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# FINANCIAL REGULATION

## Clearer Goals and Reporting Requirements Could Enhance Efforts by CFTC and SEC to Harmonize Their Regulatory Approaches



GAO

Accountability \* Integrity \* Reliability



Highlights of [GAO-10-410](#), a report to congressional committees

## Why GAO Did This Study

The conference report accompanying the Consolidated Appropriations Act of 2010 directed GAO to assess the joint report of the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) on harmonization of their regulatory approaches. In October 2009, CFTC and SEC issued this report in response to the Department of the Treasury's recommendation that the two agencies assess conflicts in their rules and statutes with respect to similar financial instruments. GAO's objectives were to review (1) how CFTC and SEC identified and assessed harmonization opportunities, (2) the agencies' progress toward implementing the joint report's recommendations, and (3) additional steps the agencies could take to reduce inconsistencies and overlap in their oversight.

To meet these objectives, GAO reviewed the joint report and related documentation, interviewed agency officials, and obtained and analyzed written comments on the report from market participants.

## What GAO Recommends

GAO recommends that CFTC and SEC establish clearer goals for harmonization, including time frames for implementing the joint report's recommendations, and develop requirements for reporting and evaluating progress toward these goals. CFTC and SEC generally agreed with our conclusions and concurred with our recommendation.

View [GAO-10-410](#) or [key components](#). For more information, contact Orice Williams Brown at (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov).

## FINANCIAL REGULATION

### Clearer Goals and Reporting Requirements Could Enhance Efforts by CFTC and SEC to Harmonize Their Regulatory Approaches

#### What GAO Found

CFTC and SEC conducted joint analyses and sought public input to inform their efforts to identify and assess significant differences in their rules and statutes and develop recommendations to address such differences. The agencies obtained public input through joint public meetings and a public comment period and worked together to analyze this input. In drafting the joint report on harmonization of their regulatory approaches, CFTC and SEC focused their analysis on eight potential areas for harmonization and made at least one recommendation in all but one of these areas. The joint report also includes several recommendations to enhance coordination between the agencies. For example, the report recommended the creation of a Joint Advisory Committee to be tasked with considering and developing solutions to issues of common interest in the futures and securities markets. The joint report did not cover gaps in the agencies' authorities to oversee over-the-counter derivatives, which were the subject of congressional deliberation at the time of their study.

The joint report's recommendations for statutory changes have yet to be enacted, and the recommendations for agency action remain in the planning stages. According to agency staff, since issuing the joint report in October 2009, the agencies have been focused on working with Congress on drafting legislation to address recommended statutory changes. Congress authorized CFTC and SEC to fund the Joint Advisory Committee, as requested in the joint report, and proposed legislation includes provisions that would partially address recommended statutory changes in areas including oversight of exchange rules and enforcement. CFTC and SEC have drafted a charter for the Joint Advisory Committee and expect to have this committee functioning by early summer 2010. Agency staff said the agencies have not set firm timelines for the implementation of the other recommendations for agency action.

Additional harmonization opportunities exist beyond those addressed by the joint report's recommendations, and future efforts by CFTC and SEC to assess these opportunities could benefit from clearer goals and accountability requirements. With only a few months to complete their report, agency staff said the agencies could not address all differences in their rules and statutes through the joint report's recommendations. Market participants identified several areas they believe could benefit from additional harmonization efforts, including portfolio margining and investor definitions and categories. The agencies plan to coordinate future harmonization efforts through the Joint Advisory Committee, but they have not yet developed clear goals for harmonization or developed requirements for the agencies to evaluate and report their progress toward meeting such goals. Without a clearer vision to guide future harmonization efforts and mechanisms to ensure accountability for these efforts, CFTC and SEC may not be strategically positioned to implement the joint report's recommendations and address remaining harmonization opportunities.

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## Abbreviations

CBOE	Chicago Board Options Exchange
CEA	Commodity Exchange Act
CFMA	Commodity Futures Modernization Act of 2000
CFTC	Commodity Futures Trading Commission
FCM	futures commission merchant
SEA	Securities Exchange Act of 1934
SEC	Securities and Exchange Commission
SIPA	Securities Investor Protection Act
SPAN	Standard Portfolio Analysis of Risk
SRO	self-regulatory organization
TIMS	Theoretical Intermarket Margin System

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United States Government Accountability Office  
Washington, DC 20548

April 22, 2010

The Honorable Richard Durbin  
Chairman  
The Honorable Susan Collins  
Ranking Member  
Subcommittee on Financial Services and General Government  
Committee on Appropriations  
United States Senate

The Honorable José E. Serrano  
Chairman  
The Honorable Jo Ann Emerson  
Ranking Member  
Subcommittee on Financial Services and General Government  
Committee on Appropriations  
House of Representatives

When Congress created the Commodity Futures Trading Commission (CFTC) in 1974 to oversee the commodity futures markets, the futures markets were relatively distinct from the securities markets overseen by the Securities and Exchange Commission (SEC).<sup>1</sup> As early as the 1970s, however, the emergence of derivative products with characteristics of both futures and securities led to periodic disputes concerning which agency should have regulatory jurisdiction over certain new products.<sup>2</sup> These jurisdictional disputes have at times consumed significant agency resources and resulted in lengthy delays in introducing product innovations to the markets. Moreover, the futures and securities markets have increasingly overlapped in terms of market participants, raising concerns about duplicative or inconsistent regulation of entities that engage in similar activities. Despite efforts by CFTC and SEC in recent decades to resolve these issues, concerns about remaining overlaps, gaps, and inconsistencies in their oversight have led to calls for a merger of the

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<sup>1</sup>Futures are agreements that obligate the holder to buy or sell a specific amount or value of an underlying asset, reference rate, or index at a specified price on a specified date. These contracts may be satisfied by delivery or by offset with another contract.

<sup>2</sup>Derivatives are contracts that have a market value determined by the price of an underlying asset, reference rate, or index (called the underlying). Underlyings include stocks, bonds, agricultural and other physical commodities, interest rates, foreign currency rates, and stock indexes.

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two agencies, or absent a merger, greater harmonization of their regulatory approaches.

In its June 2009 white paper on financial regulatory reform, the Department of the Treasury (Treasury) recommended that CFTC and SEC report to Congress by September 30, 2009, on existing conflicts in their rules and statutes with respect to similar types of financial instruments.<sup>3</sup> Treasury recommended that the agencies either explain why such differences are essential to achieving underlying policy objectives or make recommendations for changes to statutes and rules that would eliminate the differences. In October 2009, CFTC and SEC responded to Treasury's recommendation by issuing a joint report in which the agencies examined harmonization opportunities and made recommendations to reduce inconsistencies in their oversight and enhance cooperation between them.<sup>4</sup>

The conference report accompanying the Consolidated Appropriations Act of 2010 mandated that GAO review the joint report of CFTC and SEC on harmonization of their rules and statutes. Accordingly, in this report, we examine (1) how CFTC and SEC identified and assessed significant differences in their rules and statutes and developed recommendations to address such differences, (2) what progress CFTC and SEC have made toward implementation of the joint report's recommendations, and (3) what additional steps CFTC and SEC could take to eliminate or reduce inconsistencies in regulatory oversight and to enhance regulatory efficiency and effectiveness, as well as market transparency.

To satisfy our responsibility under the mandate to report the results of this work by March 1, 2010, we provided an interim report in the form of a briefing to the subcommittees' staffs on February 26, 2010. Appendix II contains the full briefing slides. This letter represents the final report.

To address our objectives, we reviewed and analyzed the joint report of CFTC and SEC on harmonization (joint report), documentation of public input collected by CFTC and SEC through joint public meetings and a public comment period, CFTC and SEC analyses of relevant differences in their statutes and regulations, and provisions of proposed legislation that

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<sup>3</sup>Treasury, *Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation*, Washington, D.C., June 2009.

<sup>4</sup>SEC and CFTC, *A Joint Report of the SEC and the CFTC on Harmonization of Regulation*, Washington, D.C., October 2009.

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address statutory changes recommended in the joint report. We interviewed CFTC and SEC staff about steps taken by the agencies to identify and assess harmonization opportunities, progress the two agencies have made toward implementing the joint report's recommendations, and additional harmonization opportunities that may exist. In addition, to identify additional steps the agencies could take to harmonize their rules and statutes, we obtained and analyzed written comments on the joint report from representatives of securities and futures market participants, the investor community, and other experts who participated in the joint public meetings hosted by the agencies to discuss harmonization opportunities. Finally, we reviewed prior GAO work on futures and securities markets regulation, financial regulatory reform, and practices that can enhance and sustain collaboration among federal agencies.<sup>5</sup>

We conducted this performance audit from January 2010 to April 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. A more extensive discussion of our scope and methodology appears in appendix I.

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## Background

Prior to the 1930s, securities markets were overseen by various state securities regulatory bodies and the securities exchanges themselves. In the aftermath of the stock market crash of 1929, the Securities Exchange Act of 1934 (SEA) created SEC as a new federal agency and gave it authority to register and oversee securities broker-dealers, as well as securities exchanges, to strengthen securities oversight and address inconsistent state securities rules. SEC's mission is to protect investors; maintain fair, orderly and efficient markets; and facilitate capital formation. In addition to regulation by SEC and state agencies, securities

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<sup>5</sup>For example, see GAO, *CFTC and SEC: Issues Related to the Shad-Johnson Jurisdictional Accord*, [GAO/GGD-00-89](#) (Washington, D.C.: Apr. 6, 2000); *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, [GAO-09-216](#) (Washington, D.C.: Jan. 8, 2009); and *Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies*, [GAO-06-15](#) (Washington, D.C.: Oct. 21, 2005). See the Related GAO Products section for additional reports.

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markets and the broker-dealers that accept and execute customer orders in these markets continue to be regulated by self-regulatory organizations (SRO), including the Financial Industry Regulatory Authority, that are funded by the participants in the industry. Among other things, these SROs establish rules and conduct examinations related to market integrity and investor protection. SEC also registers and oversees investment companies and advisers, approves rules for the industry, and conducts examinations of broker-dealers and mutual funds. State securities regulators are generally responsible for registering certain securities products and, along with SEC, investigating securities fraud. SEC is also responsible for overseeing the financial reporting and disclosures that companies issuing securities must make under U.S. securities laws.

Oversight of the trading of futures contracts has changed over the years in response to changes in the marketplace. Under the Grain Futures Act of 1922, the trading of futures contracts was overseen by the Grain Futures Administration, an office within the Department of Agriculture, reflecting the nature of the products for which futures contracts were traded. However, futures contracts were later created for nonagricultural commodities, such as energy products like oil and natural gas, metals such as gold and silver, and financial products such as Treasury bonds and foreign currencies. In 1974, as a result of the Commodity Exchange Act (CEA), CFTC was created as a new independent federal agency to oversee the trading of futures contracts. CFTC's mission is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options, and to foster open, competitive, and financially sound futures markets. Like SEC, CFTC oversees the registration of intermediaries, including futures commission merchants (FCM), and relies on SROs, including the futures exchanges and the National Futures Association, to establish and enforce rules governing member behavior.<sup>6</sup> The Commodity Futures Modernization Act of 2000 (CFMA) established a principles-based structure for the regulation of futures exchanges and derivatives clearing organizations, and clarified that some off-exchange derivatives trading—and in particular trading on

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<sup>6</sup>Futures commission merchants are individuals, associations, partnerships, corporations, and trusts that solicit or accept orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any exchange and that accept payment from or extend credit to those whose orders are accepted. Firms and individuals who trade futures with the public or give advice about futures trading must be registered with the National Futures Association, the industrywide SRO for the U.S. futures industry.

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facilities accessible only to large, sophisticated traders—was permitted and would be largely unregulated or exempt from regulation.<sup>7</sup>

In recent decades, CFTC and SEC have sought ways to resolve jurisdictional disputes and address other emerging areas of overlap in their respective oversight of futures and securities markets. For example, in 1981, CFTC and SEC reached an agreement, called the Shad-Johnson Jurisdictional Accord, to clarify their respective jurisdictions over securities-based options and futures. The accord was enacted into law in January 1983 and, among other things, confirmed SEC’s jurisdiction over securities-based options, including stocks and stock indexes; provided CFTC with jurisdiction over futures (and options thereon) on certain securities and securities indexes; and prohibited futures trading on single stocks, as well as on securities indexes that did not meet specific requirements.<sup>8</sup> In 2000, CFMA lifted the ban on futures on single stocks and narrow-based securities indexes, allowing them to be traded on securities or futures exchanges but subject to joint regulation of CFTC and SEC. Pursuant to the CFMA, the two agencies worked together to jointly create margin requirements for single stock futures. Exchanges that list and trade security futures are subject to the jurisdiction of both CFTC and SEC; this is one example of how the securities and futures markets have overlapped in terms of regulated entities. In addition, financial intermediaries must register with both CFTC and SEC if they serve investors trading in instruments subject to the jurisdiction of the two agencies. According to the joint report, approximately 45 percent of futures commission merchants are also registered with SEC as broker-dealers. The joint report provides additional examples of the agencies’ efforts to collaborate in various areas. For example, in March 2008, the

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<sup>7</sup>A derivatives clearing organization is a clearinghouse or similar organization that enables each party to a transaction to substitute the credit of the clearinghouse for the credit of the parties, provides for the settlement or netting of obligations from the transaction, or otherwise provides services mutualizing or transferring the credit risk from the transaction.

<sup>8</sup>This agreement was codified in the Securities Acts Amendments of 1982, which amended the federal securities laws, and in the Futures Trading Practices Act of 1982, which amended the CEA. The accord allowed CFTC to approve a stock index futures contract for trading if CFTC found that the contract was (1) settled in cash; (2) not readily susceptible to manipulation; and (3) based on an index that was a widely published measure of and reflected the market as a whole or a substantial segment of the market, or else was comparable to such a measure. According to SEC and CFTC, these three standards were intended to ensure that stock index futures would not be readily susceptible to manipulation, be used to manipulate the underlying securities or related options markets, or serve as a surrogate for a single stock futures contract. For more information about the Shad-Johnson Jurisdictional Accord, see [GAO/GGD-00-89](#).

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two agencies entered into a memorandum of understanding with the goal of creating a closer relationship between the agencies on a broad range of issues affecting their jurisdictions.<sup>9</sup> The agreement identified points of contact for coordination, outlined a protocol for addressing novel derivative products, and generally contemplated enhanced information sharing between the two agencies on areas of mutual concern and interest.

Despite efforts by the agencies to define their respective regulatory jurisdictions, jurisdictional disputes have periodically delayed the introduction of novel derivative products to the marketplace. The joint report notes that the governing statutes do not definitively address the fundamental question of whether certain derivative instruments qualified as futures contracts or options. In one recent example, in January 2005 the Chicago Board Options Exchange (CBOE) filed a proposal with SEC to list and trade a new option on an exchange-traded fund holding investments involving gold, but introduction of this product was delayed by over 3 years as CFTC and SEC could not reach agreement on jurisdiction. In another instance, according to the Chief Executive Officer of CBOE, an option on a credit default product was placed on hold for 7 months, while a European derivatives exchange introduced a similar product within weeks of the announcement of the proposal to list this similar product. These examples illustrate the potential for such delays to create domestic and international competitive disadvantages for U.S. exchanges and clearinghouses attempting to introduce novel products.

In its June 2009 white paper on financial regulatory reform, Treasury noted that the broad public policy objectives of futures and securities regulation are the same and that many of the differences in the regulation of the markets are no longer justified. Specifically, Treasury expressed the following concerns:

- Economically equivalent instruments may be regulated in different manners, depending on which agency has jurisdiction. For example, many futures products and financial options regulated as securities are similar, and the returns to one can often be replicated with the other.
- Jurisdictional disputes consume significant agency resources, and uncertainty about the outcome of such disputes may impede innovation.

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<sup>9</sup>SEC and CFTC, Memorandum of Understanding Between the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission Regarding Coordination in Areas of Common Regulatory Interest, Washington, D.C.: March 11, 2008.

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- Jurisdictional distinctions may have unnecessarily limited competition between markets and exchanges. Under existing law, financial instruments with similar characteristics may be forced to trade on different exchanges that are subject to different regulatory regimes.
  - The agencies follow different approaches to the regulation of exchanges, clearing organizations, and intermediaries. Pursuant to the CEA, CFTC employs a more principles-based approach to regulation, under which market participants can have greater flexibility in complying with regulatory requirements than under a more rules-based approach. Treasury suggested that the two agencies seek agreement on principles of regulation that are significantly more precise than the CEA's current "core principles."

As noted earlier, Treasury recommended that the agencies make recommendations to address differences in statutes and regulations that are not justified by the agencies' policy objectives. In the joint report, the agencies note that broad differences in futures and securities regulation reflect, in part, fundamental differences in the roles played by the two markets. Because of the role of certain securities markets in capital formation, for example, securities regulation is more concerned with disclosure than commodities regulation is. For example, securities with returns that depend on the issuer's financial performance—such as stocks issued by institutions to raise capital—require more detailed disclosure to protect investors than futures products with returns that depend on changes in the price of a physical commodity. The primary purpose of the futures markets is to facilitate the management and transfer of risk, and certain securities markets, such as securities options and other securities derivatives markets, also facilitate the management and transfer of risk. As noted above, Treasury expressed concern that certain securities options and futures products are subject to different regulatory requirements although they serve similar purposes.

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## CFTC and SEC Obtained Public Input and Conducted Joint Analyses to Identify and Assess Significant Differences in Their Statutes and Rules

To respond to Treasury's recommendation, CFTC and SEC obtained public input and conducted independent and joint analyses to identify and assess significant differences in their statutes and rules. In July and August 2009, the agencies collaborated to prioritize and categorize issues on which to solicit public input. Through joint public meetings held in early September 2009 and a request for public comments, CFTC and SEC collected views on harmonization opportunities from a range of market participants and experts. The agencies worked together to analyze the information collected, develop recommendations, and draft the joint report. On the basis of their analysis of the public input, CFTC and SEC grouped issues of regulatory conflict into eight areas, and in the joint report made at least one recommendation in all but one of these categories. The agencies also made five recommendations intended to enhance operational coordination between them. The joint report focuses on differences in the agencies' existing authorities and does not cover issues related to gaps in the agencies' authorities to oversee over-the-counter derivatives, which were the subject of congressional deliberation at the time of their analysis.

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## The Agencies Analyzed Differences in Statutes and Rules and Obtained Public Input to Help Identify Potential Areas for Harmonization

Given the tight time frame—Treasury recommended in June 2009 that the agencies report to Congress by the end of September 2009—agency staff said they focused on significant areas of difference and relied to a large extent on public input to help identify significant regulatory differences and, in turn, harmonization opportunities. As a first step, the agencies worked separately and together in July and August 2009 to analyze differences between them regarding their statutes and regulations. For example, CFTC and SEC staff completed a side-by-side analysis of the agencies' respective statutes and rules in nine areas: (1) exchanges and markets, (2) clearance and settlement, (3) trading practices, (4) intermediaries, (5) Securities Act of 1933 and applicable provisions of the Exchange Act, (6) financial responsibility rules, (7) enforcement, (8) investment companies, and (9) investment advisers. According to CFTC and SEC staff, the agencies used this analysis to identify significant statutory and regulatory differences and to prioritize and categorize issues on which to solicit public input.

Following these independent and joint analyses, CFTC and SEC sought input from the public in two ways. First, the agencies jointly arranged and hosted public meetings on September 2 and 3, 2009. For the joint public meetings, CFTC and SEC invited members of the investor community, academics, industry experts, and futures and securities market participants to participate in a series of panel discussions and provide

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their views on regulatory differences and harmonization opportunities. The agencies organized the meetings into five panel discussions, with each panel focused on one of five broad categories: (1) exchanges and markets, (2) intermediaries, (3) clearance and settlement, (4) enforcement, and (5) investment funds. Including the participation of all nine CFTC and SEC Commissioners and 30 panelists, these joint public meetings were unprecedented in the history of the two agencies, according to the joint report. Second, CFTC and SEC provided an opportunity for public comment from August 19 to September 14, 2009, on the issues to be discussed at the joint public meetings. In addition to the statements submitted by individuals who participated as panelists, the agencies received over a dozen statements offering the views of individuals or organizations not represented on the panels.<sup>10</sup>

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**CFTC and SEC Staff Said  
the Two Agencies  
Collaborated to Assess  
Harmonization  
Opportunities and Develop  
Recommendations**

According to CFTC and SEC staff, the agencies worked together to analyze the collected information, develop their findings and recommendations, and draft the joint report. On the basis of their analysis of comments obtained from the joint public meetings and public comment request, the agencies focused the joint report's analysis on eight subject areas covering issues the agencies believe emerged as the most relevant to harmonizing their statutory and regulatory regimes: (1) product listing and approval, (2) exchange/clearinghouse rule changes, (3) risk-based portfolio margining and bankruptcy/insolvency regimes, (4) market structure, (5) price manipulation and insider trading, (6) customer protection standards applicable to financial advisers, (7) regulatory compliance by dual registrants, and (8) cross-border regulatory matters.<sup>11</sup> For each of the eight areas, the joint report includes discussion of statutes and regulations relevant to SEC oversight, followed by discussion of statutes and regulations relevant to CFTC oversight. For each area, the

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<sup>10</sup>An electronic futures exchange, securities option exchanges, and a securities industry association were among those who submitted statements but were not represented by individual panelists at the joint public meetings.

<sup>11</sup>The joint report defines risk-based portfolio margining as a margin methodology that sets a minimum level of required margin by analyzing the risk of each component position in an account and then recognizing any risk-offsets in the overall portfolio of positions. The joint report discusses barriers that exist to the holding of futures in a securities portfolio margining account and vice versa. Panelists at the joint public meetings cited potential advantages of facilitating greater risk-based portfolio margining by allowing the recognition of risk offsets between certain securities and certain futures products. These advantages include enhancing capital efficiency by freeing customer capital for other purposes and increasing the international competitiveness of the U.S. financial markets.

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joint report also includes an analysis section in which the two agencies analyze the differences between their regulatory approaches. Each agency took responsibility for drafting the sections on its regulations and the statutes relevant to its authority. The agencies divided initial drafting responsibility for the analysis and recommendation sections, and CFTC and SEC staff said that the agencies shared their drafts with each other and incorporated each other's comments. In the analysis sections, the agencies also incorporated public input obtained through the joint public meetings and the public comment period.

CFTC and SEC jointly issued their report in October 2009 and made 15 recommendations that cover harmonization opportunities in all but one of the eight areas—market structure. Table 1 summarizes the joint report's recommendations for statutory change and agency action in these seven areas. The recommendations for statutory change cover changes CFTC and SEC believe require legislative action to amend one or both of the agencies' statutes, while the recommendations for agency action cover changes the agencies believe they can implement without action from Congress. In the joint report, the agencies note that market participants and other experts offered mixed views about whether differences in the futures and securities market structures are justified by the agencies' policy objectives. Later in this report, we discuss opposing views on whether Congress should legislate changes to the structure of the futures industry to introduce features of the securities market structure.<sup>12</sup>

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<sup>12</sup>In the securities markets, identical, fungible securities are traded on multiple markets as part of the "national market system." This system was mandated by Congress in 1975 through amendments to the federal securities laws. Under this market structure, exchanges compete for trading and execution services for fungible securities, and clearing is done through one central clearinghouse for each product type. In contrast, in the futures markets, although products can be similar in terms and function, they are not fungible across markets and clearing organizations. Futures exchanges direct trades for clearing to a clearinghouse, and common ownership of the exchange and the clearinghouses to which it directs clearing is common. According to the joint report, this same structure generally holds in other areas of the world, including Europe and Asia.

**Table 1: Summary of Joint Report’s Recommendations for Statutory Change and Agency Action**

Areas of difference in statutes and rules	Recommendations for statutory change	Recommendations for agency action
1. Oversight of new products	<ul style="list-style-type: none"> <li>Provide a process for expedited judicial review of jurisdictional matters regarding new products. Specifically, establish and clarify (1) legal certainty with respect to the agencies’ authority over products exempted by the other agency, and (2) a review process to ensure that any jurisdictional dispute is resolved by the commissions against a firm timeline</li> </ul>	N/A
2. Exchange and clearinghouse rules	<ul style="list-style-type: none"> <li>Enhance CFTC authority over exchange and clearinghouse compliance with CEA</li> </ul>	N/A
3. Segregation, insolvency, and margin	<ul style="list-style-type: none"> <li>Facilitate the holding of (1) futures products in a securities portfolio margin account and (2) securities options, securities futures products, and certain other securities derivatives in a futures portfolio margin account</li> </ul>	As part of the recommendation to facilitate portfolio margining, CFTC and SEC should undertake a review of additional changes that may be needed to achieve the benefits of risk-based portfolio margining and a review of whether further modifications to portfolio margining would be in the public interest.
4. Market structure	N/A	N/A
5. Manipulation, insider trading, and fraud enforcement	<ul style="list-style-type: none"> <li>Expand CFTC’s conflict-of-interest prevention authority,</li> <li>Enhance whistleblower protections,</li> <li>Clarify CEA’s restitution remedy,</li> <li>Enhance CFTC’s authority over disruptive trading practices,</li> <li>Expand the scope of insider trading provisions under CEA, and</li> <li>Expand SEC’s statutory authority for aiding and abetting</li> </ul>	N/A
6. Customer protection standards	<ul style="list-style-type: none"> <li>Impose a uniform fiduciary duty on intermediaries who provide similar investment advisory services regarding futures and securities</li> </ul>	N/A
7. Regulatory compliance by dual registrants	N/A	<ul style="list-style-type: none"> <li>Align record retention requirements for intermediaries by harmonizing the length of time records are required to be maintained,</li> <li>align customer risk disclosure documents, and</li> <li>align specific private fund reporting requirements</li> </ul>

Areas of difference in statutes and rules	Recommendations for statutory change	Recommendations for agency action
8. Cross-border access	<ul style="list-style-type: none"> <li>Empower CFTC to require certain foreign boards of trade to register with CFTC</li> </ul>	<ul style="list-style-type: none"> <li>SEC review of its approach to cross-border access to determine whether greater efficiencies could be achieved with respect to cross-border transactions consistent with the protection of investors and the public interest</li> </ul>

Source: GAO analysis of A Joint Report of the SEC and the CFTC on Harmonization of Regulation, October 2009.

Note: N/A = Not applicable.

In addition, the agencies made five recommendations to enhance operational coordination between them:

- create a Joint Advisory Committee to be tasked with considering and developing solutions to emerging and ongoing issues of common interest in the futures and securities markets;
- create a Joint Agency Enforcement Task Force to share market surveillance data, improve market oversight, enhance enforcement, and relieve duplicative regulatory burdens;
- establish a joint cross-agency training program for staff;
- develop a program for the regular sharing of staff through detail assignments; and
- create a Joint Information Technology Task Force to pursue linking information on CFTC- and SEC-regulated persons and other information the agencies jointly find useful.

The joint report’s recommendation for the creation of a Joint Advisory Committee included a request that Congress authorize CFTC and SEC to form, fund, and operate this committee. The other four recommendations for operational coordination did not identify a need for legislative action prior to implementation.

The joint report does not cover issues related to gaps in the agencies’ regulatory authority with respect to over-the-counter derivatives. The executive summary of the joint report notes that these gaps were discussed in the Treasury white paper and were the subject of deliberation before Congress at the time of the agencies’ harmonization study. Consistent with Treasury’s request that the agencies identify existing

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conflicts in their rules and statutes, CFTC and SEC staff said that they chose to focus on their existing authorities in the report.

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## Most of the Joint Report's Recommendations Have Yet to Be Enacted or Remain in the Planning Stages

The joint report's recommendations for statutory changes have yet to be enacted, and the recommendations for agency action remain in the planning stages. Congress authorized funding for the Joint Advisory Committee, as requested in the joint report, and has proposed legislation including provisions that would address several recommended statutory changes. CFTC and SEC staff told us they expect to have the Joint Advisory Committee functioning by early summer 2010. The agencies have not yet established time frames for implementing the joint report's other recommendations that do not require legislative action.

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## One Requested Legislative Action Has Been Taken, and Proposed Legislation Includes Provisions That Would Address Some Recommended Statutory Changes

According to CFTC and SEC staff, since issuing the joint report in October 2009, the agencies have been focused on working with Congress on drafting legislation to address statutory changes recommended in the joint report. To date, Congress has acted on a request in one of the agencies' recommendations to enhance operational coordination: The Consolidated Appropriations Act of 2010 authorized CFTC and SEC to fund the Joint Advisory Committee. The joint report's recommendations for changes to one or both of the agencies' statutes have yet to be enacted.

H.R. 4173, as passed by the House of Representatives, would address statutory changes recommended by the report in five areas, if enacted (see table 2).<sup>13</sup> First, H.R. 4173 includes provisions that would enhance CFTC's authority over exchange and clearinghouse compliance with the CEA, as recommended by the joint report. Second, by amending the Securities Investor Protection Act (SIPA) to extend SIPA protection to margin related to futures positions held in a securities portfolio margining account, H.R. 4173 would address one of the statutory changes recommended to facilitate portfolio margining. H.R. 4173 also includes provisions that address recommended enhancements to a specific enforcement authority for either CFTC or SEC. For example, Sections 7207 and 7208 would grant SEC specific statutory authority for aiding and

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<sup>13</sup>The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (2009) (passed by the House of Representatives on Dec. 11, 2009). The bill does not address the joint report's recommendation for statutory changes in the area of new product oversight.

abetting under the Securities Act and the Investment Company Act.<sup>14</sup> As noted in table 2, several of the H.R. 4173 provisions would represent only partial implementation of the joint report’s recommendations. For example, with respect to enhancing CFTC’s authority over exchange and clearinghouse rules, H.R. 4173 would not amend the CEA to allow CFTC to reject proposed rule changes if it cannot make a finding that the change is consistent with the CEA and regulations.<sup>15</sup> In addition, H.R. 4173 provisions regarding fiduciary duty and whistleblower protections would implement recommended statutory changes with respect to securities market participants, but not futures market participants. Finally, the H.R. 4173 provision related to cross-border access would not empower CFTC to require certain foreign boards of trade to register with CFTC, as recommended in the joint report.

**Table 2: Summary of H.R. 4173 Provisions That Would Address Certain Recommended Statutory Changes**

Area of difference	SEC/CFTC recommendation	Provision in H.R. 4173
Exchange and clearinghouse rules	Enhance CFTC authority over exchange and clearinghouse compliance with the CEA	Section 3114 would partially implement this recommendation by expanding the time period allowed for CFTC review of new rules and by repealing certain procedural requirements for CFTC to file an enforcement action for violation of core principles. Sections 3103 and 3111 include amended core principles for clearinghouses and contract markets, respectively, clarifying the CFTC’s rule-making authority to determine the appropriate manner of compliance with the CEA.
Segregation, insolvency, and margin	Facilitate the holding of (1) futures products in a securities portfolio margin account and (2) securities options, securities futures products, and certain other securities derivatives in a futures portfolio margin account	Section 7509 would partially implement this recommendation by amending SIPA to extend SIPA protection to margin related to futures positions held in a securities portfolio margin account.
Customer protection standards	Impose a uniform fiduciary duty on intermediaries who provide similar investment advisory services regarding futures and securities	Section 7103 would partially implement this recommendation by amending the SEA and the Investment Advisors Act to create a fiduciary duty for brokers, dealers, and investment advisers.

<sup>14</sup>SEC has specific statutory authority for aiding and abetting under the SEA and the Investment Advisers Act.

<sup>15</sup>In order to reject a proposed exchange rule, under existing authority CFTC must find that the rule violates the CEA. The joint report concluded that the requirement for CFTC to make such a finding may limit its ability to reject new rules that may not be in the public’s interest.

Area of difference	SEC/CFTC recommendation	Provision in H.R. 4173
Manipulation, insider trading, and fraud enforcement	Expand CFTC's conflict-of-interest prevention authority	Section 3108 would authorize CFTC to require futures commission merchants and introducing brokers to implement conflict-of-interest procedures separating research and analysis from trading and clearing activities.
	Enhance whistleblower protections	Section 7203 would partially implement this recommendation by amending the SEA to enhance whistleblower protections.
	Enhance CFTC's authority over disruptive trading practices	Section 3118 would amend the CEA to expand CFTC's authority over certain disruptive trading practices.
	Grant SEC specific statutory authority for aiding and abetting under the Securities Act and the Investment Company Act	Sections 7207 and 7208 would grant SEC specific statutory authority for aiding and abetting under the Securities Act and the Investment Company Act.
Cross-border access	Empower CFTC to require certain foreign boards of trade to register with the CFTC	Section 3115 would amend the CEA to authorize CFTC to require foreign boards of trade seeking to provide direct access to persons in the United States to meet certain standards for transparency and market integrity with respect to contracts where the price is linked to a contract trading on a U.S. exchange but does not require registration in the United States.

Source: GAO analysis of H.R.4173.

## Recommendations for Agency Action Remain in the Planning Stages

According to CFTC and SEC staff, the joint report's recommendations for action by one or both agencies generally are in the initiation or planning stage. As noted above, only one of the recommendations for enhanced interagency coordination included a request for legislative action, and Congress acted on this request to authorize funding for the Joint Advisory Committee. The agencies have drafted a charter for the Joint Advisory Committee, and CFTC and SEC staff told us they were working together to finalize the charter and consider selection of individuals to sit on the committee. The report's other recommendations requiring agency action include the other operational coordination recommendations and recommendations for the agencies to align certain requirements and study certain issues, such as portfolio margining and SEC's approach to cross-border access. Agency staff said they expect to have the Joint Advisory Committee functioning by late spring or early summer 2010 but have not set firm time frames for implementing the joint report's other recommendations requiring agency action.

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## Additional Harmonization Opportunities Exist, and the Agencies' Future Harmonization Efforts Could Benefit from Clearer Goals and Accountability Requirements

While the joint report's recommendations would reduce or eliminate certain inconsistencies in the two agencies' regulatory approaches, additional harmonization opportunities exist and the agencies' future harmonization efforts could benefit from clearer goals and accountability requirements. The agencies acknowledge that the recommendations do not address all differences that may not be justified by their policy objectives, and market participants and other experts identified areas they believe could benefit from additional harmonization efforts. Importantly, some remaining differences in the agencies' regulatory approaches could create opportunities for regulatory arbitrage. CFTC and SEC staff told us they may use the Joint Advisory Committee to further Treasury's recommendation on harmonization, but the agencies have not established clear goals for harmonization or requirements to report and evaluate progress toward such goals. Without a clear vision for future harmonization efforts, the agencies may not be strategically positioned to implement the joint report's recommendations and assess remaining opportunities for harmonization.

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## Joint Report's Recommendations Do Not Address All Differences in Statutes and Rules with Respect to Similar Products and Entities

Given time and resource constraints, agency staff said they could not address all differences through the joint report's recommendations. As noted earlier, CFTC and SEC relied heavily on public input to identify areas of focus for the joint report. Although public input generally indicated support for harmonization in several areas, on some issues, significant disagreement existed at the joint public meetings as to whether or how to achieve harmonization, presenting challenges to reaching agreement in a short time. The joint report's recommendations acknowledge a need for further study in certain areas, including risk-based portfolio margining and SEC's approach to cross-border access. However, with respect to certain other issues where disagreement existed, such as the structure of the U.S. futures markets and SEC's process for reviewing and approving exchange and clearinghouse rules, the agencies did not make any recommendations. Moreover, CFTC and SEC acknowledge that some potential harmonization opportunities not covered in the report, such as harmonizing the agencies' investor definitions, merit consideration by the agencies.

At the joint public meetings, the CFTC and SEC Chairmen both cited reducing regulatory arbitrage as an objective of the harmonization effort. Importantly, some remaining statutory and regulatory differences may create opportunities for regulatory arbitrage—that is, the potential for market participants to use a particular market or product instead of a competing market or product to exploit regulatory differences. In its white

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paper, Treasury expressed concern that economically equivalent instruments may be regulated in different manners, depending on which agency has jurisdiction, and consistent with this concern, we have endorsed the goal of consistent regulation of similar products and institutions to help minimize negative competitive outcomes.<sup>16</sup> However, the joint report's recommendations do not address all inconsistencies in oversight of similar products and institutions. For example, the joint report's recommendations do not explicitly address the potential for different margin requirements for certain economically equivalent instruments when used for similar purposes. In a joint comment letter submitted to the agencies following the joint public meetings, several securities options exchanges and the Options Clearing Corporation said that differences between the agencies' approaches to regulating margin can result in significantly different margin requirements for comparable securities options and futures products, creating a competitive disadvantage for certain options regulated as securities.<sup>17</sup> The joint report notes that CFTC, unlike SEC, generally does not have authority to set margin levels for futures contracts or options on futures, but does not recommend a statutory change to harmonize the agencies' authority over margin requirements.<sup>18</sup> In addition, SEC staff noted that all securities transactions are subject to a small fee under the SEA and that there is no comparable fee for futures transactions. The joint report did not include a discussion of this difference, and according to SEC staff, a statutory change would be required to achieve harmonization on this matter. As discussed below, market participants identified other areas where remaining differences could create the potential for regulatory arbitrage, including differences in market structure and investor definitions.

CFTC staff said that recognizing that issues related to regulatory arbitrage are often complicated is important because many factors, including statutory goals, can drive differences in the rules applicable to similar products and activities and because judgments about which regulatory

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<sup>16</sup>See [GAO-09-216](#).

<sup>17</sup>See comment letter submitted jointly by the Boston Options Exchange, CBOE, International Securities Exchange, NASDAQ Options Market, NASDAQ OMX PHLX, and the Options Clearing Corporation, September 19, 2009.

<sup>18</sup>According to CFTC staff, Section 3112 of H.R. 4173 eliminates the restriction on the CFTC's authority over margin, allowing the CFTC to address changes to rules governing margin requirements, so long as they are limited to protecting the financial integrity of a derivatives clearing organization, are designed for risk management purposes, and do not set specific margin levels.

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approach is more appropriate can be difficult. Moreover, regulatory differences with respect to similar products or institutions do not necessarily indicate that either futures or securities market requirements provide insufficient investor protection or impose excessive burdens on market participants. Nevertheless, when such differences exist, it is important to consider whether they can create incentives for market participants to engage in economically costly activities in order to take advantage of more favorable regulations.

As part of our review, we contacted the 30 panelists who participated in the joint public meetings to ask them about their views on the joint report and its recommendations. We also requested input from four other individuals, based on suggestions from CFTC and SEC. In their written comments, respondents identified areas they believe could benefit from additional harmonization efforts. These areas include (1) legal certainty for new products, (2) oversight of exchange and clearinghouse rules, (3) portfolio margining, (4) market structure, and (5) investor definitions. Respondents provided other comments on the joint report and its recommendations, but we focused on remaining areas for harmonization most emphasized by respondents.

- **Greater legal certainty for new products:** Many respondents supported the joint report's recommendation for having the U.S. Court of Appeals expeditiously resolve a dispute between CFTC and SEC over their jurisdiction over a new product in cases where the agencies do not reach agreement within a prescribed time frame. However, several expressed concern that implementation of this recommendation would not fully resolve concerns related to establishing greater legal certainty for new products.

First, a few securities market participants favored an administrative dispute resolution mechanism rather than the expedited judicial review mechanism. According to these respondents, in cases where the agencies fail to reach agreement within the prescribed time frame, directing agency appeals to an administrative body, such as Treasury or a regulatory council, could further expedite the dispute resolution process. One respondent expressed concern that referring product disputes to the courts, even under expedited time frames, could still result in delays of over a year and could entail time-consuming and expensive litigation. In support of the joint report's recommendation, CFTC and SEC staff cited precedents and pending legislation in which courts serve as venues for deciding questions concerning the legal definitions of securities and futures. SEC staff also noted that the potential for delays could be limited by the time limits suggested in the joint report's recommendation. SEC

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#### Recent Example of the Resolution Process for Jurisdictional Conflict

On January 25, 2005, CBOE filed a proposed rule change with SEC to list and trade options on shares in a trust holding investments in gold. In 2004, SEC had approved a securities exchange's proposal to list and trade the gold trust shares underlying the proposed option product, but CFTC staff took the view that the gold trust shares should be viewed as commodity transactions (rather than securities) and that, as such, CFTC should have exclusive jurisdiction over the options on the gold trust shares. As a result of this difference in views, SEC deferred action on the proposed listing of the options on gold trust shares for over three years. In the interim, CBOE submitted amendments to its proposed rule change, and four other exchanges submitted proposals to list and trade options on gold trust shares.

In addition, in October 2007, OneChicago, a security futures exchange, submitted a proposal to CFTC to list and trade futures on gold trust shares. In March 2008, pursuant to a memorandum of understanding between the agencies and discussions between CFTC and SEC staffs, SEC published the amended CBOE proposal for comment in the Federal Register. In March and April 2008, CFTC published a notice seeking public comment on exemptions from CFTC's exclusive jurisdiction for the OneChicago product and the CBOE product. The finalization of these exemptions permitted the OneChicago product to be traded and cleared as a security future subject to the joint jurisdiction of CFTC and SEC and the gold trust options to be traded and cleared as securities options subject to exclusive SEC jurisdiction. On May 29, 2008, SEC granted approval to CBOE to list and trade the gold trust options.

staff expressed concern that an administrative body, depending on its composition, could be subject to political influence. Second, two futures market participants supported changes that would allow exchanges to choose whether to list a product as a future or a security, but CFTC and SEC staff said that agency review is needed to ensure that new products fit within the legal definitions of the regime—futures or securities—under which they are regulated.

**Oversight of exchange and clearinghouse rules:** Although the joint report recommends legislation to enhance CFTC's authority over exchange and clearinghouse compliance with the CEA, it does not include a recommendation for SEC in this area. Echoing views expressed at the joint public meetings and discussed in the joint report, some respondents recommended that SEC adopt or consider adopting a process similar to CFTC's more rapid process for reviewing and approving exchange and clearinghouse rules, under which most proposed rules are immediately effective upon self-certification by the exchange or clearinghouse that the rule complies with the CEA. Exchanges noted that the self-certification process is competitively important because it allows them to implement rule changes quickly. A few respondents also urged the two agencies to reach agreement on an overarching set of principles to govern their oversight of exchange and clearinghouse rules. This view also was reflected in the joint public meetings and the joint report. As noted in the joint report, SEC recently approved a new process for streamlining review of rule changes, and SEC staff noted that about two-thirds of rule changes proposed by securities exchanges are effective immediately upon filing. SEC staff acknowledged that despite the recent streamlining, differences remain between the two agencies' rule approval processes. Under the SEA, for example, rule changes that are not effective under self-certification, in contrast to the approach under the CEA, must be approved by SEC before they are effective. In addition, all proposed rule changes on the securities side are published for comment. SEC staff noted that differences in the agencies' rule approval processes in part reflect differences in the structures of the futures and securities markets. For example, in the securities markets, multiple exchanges compete to provide a trading venue for products that are fungible across the exchanges; thus proposed securities exchange rules can have implications for competition among the exchanges.

- **Portfolio margining and insolvency regimes:** The joint report's recommendation to facilitate portfolio margining neither explicitly addresses differences in the portfolio margining methods used for futures and securities portfolio margining accounts nor fully addresses issues related to the insolvency of an intermediary that is dually registered as a

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broker-dealer and a futures commission merchant. Two respondents suggested that the agencies adopt a uniform portfolio margining regime. Currently, the portfolio margining method approved by SEC for securities portfolio margining accounts is different from the method for futures portfolio margining accounts.<sup>19</sup> Agency staff said these differences could result in different margin requirements for similar, or economically equivalent, instruments when used for similar purposes. SEC staff said they are aware of the potential for regulatory arbitrage as a result of these different methods. CFTC and SEC staff agreed that there are issues related to portfolio margining that merit further consideration. In addition, a few market participants recommended that CFTC and SEC work with Congress to harmonize the bankruptcy and customer protection rules applicable to joint broker-dealer/FCMs.<sup>20</sup> These respondents noted that harmonization of these rules is needed to help ensure the orderly unwinding of customer positions in the event of a joint broker-dealer/FCM bankruptcy.<sup>21</sup> One respondent observed that while addressing these insolvency issues cannot be characterized as a “quick win,” CFTC and SEC should begin the process soon considering its importance and the volatility of today’s markets.

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<sup>19</sup>SEC has approved use of the Option Clearing Corporation’s Theoretical Intermarket Margin System model (TIMS) for calculating margin requirements based on the net market risk of all positions in a securities portfolio margining account. TIMS is a theoretical pricing model which allows offsets among instruments referencing the same underlying asset and also recognizes offsets between certain broad-based indexes. In calculating margin for a portfolio, TIMS computes potential profits and losses on all instruments according to defined percentage increases and decreases in their prices (e.g., stocks are moved 15 percent up and 15 percent down from the current price). The method used for futures portfolio margin accounts, Standard Portfolio Analysis of Risk (SPAN), assesses the net market risk of all positions in a portfolio using a probability-based approach. Under this approach, offsets may be recognized among instruments that do not reference the same underlying asset, but have offsetting risk characteristics due to historic or expected correlations in their price movements. SPAN calculates margin based on expected price changes within an established level of statistical confidence (generally 95-99 percent).

<sup>20</sup>H.R. 4173, Section 3006 would require CFTC, SEC and the prudential regulators to make recommendations to Congress regarding changes to insolvency law, including to clarify and harmonize insolvency law applicable to dually registered entities (broker-dealer/FCMs) and portfolio margining.

<sup>21</sup>According to one respondent, the failure of Lehman Brothers in September 2008 illustrated the difficulties that can arise when trying to unwind a joint broker-dealer/FCM’s customer relationships when there are numerous and complex transactions, including exchange-traded derivatives, securities positions being financed, and over-the-counter derivatives.

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- **Market structure:** At the joint public meetings, panelists presented mixed views on the need to resolve differences in the futures and securities market structures, and the joint report discusses these views. Noting the absence of a joint report recommendation, a few respondents recommended actions to promote greater competition in the U.S. futures markets. Two respondents told us that Congress and CFTC should take steps to introduce features of the securities market structure to the futures markets to improve competition and lower costs for investors in these markets. For example, one securities market participant recommended that CFTC encourage listing of fungible products to allow trading of products on multiple exchanges and mandate interoperability of clearing organizations to permit market participants to clear trades at a clearinghouse regardless of the facility on which the trade was executed. Another respondent suggested that regulators take a more aggressive stance in using their antitrust authorities to ensure that futures exchanges and clearinghouses and their rules are not anticompetitive. In written comments provided in response to our questions, one futures market participant opposed mandated interoperability among futures clearinghouses, citing the potential for interoperability to inhibit innovation, eliminate competition among clearinghouses, and contribute to greater systemic risk by linking and exposing futures clearinghouses to one another's risks. The joint report states that securities options exchanges have been both competitive and innovative in developing new products, notwithstanding the use of central clearing. Although the joint report did not include a recommendation related to market structure, it noted that the agencies have supported provisions for nondiscriminatory access to clearing organizations for the over-the-counter derivatives market.<sup>22</sup> Moreover, in 2007, in response to Treasury's request for comments on the regulatory structure associated with financial institutions, the Department of Justice expressed support for a review of exchange-controlled clearing of financial futures, the regulatory structure that underlies it, and its alternatives.<sup>23</sup> The joint report notes that the Futures Industry Association, in its comment letter to the agencies, stated that it would welcome a comprehensive study of how best to improve competition in the market structures for both futures and listed options markets.

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<sup>22</sup>With respect to nondiscriminatory access to clearing organizations for over-the-counter derivatives, Sections 3103 and 3203 of H.R. 4173 would prohibit derivatives clearing organizations and clearing agencies from discriminating against unaffiliated trading venues.

<sup>23</sup>Comments of the U.S. Department of Justice to Review by the Treasury Department of the Regulatory Structure Associated With Financial Institutions, 72 Fed. Reg. 58939 (October 17, 2007)(notice and request for comments).

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- **Investor definitions:** Some market participants recommended that CFTC and SEC harmonize their respective customer categories and definitions with respect to oversight of intermediaries to help ensure greater consistency in the application of customer protection rules. One dually registered broker-dealer/FCM said that because essentially the same entities transact business across asset classes, the agencies could simplify definitions to include fewer categories based on net worth (rather than financial assets) and investment experience. For example, this respondent suggested that the agencies agree on the definition of “retail” investor. SEC and CFTC staff said the agencies did not cover this issue for the purposes of the joint report and that it merits further consideration by the agencies.

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### Clearer Goals and Reporting Requirements Could Enhance CFTC and SEC’s Future Harmonization Efforts

CFTC and SEC staff told us that the agencies may use the Joint Advisory Committee to coordinate their efforts to address harmonization issues involving differences between the two agencies’ approaches to regulation. In prior work, we have identified practices that can help enhance and sustain collaboration among federal agencies.<sup>24</sup> These practices include defining and articulating a common outcome; developing mechanisms to monitor, evaluate, and report on results; and reinforcing agency accountability for collaborative efforts through agency plans and reports. Although the draft charter for the Joint Advisory Committee includes furtherance of Treasury’s recommendation on harmonization as one possible activity of the committee, the agencies have not established clear goals for harmonization or requirements for the agencies to report and evaluate progress toward such goals. For example, the agencies have not created a plan for implementing the joint report’s recommendations or established clearly defined objectives for addressing remaining harmonization opportunities. Consistent financial oversight of similar products and institutions—one of nine principles we have identified for financial regulatory reform—could be used to guide the agencies’ efforts to define objectives that would allow them to readily determine which issues fall within or outside the scope of harmonization.<sup>25</sup> Without clear goals and accountability requirements to guide future coordination efforts, the agencies may not be strategically positioned to implement the joint report’s recommendations and address remaining harmonization opportunities.

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<sup>24</sup>See [GAO-06-15](#).

<sup>25</sup>See [GAO-09-216](#).

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## Conclusions

The October 2009 joint report of CFTC and SEC on harmonization represents a substantial positive step toward reducing and eliminating inconsistencies in the agencies' regulatory approaches. The two agencies' efforts to identify and assess harmonization opportunities are notable for the unprecedented dialogue held at the joint public meetings and the agencies' development of 20 recommendations in just over 3 months. However, the agencies could not address all harmonization opportunities through this time-constrained study, and additional areas for harmonization may emerge as the markets continue to evolve. With the joint report completed, sustained coordination between CFTC and SEC is crucial as the agencies work to implement the report's recommendations and to assess remaining harmonization opportunities. Indeed, several of the report's recommendations direct the agencies to create a joint body or program to facilitate operational coordination.

Although agency staff told us that they plan to use the Joint Advisory Committee to coordinate future harmonization efforts, CFTC and SEC have not yet established goals with respect to harmonization or developed requirements to report and evaluate their progress toward these goals. With regard to the status of the joint report's recommendations, the agencies expect to have the Joint Advisory Committee functioning within months, but have not yet set time frames for implementing the report's other recommendations for agency action, which generally remain in the planning stages. We recognize that relatively little time has passed since the joint report was issued and that other agency priorities, such as working with Congress on drafting legislation, may delay action toward implementing these recommendations. As the agencies continue to work toward implementation, setting appropriate goals, including time frames, and reporting progress toward these goals could help to ensure that the agencies take timely actions to address these recommendations. Moreover, the agencies have not established a formal plan for identifying and assessing remaining harmonization opportunities as well as additional areas for harmonization that may emerge as a result of regulatory reform and market developments. Such a plan could establish clear objectives for assessing remaining harmonization opportunities, such as eliminating inconsistencies and gaps in oversight of similar products and entities. Without such a plan, ongoing harmonization efforts may become stalled and the agencies may not continue the process of determining which issues fall within or outside the scope of harmonization and what actions are needed to address them.

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## Recommendation for Executive Action

To help ensure that CFTC and SEC are strategically positioned to implement the joint report's recommendations and address remaining harmonization opportunities, we recommend that as CFTC and SEC continue to develop the charter for the Joint Advisory Committee, the Chairmen of CFTC and SEC take steps to establish, with associated time frames, clearer goals for future harmonization efforts and requirements for reporting and evaluating progress toward these goals. Specifically, the agencies could benefit from formalizing a plan to assess implementation of the joint report's recommendations and harmonization opportunities that may not have been fully addressed by the joint report, such as differences in market structure and investor definitions. Such a plan could include goals for future harmonization efforts, such as time frames for implementing the recommendations; assessment of whether remaining differences in statutes and regulations result in inconsistent regulation of similar products and entities that could lead to opportunities for regulatory arbitrage; and periodic reports to Congress on their progress, including the implementation and impact of the recommendations.

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## Agency Comments and Our Evaluation

We provided the Chairmen of CFTC and SEC with a draft of this report for their review and comment. CFTC and SEC provided us with written comments, which appear in appendixes III and IV. In their comments, both agencies agreed to take steps to implement our recommendation. CFTC stated that, consistent with this recommendation, the charter for the Joint Advisory Committee now provides that "[t]he committee shall work to develop clear and specific goals toward identifying and addressing emerging regulatory risks, protecting investors and customers, and furthering regulatory harmonization, and to recommend processes and procedures for achieving and reporting on those goals." SEC agreed that the agencies should work to define specific goals for harmonization, including setting time frames for implementing the joint report's recommendations and developing periodic reports to evaluate their progress in this area. SEC also agreed that developing a formal plan for identifying and assessing remaining and emerging harmonization opportunities would be beneficial to furthering the agencies' efforts. Both agencies noted their appreciation of our recognition of the joint report as a substantial positive step and commented that they are continuing to work toward implementing the joint report's recommendations. Finally, we received technical comments from CFTC and SEC that we have incorporated into the report, as appropriate.

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We are sending a copy of this report to the Chairman and the Ranking Member of the Subcommittee on Agriculture, Rural Development, Food and Drug Administration, and Related Agencies of the House Committee on Appropriations. We are also sending copies to the Chairman of the Commodity Futures Trading Commission, the Chairman of the Securities and Exchange Commission, and other interested parties. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions regarding this report, please contact me at (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in Appendix V.



Orice Williams Brown  
Director, Financial Markets  
and Community Investment

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# Appendix I: Scope and Methodology

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To describe how the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) identified and assessed significant differences in their statutes and rules, we reviewed and analyzed the joint report of CFTC and SEC on harmonization (joint report); transcripts of the panel discussions held at the joint public meetings hosted by the agencies on September 2 and 3, 2009; statements submitted to CFTC and SEC in response to the agencies' request for public comment on opportunities for harmonization; CFTC and SEC analyses of relevant differences in their statutes and regulations; and other agency documentation related to the joint report. We also interviewed CFTC and SEC staff who participated in the agencies' efforts to collect public input and draft the joint report.

To describe the status of the agencies' efforts to implement the joint report's recommendations, we reviewed and analyzed relevant provisions of proposed and enacted legislation that address legislative actions, including statutory changes, recommended in the joint report. Specifically, we analyzed and summarized provisions of H.R. 4173, as passed by the House of Representatives, that would address, at least in part, recommendations in the joint report. We reviewed the provision of the Consolidated Appropriations Act, 2010, that authorized funding for the Joint Advisory Committee as well as the agencies' draft charter for this committee. Finally, we spoke with CFTC and SEC staff about the status of statutory changes and agency actions recommended in the joint report.

To identify additional steps CFTC and SEC could take to harmonize their regulatory approaches, we interviewed CFTC and SEC staff and obtained and analyzed written comments on the joint report from representatives of securities and futures market participants, the investor community, and other experts who participated in the joint public meetings. Specifically, in January and February 2010, we developed and implemented a brief e-mail questionnaire to collect feedback on the joint report and its recommendations from market participants and other experts. On the basis of our review of the list of panelists who participated in the joint public meetings and our discussions with CFTC and SEC about how these panelists were selected, we determined that the 30 individuals who served as panelists were an appropriate group of respondents for this questionnaire. We also e-mailed this questionnaire to four other individuals, based on suggestions from CFTC and SEC. These individuals included former CFTC Commissioners and a representative of the Securities Industry and Future Markets Association who did not participate in the joint public meetings but submitted comments to the agencies on harmonization. In January 2010, we e-mailed our

questionnaire to the 34 individuals and requested written comments by early February 2010. We received 22 responses and analyzed these responses to identify areas that respondents believed could benefit from additional harmonization. Finally, we reviewed our prior work on futures and securities markets regulation, financial regulatory reform, and practices that can enhance and sustain collaboration among federal agencies.<sup>1</sup>

We conducted this performance audit from January 2010 to April 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>1</sup>For example, see [GAO/GGD-00-89](#), [GAO-09-216](#), and [GAO-06-15](#).

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# Appendix II: Briefing to Congressional Staff

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## **Briefing to Subcommittees on Financial Services and General Government, House and Senate Appropriations Committees**

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### **Mandated Review of the Joint Report of SEC and CFTC on Harmonization of Regulation**

#### **Preliminary Findings**

**February 26, 2010**

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## Briefing Outline

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- Objectives
  - Scope and Methodology
  - Background
  - Summary
  - CFTC and SEC Conducted Joint Analyses and Considered Public Input in Identifying and Assessing Significant Conflicts in Their Rules and Statutes
  - The Agencies Have Worked with Congress on Several Recommended Statutory Changes, While Most Recommendations for Agency Actions Remain in Planning Stages
  - Additional Harmonization Opportunities Exist, and Efforts to Assess These Opportunities Could Benefit from Clearer Goals and Accountability Requirements
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Draft – Preliminary Findings

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## Objectives

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1. How did the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) identify and assess conflicts between their laws and regulations and develop recommendations to address such conflicts?
  2. What progress have CFTC and SEC made towards implementation of the joint report's recommendations?
  3. What additional steps, if any, could CFTC and SEC take to eliminate or reduce inconsistencies in oversight, and enhance regulatory efficiency and effectiveness, as well as market transparency?
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Draft – Preliminary Findings

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## Scope and Methodology

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To accomplish our objectives, we

- reviewed and analyzed the SEC/CFTC harmonization report, documentation of public input obtained by CFTC and SEC through joint public meetings and a public comment period, and preliminary analyses conducted by CFTC and SEC on relevant differences in their statutes and regulations;
  - interviewed CFTC and SEC officials about how they identified and assessed harmonization opportunities and developed recommendations; progress made on the report's recommendations; and additional harmonization opportunities that may exist;
  - reviewed provisions in proposed legislation that may address SEC/CFTC recommendations for statutory changes;
  - obtained the views of market participants and other experts on the report's recommendations and additional opportunities for harmonization; and
  - reviewed prior GAO work and other relevant studies.
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Draft – Preliminary Findings

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## Background

- CFTC was created in 1974 with the mandate to regulate commodity futures and commodity options markets.
  - CFTC's mission is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options, and to foster open, competitive and financially sound futures and options markets.
  - Futures markets serve to provide a means for risk management and price discovery.
- SEC was created in 1934 to oversee the securities markets.
  - SEC's mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.
  - While both CFTC and SEC seek to promote market integrity and transparency, securities markets are concerned with capital formation. Certain securities markets, such as securities options and other securities derivatives markets, also facilitate the transfer of risk.
- Although CFTC and SEC generally oversee separate markets, their jurisdiction has overlapped in several areas. These areas have included:
  - Futures on single stocks and the Shad-Johnson Accord;
  - Innovative products that have features of both futures and securities; and
  - Dually registered broker-dealers and futures commission merchants.

Draft – Preliminary Findings

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## Background (continued)

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- In its June 2009 White Paper on financial regulatory reform, the Department of the Treasury (Treasury) noted that the broad public policy objectives of futures and securities regulation are the same, and that many differences in regulation exist between the markets that are no longer justified.
  - Treasury expressed the following concerns:
    - Economically equivalent instruments may be regulated in a different manner, depending on which agency has jurisdiction;
    - Jurisdictional disputes consume significant agency resources, and uncertainty about the outcome of such disputes may impede innovation; and
    - The agencies follow different approaches to regulation of exchanges, clearing organizations, and intermediaries.
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Draft – Preliminary Findings

6



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## Background (continued)

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- In the White Paper, Treasury recommended that CFTC and SEC issue a report to Congress by September 30, 2009 on all existing conflicts in statutes and regulations with respect to similar types of financial instruments. The report was either to explain why those differences are essential to achieving underlying policy objectives or to make recommendations for changes to statutes and regulations that would eliminate the differences.
- In October 2009, CFTC and SEC responded to this request with a joint report on harmonization of their regulatory approaches.

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Draft – Preliminary Findings

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## Summary

- CFTC and SEC conducted joint analyses and sought public input to inform their efforts to identify and assess significant conflicts in their rules and statutes. The agencies obtained public input through joint public meetings and a public comment period and worked together to analyze this input. In drafting the report, CFTC and SEC grouped issues into eight potential areas for harmonization and made at least one recommendation in all but one of these areas. The joint report also includes several recommendations to enhance coordination between the agencies.
- Most of the joint report's recommendations for statutory changes have yet to be enacted, and the recommendations for agency action are in the planning stages. According to agency officials, since October 2009, CFTC and SEC have focused on working with Congress on drafting legislation to address recommended statutory changes. Proposed legislation includes provisions that may address the joint report's recommendations to expand the authority of one or both of the agencies in areas including exchange rules, enforcement, and cross-border access.

Draft – Preliminary Findings

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## Summary (continued)

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- Additional harmonization opportunities exist, and future efforts by CFTC and SEC to assess these opportunities could benefit from clearer goals and accountability requirements. Given time constraints, agency officials said that the agencies could not address all conflicts through the joint report's recommendations. Market participants identified several areas they believe could benefit from additional harmonization efforts, including portfolio margining and investor definitions. The agencies plan to coordinate future harmonization efforts through a joint committee, but the draft charter for this committee does not include clear goals for harmonization and requirements for the agencies to report and evaluate their progress towards meeting such goals. Without a clearer vision to guide future harmonization efforts and mechanisms to ensure accountability for these efforts, CFTC and SEC may not be strategically positioned to address remaining opportunities for harmonization.
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Draft – Preliminary Findings

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## Agencies Conducted Joint Analyses and Sought Public Input to Inform Report

- CFTC and SEC conducted joint analyses and obtained public input to identify significant conflicts in statutes and regulations.
  - In July and August 2009, CFTC and SEC worked together on a preliminary side-by-side analysis of their statutes and regulations.
  - The agencies sought input from market participants and other experts by hosting joint public meetings in early September 2009 and providing an opportunity for public comment from August 19 to September 14, 2009.
  - At the joint public meetings, CFTC and SEC held panel discussions to address differences in five broad categories: (1) regulation of exchanges and markets; (2) regulation of intermediaries; (3) regulation of clearance and settlement; (4) enforcement; and (5) regulation of investment funds.
  - CFTC and SEC officials said that given the short timeline, they focused on identifying significant areas of difference and developing actionable recommendations.

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## Agencies Conducted Joint Analyses and Sought Public Input to Inform Report

- CFTC and SEC worked together to analyze the public input and to develop the report's recommendations.
- In drafting the joint report, the agencies grouped issues into eight potential areas for harmonization and made at least one recommendation in all but one of these areas.
- The agencies also made several recommendations to enhance coordination between them:
  - Create a Joint Advisory Committee to be tasked with considering and developing solutions to emerging and ongoing issues of common interest in the futures and securities markets;
  - Create a Joint Agency Enforcement Task Force;
  - Establish a cross-agency training program;
  - Develop a program for sharing staff through detail assignments; and
  - Create a Joint Information Technology Task Force.

Draft – Preliminary Findings

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## Overview of Recommendations

Areas of Difference	Recommendations for statutory change	Recommendations for agency action
1. New products	Facilitate product approval process and provide legal certainty	N/A
2. Exchange rules	Enhance CFTC authority over exchange compliance with CEA <sup>1</sup>	N/A
3. Margin/insolvency	Facilitate portfolio margining	Study effects of portfolio margining changes
4. Market structure	N/A	N/A
5. Trading practices	Expand CFTC’s conflict of interest prevention authority; enhance whistleblower protections; clarify CEA’s restitution remedy; enhance CFTC’s authority over disruptive trading practices; expand the scope of insider trading provisions under the CEA; and expand SEC’s statutory authority for aiding and abetting	N/A

<sup>1</sup> Commodity Exchange Act



## Overview of Recommendations (continued)

Areas of Difference	Recommendations for statutory change	Recommendations for agency action
6. Customer protection standards	Establish a uniform fiduciary standard for those providing investment advisory services	N/A
7. Dual registrants	N/A	Align record retention requirements for intermediaries; align customer risk disclosure documents; and align specific private fund reporting requirements
8. Cross-border access	Empower CFTC to require foreign boards of trade to register with CFTC	Review approach to cross-border access (SEC)

Source: SEC and CFTC, *Joint Report of the SEC and the CFTC on Harmonization of Regulation*, October 2009.

N/A = Not applicable

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## Most Recommendations Have Yet to Be Enacted or Remain in Planning Stages

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- Status of recommendations for statutory changes:
  - SEC and CFTC officials said that since the report issued in October 2009, they have focused on assisting Congress with drafting language for statutory changes.
  - Congress has authorized funding for the Joint Advisory Committee, but other recommended statutory changes have not been enacted.
  - Provisions in H.R. 4173, as passed by the House of Representatives, would address some of these recommendations.

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## Most Recommendations Have Yet to Be Enacted or Remain in Planning Stages

### Summary of H.R. 4173 provisions that would address recommended changes:

Area of Difference	SEC/CFTC Recommendation	Provision in H.R. 4173
Exchange Rules	Enhance CFTC authority over exchange and clearinghouse compliance with the CEA	Section 3114 would partially implement this recommendation by expanding the time period allowed for CFTC review of new rules and by repealing certain procedural requirements for CFTC to file an enforcement action for violation of core principles. Sections 3103 and 3111 include amended core principles for clearinghouses and contract markets, respectively, clarifying the CFTC's rulemaking authority to determine the appropriate manner of compliance with the CEA. H.R. 4173 would not amend the CEA to provide for agency approval of proposed rule changes based on a finding that the change is consistent with the CEA and regulations.
Margin / Insolvency	Facilitate portfolio margining	Section 7509 would partially implement this recommendation by amending the Securities Investor Protection Act to extend insurance protection to futures held in a securities portfolio margin account.
Customer Protection Standards	Establish a uniform fiduciary duty standard for those providing investment advisory services	Section 7103 would partially implement this recommendation by amending the Securities Exchange Act (SEA) and the Investment Advisors Act to create a fiduciary duty for brokers, dealers, and investment advisors.

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## Most Recommendations Have Yet to Be Enacted or Remain in Planning Stages

**Summary of H.R. 4173 provisions that would address recommended changes (continued):**

Area of Difference	SEC/CFTC Recommendation	Provision in H.R. 4173
Trading Practices	Expand CFTC’s conflict of interest prevention authority  Enhance whistleblower protections  Enhance CFTC authority over disruptive trading practices  Grant SEC specific statutory authority for aiding and abetting under the Securities Act and the Investment Company Act	Section 3108 would authorize CFTC to require futures commission merchants and introducing brokers to implement conflict of interest procedures separating research and analysis from trading and clearing activities.  Section 7203 would partially implement this recommendation by amending the SEA to enhance whistleblower protections.  Section 3118 would amend the CEA to expand CFTC’s authority over certain disruptive trading practices.  Sections 7207 & 7208 would grant SEC specific statutory authority for aiding and abetting under the Securities Act and the Investment Company Act.
Cross-border access	Empower CFTC to require certain foreign boards of trade to register with CFTC and to meet certain standards that enhance transparency and market integrity.	Section 3115 would amend the CEA to authorize CFTC to require foreign boards of trade seeking to provide direct access to persons in the U.S. to meet certain standards for transparency and market integrity with respect to contracts where the price is linked to a contract trading on a U.S. exchange, but does not require registration in the U.S.



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## Most Recommendations Have Yet to Be Enacted or Remain in Planning Stages

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Status of recommendations for agency action:

- CFTC and SEC have drafted a charter for the Joint Advisory Committee.
- The report's other recommendations for agency action generally are in the planning or initiation stages.
- The agencies plan to have the Joint Advisory Committee functioning by late spring or early summer 2010, but have not set timelines for implementing the other recommendations that do not require statutory changes.

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Draft – Preliminary Findings

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## **Additional Opportunities for Harmonization Exist**

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- Given time and resource constraints, agency officials said that they could not address all areas of difference through the joint report’s recommendations.
  - CFTC and SEC officials said they did not explicitly define the term “harmonization” and focused on jurisdictional disputes and broad differences in regulation, which agency officials viewed as encompassing differences in the regulation of economically equivalent products.
  - The report does not recommend changes to address some differences that may create incentives for regulatory arbitrage—that is, some remaining differences in rules and statutes may influence market participants’ incentives to invest in a particular product or have a product regulated as a security or future.
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Draft – Preliminary Findings

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## Additional Opportunities for Harmonization Exist

- In written comments provided to GAO, market participants and other experts identified areas they believe could benefit from additional harmonization efforts.
  - **Greater legal certainty for new products:** Some market participants called for an administrative body to resolve disputes, but agency officials cited precedents and pending legislation in which courts serve as venues for deciding questions concerning the legal definitions of securities and futures.
  - **Oversight of exchange and clearinghouse rules:** Some market participants recommended that SEC move towards greater self-certification of new exchange rules. SEC officials noted that recent changes streamlined SEC's process, but acknowledged that differences remain.
  - **Portfolio margining:** Agency officials agreed that there are issues related to portfolio margining that merit further consideration.
  - **Market structure:** Market participants had mixed views on the need to resolve differences in market structure.
  - **Harmonizing investor definitions:** Agency officials agreed that this is an area for potential harmonization.

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## Clearer Goals and Accountability Requirements Could Enhance Future Harmonization Efforts

- CFTC and SEC officials told us that the agencies may use the Joint Advisory Committee to identify and address harmonization issues involving conflicts between the two agencies' approaches to regulation.
- However, the draft charter for the Joint Advisory Committee does not establish clear goals for harmonization and requirements for reporting and evaluating progress towards such goals.
- GAO has identified practices that can help enhance and sustain coordination among federal agencies. These practices include:
  - defining and articulating a common outcome;
  - developing mechanisms to monitor, evaluate, and report on results; and
  - reinforcing agency accountability for collaborative efforts through agency plans and reports. (GAO-06-15)
- Consistent financial oversight of similar products and institutions – one of GAO's nine principles for financial regulatory reform – could be used to guide CFTC/SEC efforts to define and articulate a common outcome. (GAO-09-216)
- Without clear goals and accountability requirements to guide future coordination efforts, the agencies may not be strategically positioned to address remaining harmonization opportunities. Furthermore, without clearly defined objectives for harmonization, CFTC and SEC cannot readily determine which issues fall within or outside the scope of harmonization.

Draft – Preliminary Findings

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## Recommendation

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- To ensure that CFTC and SEC are strategically positioned to implement the joint report's recommendations and address remaining harmonization opportunities, we recommend that as CFTC and SEC continue to develop the charter for the Joint Advisory Committee, they take steps to establish clearer goals for future harmonization efforts and requirements for reporting and evaluating progress towards these goals. Specifically, the agencies could benefit from formalizing a plan to assess implementation of the joint report's recommendations and harmonization opportunities that may not have been fully addressed by the joint report, such as differences in market structure and investor definitions. Such a plan could include assessment of whether remaining differences in statutes and regulations result in inconsistent regulation of similar products and entities that could lead to opportunities for regulatory arbitrage, and periodic reports to Congress on their progress, including the implementation and impact of the recommendations.
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# Appendix III: Comments from the Commodity Futures Trading Commission



## U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581  
Telephone: (202) 418-5000  
Facsimile: (202) 418-5521  
[www.cftc.gov](http://www.cftc.gov)

April 16, 2010

Orice Williams Brown  
Director  
Financial Markets and Community Investment  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Ms. Brown:

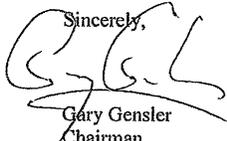
We have received and reviewed the Government Accountability Office's ("GAO's") draft report entitled "Clearer Goals and Reporting Requirements Could Enhance Efforts by CFTC and SEC to Harmonize Their Regulatory Approaches" ("Report"). We commend you for the time and effort that the GAO has devoted to preparing this Report.

We appreciate the GAO's conclusion that the joint report on harmonization of CFTC and SEC regulation ("joint report") represented "a substantial positive step towards reducing and eliminating inconsistencies in the agencies' regulatory approaches." The joint report was made possible by unprecedented dialogue and cooperation between the two agencies.

We note the Report's observation that many of the joint report's recommendations are either currently under consideration by Congress or in the planning stages. Congress is making great progress on legislation to reform financial regulation. As the Report states, a number of the legislative recommendations are included in the financial regulatory reform bill recently passed by the House of Representatives, H.R. 4173. Additionally, the CFTC and the SEC are moving forward with plans to establish a joint advisory committee. In this regard, and consistent with the Report's recommendation, the joint advisory committee charter now provides that "[t]he committee shall work to develop clear and specific goals toward identifying and addressing emerging regulatory risks, protecting investors and customers, and furthering regulatory harmonization, and to recommend processes and procedures for achieving and reporting on those goals." The agencies continue to work on the other recommendations included in the joint report.

Once again, we thank you and your staff for their work on this project.

Sincerely,



Gary Gensler  
Chairman

# Appendix IV: Comments from the Securities and Exchange Commission



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

April 15, 2010

Ms. Orice Williams Brown  
Director, Financial Markets and Community Investment  
United States Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Ms. Brown:

This letter responds to your request, dated April 1, 2010, to review and comment on the draft report entitled *Financial Regulation: Clearer Goals and Reporting Requirements Could Enhance Efforts by CFTC and SEC to Harmonize Their Regulatory Approaches* (GAO-10-410) ("GAO Report").

Thank you for providing us with the opportunity to comment on the draft GAO Report. We appreciate the GAO Report's recognition that the *Joint Report of the SEC and the CFTC on Harmonization of Regulation* ("Joint Report") represents a substantial positive step towards reducing and eliminating inconsistencies in the agencies' regulatory approaches. Specifically, the GAO Report acknowledges the unprecedented dialogue that resulted from the first ever public joint meetings held by the two agencies and the agencies' development of 20 recommendations in just over three months.

The issuance of the Joint Report represents a significant step forward that will help us to achieve the many benefits of greater coordination and harmonization between the SEC and the CFTC. As the GAO noted, the focus of the Joint Report was on a number of significant issues that emerged from the agencies' public deliberations as the matters most relevant to a reconciliation of the two agencies' statutory and regulatory schemes. The 20 recommendations offered in the Joint Report will help to fill regulatory gaps, eliminate inconsistent oversight, and promote greater collaboration.

The agencies are working together and are committed to ensuring that progress is being made towards the implementation of the Joint Report's recommendations. As noted in the GAO Report, several of the substantive recommendations in the Joint Report require action by Congress. The Commission staff has been working with the CFTC staff on providing recommendations for legislation. Further, the establishment of the Joint Advisory Committee will be an important resource as the SEC and CFTC fulfill their respective missions and further the initiative on harmonization.

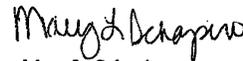
Ms. Orice Williams Brown  
Page 2

At the same time, we agree with the GAO that the Commission and the CFTC should continue to evaluate and consider areas where there may be opportunities for additional harmonization. Accordingly, the GAO's suggestion of developing a formal plan for identifying and assessing remaining and emerging harmonization opportunities would be beneficial to furthering the agencies' efforts.

In addition, to ensure that the Joint Report's recommendations are implemented and to continue to move forward with our harmonization efforts, we agree with the GAO that the agencies should work to define specific goals for harmonization, including setting time frames for implementing the Joint Report's recommendations and developing periodic reports to evaluate our progress in this area.

Thank you again for the consideration that you and your staff have shown to our staff and the opportunity to comment on this draft report. If you have any questions or would like to further discuss this letter, please feel free to contact Robert Cook, Director of the Division of Trading and Markets, at (202)551-5500, or Jamie Brigagliano, Deputy Director, at (202)551-5700.

Sincerely,



Mary L. Schapiro  
Chairman

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# Appendix V: GAO Contact and Staff Acknowledgments

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## GAO Contact

Orice Williams Brown (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Karen Tremba (Assistant Director), John Fisher, Matt McDonald, Omyra Ramsingh, Jennifer Schwartz, Andrew Stavisky, and Richard Tshara made significant contributions to this report.

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# Related GAO Products

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*Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System.* [GAO-09-216](#). Washington, D.C.: January 8, 2009.

*Commodity Futures Trading Commission: Trends in Energy Derivatives Markets Raise Questions about CFTC's Oversight.* [GAO-08-25](#). Washington, D.C.: October 19, 2007.

*Financial Regulation: Industry Trends Continue to Challenge the Federal Regulatory Structure.* [GAO-08-32](#). Washington, D.C.: October 12, 2007.

*Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies.* [GAO-06-15](#). Washington, D.C.: October 21, 2005.

*Financial Regulation: Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure.* [GAO-05-61](#). Washington, D.C.: October 6, 2004.

*CFTC and SEC: Issues Related to the Shad-Johnson Jurisdictional Accord.* [GAO/GGD-00-89](#). Washington, D.C. April 6, 2000.

*The Commodity Exchange Act: Issues Related to the Commodity Futures Trading Commission's Reauthorization.* [GAO/GGD-99-74](#). Washington, D.C.: May 5, 1999.

*The Commodity Exchange Act: Legal and Regulatory Issues Remain.* [GAO/GGD-97-50](#). Washington, D.C.: April 7, 1997.

*Financial Market Regulation: Benefits and Risks of Merging SEC and CFTC.* [GAO/T-GGD-95-153](#). Washington, D.C.: May 3, 1995.

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