a.m.
March 2, 1982

Statement of
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Before the
Subcommittee on Agricultural Research and General Legislation
of the
Senate Committee on Agriculture, Nutrition, and Forestry
on the
Reauthorization of the Commodity Futures Trading Commission

Mr. Chairman and Members of the Subcommittee:

We welcome your invitation to be here today to discuss our recently completed review of the Commodity Futures Trading Commission.

In recent years the commodity futures industry has experienced dramatic growth. In the past 5 years futures volume has nearly tripled, from 37 million contracts to about 100 million contracts annually. The term "commodity" has come to embrace a variety of financial instruments including Government securities and certificates of deposit. Substantial trading in futures contracts for these commodities has developed. The expected proliferation and growth in trading of these instruments, as well as continued growth in agricultural and "natural resources"

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futures--such as petroleum products--will substantially increase the importance of futures in the national economy.

We have concluded that Federal programs protecting commodity futures customers should be reauthorized. The Commodity Futures Trading Commission, which is responsible for these programs, has made progress in developing a regulatory framework to protect futures markets and customers. The Commission's principal programs--including registration of commodities professionals, market surveillance, review of exchange rule enforcement, and reparations--should be retained and also improved to keep rapidly expanding trading reasonably free from abuse. Even if the futures industry assumes an increasing responsibility for regulation--and we concur in this objective--the Commission will need to continue to monitor the performance of industry self-regulatory bodies.

CONGRESS NEEDS TO AMEND THE COMMODITY
EXCHANGE ACT TO FACILITATE SHIFT
IN REGULATORY RESPONSIBILITIES

In reauthorizing the Commission's programs, the Congress should encourage a shift in regulatory responsibilities through amendments to the Commodity Exchange Act. The Commission maintains a program for registering futures professionals. We believe the newly created National Futures Association should assume many of these responsibilities, allowing the Commission to confine itself more strictly to an oversight role in this area.

To assist this transfer, the Congress needs to amend the act to authorize the Association to register all futures professionals, including Futures Commission Merchants, Commodity Trading Advisors, Commodity Pool Operators, and Floor Brokers; screen them through appropriate fitness checks, including fingerprinting; test them

for proficiency in futures trading; and allow professionals to appeal Association registration decisions to the Commission.

As self-regulatory organizations, commodity exchanges conduct market surveillance to detect adverse market situations such as price manipulations as they develop and to prevent disruption of the markets. Futures traders' position data presently collected by the Commission is often more detailed than that collected by many exchanges. To increase the ability of exchanges to conduct market surveillance, the Congress should amend the act to allow for the flow of this information to the exchanges on a routine basis.

CFTC MUST INCREASE THE EFFECTIVENESS
OF INDUSTRY SELF-REGULATION AND ITS
REGULATORY APPROACHES

Extensive reliance on exchange self-regulation to preserve the integrity of markets and to protect the rights of market participants has been a prominent feature of futures regulation since well before the 1974 amendments which created the Commission. We believe the Commission must improve the effectiveness of industry self-regulation as well as its own regulatory programs. Our review has identified a number of essential improvements.

The Commission's rule enforcement review program, its principal tool for monitoring enforcement by the exchanges of their own rules, needs strengthening. The reviews tend to concern themselves with whether essential self-regulatory machinery is in place, rather than how well it is working. Moreover, the Commission needs to develop improved evaluation criteria, to guide exchange self-regulatory efforts as well as to assist the Commission's assessment of exchange self-regulation.

To promote the efficient functioning of futures markets, the Commission reviews and approves futures contracts before they can be traded. The agency needs to make its criteria for contract approval more explicit and meaningful. For example, the agency should amend its criteria to require exchanges to collect additional economic data to demonstrate that a proposed contract can reasonably be expected to serve a price discovery or risk shifting (hedging) function. The Commission also needs to adopt procedures which will streamline the approval process.

The Commodity Exchange Act specifies that contracts, once approved, must continue to meet initial approval requirements. The Commission has not given this area sufficient attention. The Commission needs to undertake a systematic review of existing contracts to determine whether they actually provide for price discovery or risk shifting and protect against price manipulation and market congestion.

Moreover, the Commission has yet to tie its approval of trading in proposed contracts at a particular exchange to the results of the rule enforcement reviews it conducts at the exchange, as authorized by the act. Making contract approvals contingent on adequate rule enforcement would encourage the exchanges to enforce their own rules more effectively.

The Commission's contract approval, in effect, licenses an exchange to carry on a business activity. Consequently, the exchanges derive considerable benefits from the approval of proposed contracts. We propose that the Commission assess a one-time fee to defray the appropriate costs of contract approval.

IMPROVED PROTECTION OF FUTURES CUSTOMERS

To assure that futures customers are protected in their dealings with commodity professionals, and assure a minimum level of competence, the Commission should improve its registration program by (1) requiring the registration of sales and supervisory personnel of Commodity Trading Advisors and Commodity Pool Operators, (2) implementing a "sponsorship" program for associated persons by Futures Commission Merchants, (3) initiating fingerprinting of applicants for registration, (4) periodically checking the fitness of registrants, and (5) establishing proficiency testing. The Commission also needs to do a better job of planning for the assumption of registration functions by the National Futures Association.

The Commission has overall responsibility for ensuring that commodity customer funds are properly safeguarded. The Commission needs to place greater emphasis on providing additional guidance to exchanges and independent public accountants who are also responsible for auditing industry participants.

The Commission's reparations program--a forum for resolving disputes between commodity customers and industry professionals--is not meeting its objectives. The Commission needs to simplify its rules and procedures. The Commission should also take steps to make arbitration a more attractive and effective alternative to reparations.

A considerable burden can be shifted from the reparations program by removing certain limitations to increased use of arbitration. To increase the potential for use of arbitration, the Congress should raise from \$15,000 to \$25,000 the dollar limit for

claims that customers can compel exchange members or members of the National Futures Association to arbitrate. To resolve the issue of the availability of Federal court litigation, the Congress needs to clarify its intent regarding whether customers have a private right of action to adjudicate commodity-related claims in Federal court.

CFTC SHOULD IMPROVE EFFICIENCY THROUGH
BETTER USE OF AUTOMATIC DATA PROCESSING

To keep abreast of a rapidly expanding futures industry and to enhance the effectiveness of its regulatory programs, the Commission needs to improve its use of automatic data processing. This need is greatest in tracking and analyzing the futures positions of large traders to identify possible manipulations, corners, or other situations affecting market integrity. The Commission needs to give the automatic data processing program overall direction as well as develop agency-wide standards to plan and control software development projects. Once needed improvements have been made, the Commission will need to make more effective use of automatic data processing in conducting market surveillance, managing the reparations program and supporting Commission operations generally.

While we propose improvements in a number of key regulatory functions, we believe that these improvements can be achieved largely through a shift of resources rather than through a significant increase in the Commission's budget. Furthermore, many of the actions we recommend, such as improved use of automatic data processing and transfer of selected regulatory functions to industry self-regulatory bodies, offer the potential for substantial long-term savings and streamlining of Commission operations.

In the short-run, improved planning and prioritization of Commission activities, as well as appropriate use of fees to recover a portion of the cost of Commission operations, offer additional ways to minimize the impact of needed improvements on the Federal budget.

That concludes my prepared statement. Our specific legislative proposals are attached as an appendix to my statement. We will be glad to respond to any questions.

PROPOSED AMENDMENTS TO
THE COMMODITY EXCHANGE ACT

To amend the Commodity Exchange Act to broaden the regulatory powers of the Commodity Futures Trading Commission and to authorize the delegation of various Commission responsibilities to registered futures associations.

Be it enacted by the Senate and the House of Representatives of the United States of America in Congress assembled,

Sec. 101: This act may be cited as the "Commodity Exchange Act Amendments of 1982."

Sec. 102: In order to authorize the Commodity Futures Trading Commission to delegate its registration functions set out in section 8a (1)-(4) of the Commodity Exchange Act, as amended, and to allow appeals to the Commission from decisions of registered futures associations, section 8a of the act is further amended by adding a new subsection (10) to read as follows:

"(10) to delegate to a registered futures association the registration functions listed in paragraphs (1) through (4) in accordance with rules approved by the Commission and subject to the procedural hearing requirements contained therein: provided, however, that any person subject to an adverse decision by a registered futures association may appeal such decision to the Commission who shall afford such person an opportunity for a hearing on the record."

Sec. 103: In order to authorize the Commodity Futures Trading Commission or its designee to establish examination standards for commodity trading advisors and commodity pool operators, section 4p of the Commodity Exchange Act, as amended, is further amended by inserting the phrase "commodity trading advisors, commodity pool operators," before the phrase "futures commission merchants, floor brokers, and those persons associated with futures commission merchants or floor brokers" where it appears in the first, second, and third sentences thereof; and by inserting the phrase "commodity trading advisors and commodity pool operators" at the end of the fourth sentence thereof.

Sec. 104: In order to clarify section 17 of the act, to expressly authorize a registered futures association to collect the fingerprints of its members, and to submit those fingerprints

to the FBI, section 17(b)(4)(E) of the act, as amended, is further amended by adding at the end thereof the following:

"* * *, which may require the applicant to be fingerprinted and to submit, or cause to be submitted, such fingerprints to the Attorney General for identification and appropriate processing."

Sec. 105: [Should the Congress decide to provide aggrieved commodity purchasers an explicit cause of action against commodity professionals who violate provisions of the act,] section 14 of the act, as amended, is further amended by adding a new subsection (j) to read as follows:

"(j)(1) As an alternative to the procedure otherwise provided by this section or any other provision of this act, any person who is injured by a violation of any provision of this act or any rule, regulation, or order issued thereunder by the Commission by any person who is registered or required to be registered under sections 4d, 4e, 4k, or 4m of this act or regulations promulgated by the Commission under this act, may elect, at any time within two years after the injury complained of occurs, to bring a civil action for damages in any district court of the United States. Any action under this subsection may be brought in the district in which the defendant resides or is an inhabitant or transacts business or wherein the act or omission complained of occurred.

"(2) Any order of a district court awarding damages under paragraph 1 hereof shall be reviewable by the United States Court of Appeals for any circuit in which such action was brought in accordance with the provisions of subsection (g) of this section. Upon the failure of any person to satisfy any judgment of a district court awarding damages under paragraph 1 hereof within the period allowed for compliance or to take an appeal as herein authorized, he shall be subject to the penalty provided in subsection (h) of this section."

Sec. 106: To increase the dollar limitation on claims for which customers can arbitrate, sections 5a(11)(ii) and 17(b)(10)(ii) of the Commodity Exchange Act, as amended, are amended by deleting "\$15,000" therefrom and inserting "\$25,000"

therefor. Sections 5a(11)(ii) and 17(b)(10)(ii) of the Commodity Exchange Act, as amended, are further amended by adding to the end thereof the following:

"Provided further, however, that the Commission may periodically adjust the limitation in subparagraph (ii) above to not exceed \$50,000 to reflect changes in the Consumer Price Index, in the average amount of claims submitted to the Commission pursuant to section 14 of this act, and other pertinent factors."

Sec. 107: To authorize the Commission to disclose certain information to contract markets for market surveillance purposes, section 8a(6) of the Commodity Exchange Act, as amended, is further amended to read as follows:

"(6) to communicate or routinely supply to the proper committee or officer of any contract market, notwithstanding the provisions of section 8 of this act, the full facts concerning any transaction, market positions, or market operation, including the names of parties thereto, which in the judgment of the Commission disrupts or tends to disrupt any market or is otherwise harmful or against the best interests of producers and consumers or which in the judgment of the Commission would facilitate surveillance of market activities by any contract market: Provided, however, any information furnished by the Commission under this subsection, either on an occasional or routine basis, shall not be disclosed by such contract market except in a self-regulatory action or proceeding."

Sec. 108: (a) Section 4f of the Commodity Exchange Act, as amended, is further amended by adding a new paragraph (3) to read as follows:

"(3) The Commission may authorize a registered futures association to perform any portion of the registration functions under this section, in accordance with rules approved by the Commission, and subject to the provisions of this chapter applicable to registrations granted by the Commission."

(b) Section 4n of the Commodity Exchange Act, as amended, is further amended by adding a new subparagraph (7) to read as follows:

"(7) The Commission may authorize a registered futures association to perform any portion of the registration functions under this section, in accordance with rules approved by the Commission, and subject to the provisions of this chapter applicable to registrations granted by the Commission."