

COMMODITY FUTURES TRADING COMMISSION

**SEMIANNUAL REPORT  
OF THE**

**OFFICE OF THE  
INSPECTOR GENERAL**



FOR THE PERIOD ENDING September 30, 2011



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of the  
Inspector General

October 31, 2011

TO: The Commission

FROM: A. Roy Lavik *ARL*  
Inspector General

SUBJECT: Semiannual Report of the Office of the Inspector General

Attached is the Office of the Inspector General's Semiannual Report (SAR) for the period from April 1, 2011 through September 30, 2011. This report is submitted to you in accordance with the requirements of Section 5 of the Inspector General Act of 1978, as amended. 5 USC App. 3 sec. 5.

The Dodd-Frank Act altered the relationship of the designated Federal entity Offices of Inspector General with the agency head by establishing that "head" of a designated Federal entity means "the board or commission of the designated Federal entity." P.L. 111-203, Title IX, Subtitle I, sec. 989B, 124 Stat. 1945 (codified at 5 USC App. 3 sec. 8G(a)(4)). In accordance with the Dodd-Frank Act, we submit this report to the Chairman and to each Commissioner.

Under section 5(b) of the IG Act, the SAR shall be transmitted to the appropriate committees or subcommittees of the Congress within thirty days after receipt of the Semiannual report, together with a report by the head of the establishment conforming to the requirements of section 5(b) of the IG Act.

I appreciate your continuing support of this office.

**Recipients:**

**Gary Gensler  
Chairman**

**Bart Chilton  
Commissioner**

**Mark P. Wetjen  
Commissioner**

**Scott D. O'Malia  
Commissioner**

**Jill E. Sommers  
Commissioner**

**Attachment:**

**Semiannual Report for the CFTC OIG**

# OFFICE OF THE INSPECTOR GENERAL COMMODITY FUTURES TRADING COMMISSION

SEMIANNUAL REPORT  
FOR THE PERIOD FROM  
April 1, 2011 through September 30, 2011

## EXECUTIVE SUMMARY

This semiannual report is issued by the Office of the Inspector General (OIG) for the Commodity Futures Trading Commission (CFTC) pursuant to the Inspector General Act of 1978, as amended. It summarizes OIG's activities and accomplishments for the period April 1, 2011, through September 30, 2011. During this period, OIG completed one investigation, completed one review, completed a procurement, began an investigation, and began the Fiscal Year (FY) 2011 contract audits of CFTC's financial statements and the Customer Protection Fund's financial statements. OIG reviewed proposed enforcement actions and rules proposed by CFTC and by regulated entities, participated in training, visited CFTC field offices, and participated in Government-wide OIG professional and cooperative meetings and training. One investigation was closed during the reporting period. One investigation, initiated in the last reporting period, remained pending at the close of this reporting period. No significant problems, abuses or deficiencies regarding CFTC programs and operations were identified during this reporting period.

Highlights of OIG's completed and ongoing audit, inspection, review, investigative and other projects include:

- OIG completed two reports addressing the cost-benefit analyses performed by the Agency in connection with proposed rulemakings undertaken pursuant to the Dodd-Frank Act. OIG examined in detail the cost-benefit analyses published in connection with eight proposed rulemakings. Overall, our examinations indicated that the cost-benefit analyses in most cases were largely drafted, supervised, or controlled by attorneys, with input from economists at times lacking or disregarded. We recommended that the cost-benefit analyses be more robust, with the economists given a greater role, and are pleased with subsequent guidance for cost-benefit analyses issued by the Agency, as well as the cost-benefit analysis to apply to the final rules published in order to implement Dodd-Frank.
- OIG began its contract audit of CFTC's FY 2011 financial statements.
- OIG began its FY 2011 review of CFTC's implementation of the Federal Managers' Financial Integrity Act (FMFIA)
- OIG began its FY 2011 review of CFTC's implementation of the Federal Information Security Management Act (FISMA)

- In accordance with the Dodd-Frank Act, OIG began a contract audit of the CFTC Customer Protection Fund.
- OIG began an inspection into record retention practices by the Division of Enforcement pertaining to investigative records. This inspection should enable us to ascertain, over the review period, whether CFTC-DOE policies and procedures complied with National Archives and Records Administration (NARA) guidelines for retaining/destroying investigative files.
- OIG began an inspection into a disclosure of trade information to Congress in 2008. This inspection should enable us to ascertain the Commissions' procedures and controls associated with the disclosure of trade information in 2008 (and to review any revisions since then), to determine whether existing procedures were adequate and followed.
- OIG began an investigation of anonymous allegations pertaining generally to technical aspects of the proposed rulemaking addressing position limits for swaps, and alleging poor management of the rulemaking team.
- OIG hired an experienced auditor and implemented the recommendations reported in the peer review of the OIG audit function issued by the Federal Election Commission OIG on March 31, 2011.

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# OFFICE OF THE INSPECTOR GENERAL COMMODITY FUTURES TRADING COMMISSION

SEMIANNUAL REPORT  
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## INTRODUCTION

### 1. CFTC Programs and Operations

Congress created the Commodity Futures Trading Commission in 1974 as an independent agency with the mandate to regulate commodity futures and options markets in the United States. The Commission's mandate was renewed and/or expanded in 1978, 1982, 1986, 1992 and 1995. In December 2000, the Commission was reauthorized by Congress and the President through Fiscal Year 2005 with the passage of the Commodity Futures Modernization Act of 2000 (CFMA). In May of 2008, Congress reauthorized the CFTC through Fiscal Year 2013. On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), P.L. 111-203, which expanded CFTC's jurisdiction and authorities.

The CFTC is responsible for fostering the economic utility of futures markets by encouraging their competitiveness and efficiency, ensuring their integrity and protecting market participants against manipulation, abusive trade practices and fraud. Through effective oversight regulation, the CFTC enables the commodity futures markets better to serve their vital function in the nation's economy—providing a mechanism for price discovery and a means of offsetting price risks. The new Dodd-Frank Act authorizes the CFTC to regulate swap dealers, increase transparency and improve pricing in the derivatives marketplace, and lower risk to the American public.

The CFTC operating divisions are: Office of the Chairman, Office of the Executive Director, Office of General Counsel, Office of the Chief Economist, Division of Clearing and Risk, Division of Data and Technology, Division of Enforcement, Office of International Affairs, Division of Market Oversight, and Division of Swap Dealer and Intermediary Oversight. In addition to its headquarters office in Washington, DC, the CFTC maintains offices in Chicago, Illinois; Kansas City, Missouri; and New York, New York.

### 2. OIG Responsibilities

The CFTC OIG was created in 1989 in accordance with the 1988 amendments to the Inspector General Act of 1978 (P.L. 95-452). OIG was established as an independent unit to:

- Promote economy, efficiency and effectiveness in the administration of CFTC programs and operations and detect and prevent fraud, waste and abuse in such programs and operations;
- Conduct and supervise audits, inspections, evaluations, reviews, projects and, where necessary, investigations relating to the administration of CFTC programs and operations;

- Review existing and proposed legislation, regulations and exchange rules and make recommendations concerning their impact on the economy and efficiency of CFTC programs and operations or the prevention and detection of fraud and abuse; and
- Keep the Chairman and Congress fully informed about any problems or deficiencies in the administration of CFTC programs and operations and provide recommendations for correction of these problems or deficiencies.

It is the duty and responsibility of the OIG to conduct, supervise and coordinate audits relating to CFTC programs and operations in accordance with generally accepted government auditing standards. OIG is also charged with the duty and responsibility to recommend changes to existing and proposed CFTC programs and operations to promote economy, efficiency and effectiveness and to prevent and detect fraud and abuse.

The purpose of OIG audits, inspections, evaluations, reviews and projects generally is to ensure that:

- Funds have been expended in a manner consistent with related laws, regulations and policies;
- Resources have been managed effectively and efficiently;
- Stipulated program objectives have been achieved;
- Agency operations have not been subject to improper influence or corruption; and
- Resources have been safeguarded.

OIG operates independently of the Agency and has not experienced any interference from the CFTC Chairman in connection with the conduct of any investigation or audit, inspection, evaluation, review or project, and our investigations have been pursued regardless of the rank or party affiliation of the target. OIG has also conducted audits, inspections, evaluations, reviews and other projects without interference where OIG has perceived the need to recommend improvement to futures regulation efforts, again without regard to the party affiliation of any Chairman.<sup>1</sup>

CFTC is a designated Federal entity (DFE) under the IG Act of 1978, as amended. 5 USC App. 3 sec. 8G(a)(2). The Dodd-Frank Wall Street Reform and Consumer Protection Act altered the relationship between the DFE Inspectors General and the agency head by clarifying that “head” of a DFE means “the board or commission of the designated Federal entity.” P.L. 111-203, Title IX, Subtitle I, sec. 989B, 124 Stat. 1945 (codified at 5 USC App. 3 sec. 8G(a)(4)). The effective date of this provision was July 22, 2010. The OIG has not experienced any interference from the head of the CFTC in the conduct of its official duties.

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<sup>1</sup> The Inspector General Act of 1978, as amended, states: “Neither the head of the establishment nor the officer next in rank below such head shall prevent or prohibit the Inspector General from initiating, carrying out, or completing any audit or investigation....” 5 U.S.C. App. 3 sec. 3(a).

### 3. OIG Resources

OIG consists of the Inspector General, a part-time Supervisory Senior Auditor hired at the close of the prior reporting period, a full-time Senior Auditor, an Attorney-Advisor and a secretary. The Inspector General assumed his position on October 7, 1990. The part-time Supervisory Senior Auditor joined the office in March 2011, the full-time Senior Auditor joined the office in 1999, and the Attorney-Advisor joined in 2007.

## COMPLETED AUDITS, INSPECTIONS, EVALUATIONS, REVIEWS and OTHER PROJECTS

### 1. Completed Audits

No audits were completed during this reporting period.

### 2. Completed Inspections, Evaluations, Reviews and Other Projects

On May 4, 2011, we received a request from 10 Senators seeking our review of CFTC's cost-benefit analyses provided in connection with an additional four rules proposed under Dodd-Frank. The 10 Senators requested similar reviews of the economic analysis devoted to Dodd-Frank rulemakings from the Inspectors General for the Federal Reserve Board, the Department of Treasury, the Securities and Exchange Commission, and the Federal Deposit Insurance Corporation. CFTC OIG completed its review on June 15, 2011, and it is discussed fully under Congressional Inquiries *infra* at page 8.

## IN-PROCESS AUDITS, INSPECTIONS, EVALUATIONS, REVIEWS and OTHER PROJECTS

### 1. In-process Audits

#### a. Audit of CFTC Financial Statements for Fiscal Year 2011

##### Background

In FY 2002, Congress passed the Accountability of Tax Dollars Act. The Act requires the CFTC, along with numerous other Federal entities, to obtain an independent financial statement audit each year. During the reporting period, the Inspector General selected an independent public accountant (IPA) to render an opinion on the agency's financial statements for Fiscal Year 2011 in accordance with generally accepted auditing standards, Government Auditing Standards, OMB Bulletin 01-02 and OMB Circular A-136.

## Audit Objective

The objective of this audit is to render an opinion on the CFTC's financial statements and report on internal controls and compliance with laws and regulations.

## Status

In May 2011, the Inspector General selected an independent public accountant to conduct the CFTC Financial Statement Audit. The Fiscal Year 2011 audit began in June with an entrance conference with senior agency managers, the OIG and representatives from the IPA. Further meetings and reviews have taken place throughout this reporting period while work on the audit is ongoing. The final audit report is to be delivered to the Office of the Inspector General in November 2011.<sup>2</sup>

## **b. Audit of CFTC Customer Protection Fund for Fiscal Year 2011**

### Background

Section 745(g)(5)(I) of the Dodd-Frank Act requires the Agency to submit to Congress a yearly report on the Commission's whistleblower award program that includes a complete set of audited financial statements, including a balance sheet, income statement, and cash flow analysis. The OIG is undertaking this required audit.

### Audit Objective

The objective of this audit is to render an opinion on the CFTC's Customer Protection Fund's financial statements and report on the Customer Protection Fund's internal controls and compliance with laws and regulations. As part of this audit, the OIG will also review the agency's report to select Congressional committees on activities of the Customer Protection Fund during the previous year.

### Status

Prior to the close of the reporting period CFTC OIG contracted with an independent public accounting firm to perform this audit, and the audit was in progress at the close of the reporting period. The audit report is scheduled to be issued by October 24, 2011.

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<sup>2</sup> The IG Act and the Federal Financial Management Improvement Act of 1996 (FFMIA) require the Inspectors General of certain agencies to report "instances and reasons" when the Agency has not met intermediate target dates established in a remediation plan to bring the Agency's financial management system into substantial compliance with the FFMIA. CFTC is not subject to the FFMIA; however, it voluntarily seeks to comply with its requirements. During this reporting period, there were no events giving rise to a duty to report under FFMIA.

## **2. In-process Inspections, Evaluations, Reviews and Other Projects**

### **a. Review of Compliance with the Federal Managers' Financial Integrity Act, FMFIA**

The Federal Managers' Financial Integrity Act of 1982 requires federal managers to establish a continuous process for evaluating, improving, and reporting on the internal control and accounting systems for which they are responsible. OMB Circular A-123, revised December 2004, "Management Accountability and Control," is the implementing guidance for FMFIA. The annual FMFIA report will be included in the CFTC Annual Performance Report (APR).

#### **Status**

The Office of the Inspector General is in the process of receiving and reviewing draft internal control reviews produced by agency staff, and will provide comments to the originating divisions. OIG will report its evaluation of the final FMFIA documents in its annual assurance letters to the Chairman which will be included in the APR.

### **b. Evaluation of Compliance with the Federal Information Security Management Act at CFTC**

The Federal Information Security Management Act (FISMA) was enacted on December 17, 2002. FISMA requires the Office of the Inspector General to perform annual independent evaluations of the information security program and practices of the agency.

#### **Status**

The OIG is currently completing its evaluation of the agency's FISMA related documents and will submit its assessment along with the agency's documents to the Office of Management and Budget by November 1, 2011.

### **c. Inspection of the Division of Enforcement's Investigative Records Disposition Policy**

#### **Background**

The CFTC Division of Enforcement (CFTC-DOE) is authorized to conduct investigations of industry participants for non-compliance with the Commodity Exchange Act and product related malfeasance. It is incumbent upon CFTC-DOE management to assure that all enforcement records are disposed of as authorized under record retention schedules approved by the National Archives and Records Administration.

## Objective

This inspection will enable us to ascertain, over the review period (January 1, 2008 to August 1, 2011), whether the CFTC-DOE policies and procedures complied with National Archives and Records Administration guidelines for retaining/destroying investigative files.

## Status

At the close of the reporting period this inspection was ongoing.

# AUDIT REPORTS and REVIEWS OVER SIX MONTHS OLD

## 1. Corrective Action not Completed

There were no instances of audit reports over six months old where corrective action had not been completed.

## 2. Corrective Action Completed

There were no instances of reports issued before the commencement of the reporting period for which corrective action had been completed by the end of the reporting period.

## 3. Management Decision not Made

There were no instances of a report issued before the commencement of the reporting period for which a management decision had not been made by the end of the reporting period.

# INVESTIGATIONS

## 1. Completed Investigations

The Inspector General Act of 1978, as amended, provides that the Inspector General may receive and investigate complaints or information from the Commission's employees and other sources concerning the possible existence of an activity constituting a violation of law, rules or regulations, or mismanagement, abuse of authority, or gross waste of funds, or a substantial and specific danger to the public health and safety. At the end of the prior reporting period, significant staff resources were devoted to an investigation requested by the Chairman of the House Agriculture Committee and the Chairman of the Subcommittee on General Farm

Commodities and Risk Management regarding cost benefit analyses under the Dodd-Frank Act. OIG issued its report of investigation on April 15, 2011, and it is discussed fully under Congressional Inquiries *infra* at page 8.

2. **Ongoing Investigations**

The CFTC OIG does not comment on all ongoing investigations. Ongoing investigations that have become public, through the press or otherwise, will be discussed in semi-annual reports, absent exigent circumstances.

Investigation Involving the Office of Proceedings During the prior reporting period, we received an allegation of misconduct involving staff and management in the Office of Proceedings. Due to an internal conflict within the OIG, as well as resource concerns, we reached out to the OIG investigative community and obtained consent from the Treasury Inspector General for Tax Administration (TIGTA) to conduct this investigation. The CFTC entered into a formal Economy Act<sup>3</sup> agreement with TIGTA, and the investigation was ongoing at the close of this reporting period.

Investigation Involving Position Limits Rulemaking During this reporting period we received two anonymous allegations pertaining to the position limit rulemaking currently being undertaken by the CFTC pursuant to the Dodd-Frank Act. At the close of the reporting period, the rule was not yet final. After receiving the allegations, CFTC OIG began interviews in order to review or survey the position limits rulemaking. This inquiry was ongoing at the end of the reporting period.

<p style="text-align: center;"><b>SUMMARY OF MATTERS REFERRED TO PROSECUTORIAL AUTHORITIES</b></p>
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No matters were referred to prosecutorial authorities during this reporting period.

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<sup>3</sup> The Economy Act (31 U.S.C. 1535) authorizes agencies to enter into agreements to obtain supplies or services by interagency acquisition.

## CONGRESSIONAL INQUIRIES

The Inspector General continues to be involved in legislative activities pertaining to both the CFTC and the IG community. The IG serves on the legislation committee for the Council of Inspectors General on Integrity and Efficiency, which discusses and provides guidance on pending legislation affecting the IG community. At the end of the prior reporting period significant staff resources were devoted to an investigation requested by the Chairman of the House Agriculture Committee and the Chairman of the Subcommittee on General Farm Commodities and Risk Management. The investigation addressed the cost-benefit analyses issued in connection with four of CFTC's proposed rulemakings under the Dodd-Frank Act, and OIG completed this investigation on April 15, 2011.

On May 4, 2011, OIG received a request from 10 Senators seeking our review of CFTC's cost-benefit analyses provided in connection with an additional four rules proposed under Dodd-Frank. The 10 Senators additionally requested reviews of the economic analyses devoted to Dodd-Frank rulemakings from the Inspectors General for the Federal Reserve Board, the Department of Treasury, the Securities and Exchange Commission, and the Federal Deposit Insurance Corporation. CFTC OIG completed its review on June 15, 2011.

### **1. A Review of Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act**

#### **Background**

CFTC OIG reviewed the formulation of cost benefit analyses for four notices of proposed rulemakings recently published by the Commodity Futures Trading Commission. We undertook this review at the request of ten members of the Senate Committee on Banking, Housing, and Urban Affairs. The request issued May 4, 2011, and requested our response by June 13, 2011.

The four rules addressed: 1) the treatment of segregated funds of swaps customers; 2) derivatives clearing organization risk management requirements; 3) swaps relationship documentation requirements; and 4) core principles for swap execution facilities. Three of the proposed rules were published in the Federal Register in January and February of this year. The proposed rule addressing the treatment of segregated funds of swaps customers was issued by the Commission in April 2011.

In order to complete this review, we reviewed drafts of the cost-benefit analyses for the four proposed rules, as well as staff e-mail and internal memoranda. In addition, we conducted interviews with 28 CFTC employees at various staff and management levels who were involved with the cost-benefit analyses processes for the four rules. Multiple interviews were conducted with some employees.



## Objectives and Methodology

In this review we sought to examine six factors pertaining to the Agency's cost-benefit analyses:

- A. The quantitative methodologies the agency uses to evaluate the costs and benefits of proposed rules and the effects those rules could have on job creation and economic growth;
- B. The qualitative methods the agency uses to categorize or rank the effects of proposed rules;
- C. The extent to which the agency considers alternative approaches to its proposed rules;
- D. The extent to which the agency examines the costs, benefits, and economic impact of reasonable alternatives to its proposed rules;
- E. The extent to which the agency seeks public input and expertise in evaluating the costs, benefits, and economic impact of its proposed rules, and the extent to which the agency incorporates the public input into its proposed rules; and
- F. The extent to which the economic analysis performed by the agency with respect to its proposed rulemakings is transparent and the results are reproducible.

In order to complete the investigation, we reviewed drafts of the cost-benefit analyses for the four proposed rules, staff email, and internal memoranda. In addition, we conducted interviews with 28 CFTC employees at staff and various management levels who were involved (or were reported to us as involved) with the cost-benefit analyses processes for the four rules.

## Summary of Findings and Recommendations

Prior to publication of the four proposed rules, the Office of General Counsel and Office of Chief Economist created a uniform methodology for cost-benefit analysis for use with all proposed rulemakings under Dodd-Frank. That methodology set out in some detail the types of qualitative considerations that might inform a cost-benefit analysis, encouraged the use of both qualitative and quantitative data, and included a template for everyone to follow.

While the methodology initially adopted by the Office of General Counsel and the Office of Chief Economist would permit a detailed and thorough approach to the task, in the three earlier rules we examined it appears the Commission generally adopted a "one size fits all" approach to section 15(a) compliance without giving significant regard to the deliberations addressing idiosyncratic cost and benefit issues that were shaping each rule, and often addressed in the preamble. In fact, although the development of a uniform methodology appeared to be an equal effort between the Office of General Counsel and the Office of Chief Economist, at the outset of the rulemaking efforts the cost-benefit analyses involved less input from the Office of

Chief Economist, with the Office of General Counsel taking a dominant role. For the three proposed rules we reviewed that were published in January or February 2011, the cost-benefit analyses were drafted by Commission staff in divisions other than the Office of Chief Economist. In these earlier rulemakings, staff from the Office of Chief Economist did review the drafts, but their edits were not always accepted. In one rulemaking, the Office of Chief Economist did not participate at all.

For the more recent cost-benefit analysis accompanying the proposed segregation/bankruptcy rule, we were pleased with the cost-benefit discussion. Although staff told us this rule was different with regard to cost considerations from the start, they also told us the cost-benefit analysis section was influenced by concerns voiced this year regarding cost-benefit analyses, including an earlier CFTC OIG report addressing cost-benefit considerations in connection with Dodd-Frank rulemakings.

With regard to the segregation/bankruptcy rule, the only deficiencies we detected, based on our review, were somewhat minor. We noted both the lack of clarification of the role of Paperwork Reduction Act costs in the context of the cost-benefit analysis, and the lack of quantified costs to the Agency to implement the regulation. Because the Agency currently includes with its budget requests amounts necessary to implement the Dodd-Frank Act, we believe these costs could also be discussed in the context of Dodd-Frank rulemakings. We believe internal Agency costs, including opportunity costs, are relevant because they may influence the Commission's decisions when faced with regulatory alternatives.

## **2. An Investigation Regarding Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act**

### **Background**

During the prior reporting period, we received a request from the Chairman of the House Committee on Agriculture and from the Chairman of the House Subcommittee on General Farm Commodities and Risk Management, for an investigation into cost-benefit analyses performed by the CFTC in connection with four proposed rules under the Dodd-Frank Act:

1. Further Defining “Swap Dealer”, “Security-based Swap Dealer”, “Major Swap Participant,” “Major Security-based Swap Participant,” and “Eligible Contract Participant, 75 FR 80174 (December 21, 2010) (Joint proposed rule; proposed interpretations)<sup>4</sup>;
2. Confirmation, Portfolio Reconciliation, Compression Requirements for Swap Dealers and Major Swap Participants, 75 FR 81519 (December 28, 2010) (Notice of proposed rulemaking);

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<sup>4</sup> The Commission published this proposed rule jointly with the Securities and Exchange Commission, in consultation with the Board of Governors of the Federal Reserve System. 75 FR 80174 (December 21, 2010).

3. Core Principles and Other Requirements for Designated Contract Markets, 75 FR 80572 (December 22, 2010) (Notice of proposed rulemaking);
4. Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 FR 71397 (November 23, 2010) (Notice of proposed rulemaking).

### Objectives and Methodology

In addition to specifying four rules for examination, the Chairman of the House Committee on Agriculture and the Chairman of the Subcommittee on General Farm Commodities and Risk Management set out eight areas of specific inquiry to be addressed:

1. The methodologies the CFTC uses to evaluate costs and benefits;
2. Whether the sequence by which rules are proposed impacts the CFTC's ability to adequately evaluate costs and benefits;
3. The extent to which, in light of budget constraints, the CFTC has sought outside input and expertise in evaluating costs and benefits;
4. The extent to which the CFTC has evaluated and distinguished the costs and benefits of proposed regulations on market participants of diverse sizes and from diverse sectors. For example, did the CFTC give consideration to the costs and benefits a "Swap Dealer" designation would have for non-bank, non-financial companies in addition to large global financial institutions?
5. The extent to which the CFTC gives special consideration to evaluating the costs and benefits for small businesses;
6. The amount of time, on average, that Commission staff spends per rule evaluating costs and benefits as required by 15(a);
7. When one proposed rule is highly dependent on another, as is often the case in Title VII, the extent to which the CFTC gives consideration to the impact preceding or subsequent rules may have on the costs or the benefits of the rule under consideration;
8. The impact the current statutory deadline of Title VII has on the Commission's ability to conduct meaningful cost-benefit analysis and the extent to which an extension of the statutory deadline would improve the Commission's ability to consider the costs associated with proposed rules

Because specific misconduct was not alleged and specific targets were not named, we treated this as an administrative inquiry rather than a criminal investigation or an investigation designed to support recommended adverse action against any individual.

In order to complete the investigation, we reviewed drafts of the cost-benefit analyses for the four proposed rules, staff email, and internal memoranda. In addition, we conducted interviews with 24 CFTC employees at staff and various management levels who were involved (or were reported to us as involved) with the cost-benefit analyses processes for the four rules. We issued our report on April 15, 2011.

### Summary of Findings and Recommendations

We found that although the development of a uniform cost-benefit analysis methodology prepared in connection with the Dodd-Frank rulemakings appeared to be an equal effort between the Office of General Counsel and the Office of Chief Economist, in practice the cost-benefit analyses involved less input from the Office of Chief Economist, with the Office of General Counsel taking a dominant role. For the four rules we reviewed, the cost-benefit analyses were drafted by Commission staff in divisions other than the Office of Chief Economist. Staff from the Office of Chief Economist did review the drafts, but their edits were not always accepted. To a greater or lesser extent for the four examined rules, the Office of General Counsel appeared to have the greater “say” in the proposed cost-benefit analyses, and appeared to rely heavily on an historic (and somewhat stripped down) analytical approach. It appeared clear to us that a more robust process was clearly permitted under the cost-benefit guidance issued by the Office of General Counsel and the Office of Chief Economist, and we believed a more robust approach would be desirable, with greater input from the Office of Chief Economist.

Following issuance of our report, the Agency created updated guidance for cost-benefit analyses for use with final rulemakings under Dodd-Frank. We note the updated guidance with approval and continue to recommend that the Office of Chief Economist take on an enhanced or greater role under both the existing methodology and any future methodologies for cost-benefit analyses for both proposed and final rules under the Commodity Exchange Act.

## **LEGISLATIVE, REGULATORY AND RULE REVIEWS**

### **1. Introduction and Summary**

As specified in Section 4(a)(2) of the Inspector General Act of 1978, OIG reviews the impact of existing and proposed legislation and regulations on CFTC programs and operations and makes recommendations regarding more effective or efficient alternatives or protections against fraud and abuse. OIG also reviews exchange rule proposals circulated to senior staff at CFTC.

OIG notifies the responsible Divisions as to any concerns with draft and final documents relating to legislation, rules (including exchange rules) or investigations. Initial discussions are usually informal. The OIG actively monitors the proposed rules and regulations under development as a result of Dodd-Frank Act. Formal comments were not submitted to the Commission during this reporting period.

2. **Rule Reviews Initiated in Previous Reporting Periods**

There were no rule reviews initiated in previous reporting periods which were continued into this reporting period.

3. **Rule Reviews Initiated this Reporting Period**

No rule reviews were initiated during this reporting period.

4. **Legislative Activities**

OIG tracked legislation impacting programs and operations of the CFTC and of the Office of Inspector General, and made contact with Congressional staff concerning various agency and IG issues as appropriate. The IG served on the legislation committee for the Council of Inspectors General on Integrity and Efficiency, which comments on proposed amendments to the IG Act and other legislation affecting the IG community.

<b>OTHER REVIEWS</b>
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An important function in each Agency OIG is the peer review process. The Inspector General community's annual report, *A Progress Report to the President, Fiscal Year 2007*,<sup>5</sup> described the processes for audits and investigative peer reviews as follows:

*Government Auditing Standards* require that audit organizations conducting audits of Federal agencies undergo peer reviews every 3 years. The IG community has implemented a process to meet this requirement. The purpose of the peer review is to determine whether the reviewed audit organization's internal quality control systems are adequate and provide reasonable assurance that applicable auditing standards, policies and procedures are met.

Similarly, investigative peer reviews are conducted to ensure compliance with the requirements of the *Quality Standards for Investigations* and determine whether adequate internal safeguards and management procedures exist to ensure that law enforcement powers are properly exercised.<sup>6</sup>

Section 989C of the Dodd-Frank Act implemented a requirement to include in each OIG semiannual report an appendix containing

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<sup>5</sup> <http://www.ignet.gov/randp/fy07apr.pdf>.

<sup>6</sup> *Id.* at p.19.

- the results of any peer review conducted by another Office of Inspector General during the reporting period; or if no peer review was conducted within that reporting period, a statement identifying the date of the last peer review conducted by another Office of Inspector General;
- a list of any outstanding recommendations from any peer review conducted by another Office of Inspector General that have not been fully implemented, including a statement describing the status of the implementation and why implementation is not complete; and
- a list of any peer reviews conducted by the Inspector General of another Office of the Inspector General during the reporting period, including a list of any outstanding recommendations made from any previous peer review (including any peer review conducted before the reporting period) that remain outstanding or have not been fully implemented.

In accordance with Section 989C of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Pub. L. 111-203, 124 Stat. 1376 (2010), please be advised that no peer review was conducted of the CFTC OIG during this reporting period. However, during the prior reporting period, the Federal Election Commission Office of Inspector General completed a peer review of CFTC OIG, as of March 31, 2011, that resulted in 35 recommendations for improving CFTC OIG's operations. As of September 30, 2011, CFTC OIG had fully implemented all of the recommendations. CFTC OIG did not conduct any peer reviews during this reporting period and there remain no outstanding recommendations from peer reviews previously conducted by CFTC OIG.

**2. Other Reviews and Activities**

No other review activity took place during this reporting period.

**SUMMARY OF EACH REPORT MADE TO  
THE AGENCY HEAD CONCERNING REQUESTS FOR  
INFORMATION OR ASSISTANCE**

No reports were made to the Agency head under section 6(b)(2) concerning information or assistance unreasonably refused or not provided (mandated under section 5(a)(5) of the Act).

**REVISED MANAGEMENT DECISIONS**

No management decisions were revised during this reporting period.

## INSPECTOR GENERAL DISAGREEMENT

The Inspector General did not disagree with any management decisions on OIG recommendations during this reporting period. In 2006, the CFTC OIG issued a report titled "Review of the Need for a Western Regional Office in Los Angeles." That report recommended, among other things, that the Commission review the feasibility of reestablishing the former Los Angeles field office. That recommendation was not carried out largely due to budget constraints. In January 2008, partially in response to a Congressional inquiry, CFTC OIG updated its analysis and on March 12, 2008, issued a follow-up report which reiterated the earlier recommendation. In January 2009, the Acting Chairman issued a decision declining to implement the recommendation generally due to cost considerations, but required the Agency on a yearly basis to provide to OIG an analysis of regional case filing statistics and costs associated with cases in various regions of the country. The Division of Enforcement submitted their yearly analysis to OIG in March 2010. In light of increased funding for FY09, FY10 and FY 11 (anticipated), corresponding anticipated staffing increases and the enactment of legislation that expands CFTC jurisdiction, we renew the recommendation that the Commission consider opening an additional CFTC office on the West Coast.

## GAO LIAISON

OIG is charged with providing policy direction for, and conducting, supervising, and coordinating audits and investigations relating to CFTC programs and operations. In addition, OIG is required to recommend policies for, and conduct, supervise, and coordinate with other Federal agencies, state and local governmental agencies, and nongovernmental entities, audits, investigations, reviews and evaluations regarding the economy, efficiency, and effectiveness of CFTC programs and operations.

GAO also conducts audits of CFTC activities, and OIG plans its audits so as not to duplicate GAO's efforts. Moreover, OIG in its audit, review and inspection activities identifies the goals of each endeavor and the methods of reaching the goals so as to minimize the requirements placed on CFTC resources.

## STRATEGIC PLAN FOR THE OFFICE OF THE INSPECTOR GENERAL

### 1. Investigative Agenda.

The Inspector General Act of 1978, as amended, provides that the Inspector General may receive and investigate complaints or information from the Commission's employees concerning the possible existence of an activity constituting a violation of law, rules or regulations, or mismanagement, gross waste of funds, abuse of authority or a substantial and specific danger to the public health and safety.

OIG has to date conducted only a reactive investigative program chiefly relying on unsolicited employee complaints as the source of investigative leads. However, allegations and complaints are also received from the general public and Congress. This reactive program has resulted in only a handful of investigations per year. This strategy was followed because OIG believed that an independent regulatory agency such as the CFTC, without grant money or substantial contracts to award, was not likely to generate a substantial investigative workload.

To insure that employee complaints could easily reach OIG, a 24-hour hotline was established in February 1993 to receive complaints. The hotline phone number is (202)418-5510.

Because of the necessarily reactive nature of OIG's investigative program, no investigative agenda has been established.

## **2. Legislative and Regulatory Review Agenda.**

Because of the importance of this activity in a financial and economic regulatory agency, OIG reviews proposed and final CFTC regulations, legislation and selected exchange rules using six basic criteria: Whether the agency: (1) has identified specifically the problem(s) to be addressed by the proposal; (2) has defined through case study or data analysis a clear link between the proposed solution and the identified problem(s); (3) has specified clearly the means to effectively and efficiently enforce the proposal; (4) has assessed the likely efficiency and effectiveness of alternative solutions; (5) can reasonably document that the proposal will yield positive net benefits over the long term; and (6) has met the requirements of the Regulatory Flexibility Act and the Paperwork Reduction Act.

The Regulatory Flexibility Act requires the agency to evaluate the impact of its regulations on small entities. The Paperwork Reduction Act requires the agency to manage effectively and efficiently its information collections so that they are the least burdensome necessary to achieve the stipulated objectives.

Because OIG does not initiate legislation or, generally, regulations, OIG legislative and regulatory review program is reactive to the legislative and regulatory proposals developed by others. Accordingly, no independent legislative and regulatory review agenda has been established.

## **3. Audit, Inspection, Evaluation and Review Agenda**

### **a. Introduction**

The primary objectives of the OIG audit, inspection, evaluation and review agenda is to promote long-term efficiency and effectiveness in the administration and operation of the Commission and to protect against fraud and abuse. The audit, review, evaluation, and inspection agenda and priorities for OIG are determined based on the following factors:



- Adequacy of internal control systems as indicated by vulnerability assessments and internal control reviews recommended by OMB Circular A-123;
- Changes in the program conditions or particular vulnerability of the organization, program, activity, or function to problems or deficiencies;
- Current and potential dollar magnitude and likely benefits of a review on the efficiency or effectiveness of CFTC programs and operations;
- Management priorities and improvements that may be possible;
- Results of audits of CFTC programs and operations by other Federal agencies; and
- Availability of audit resources and the potential opportunity costs to the agency.

**b. Annual Audit**

The following required audit is performed on an annual basis.

**Audit of CFTC Financial Statements**

In FY 2002, Congress passed the Accountability of Tax Dollars Act. The Act requires the CFTC, along with numerous other Federal entities, to have its financial statements audited annually. To this end, OIG has engaged a contractor to provide the audit effort required to enable the contractor to render an opinion on the agency's financial statements for each fiscal year in accordance with generally accepted auditing standards, Government Auditing Standards and OMB Bulletin 07-04.

**c. Annual Review and Evaluation**

We will perform the following review and evaluation on an annual basis:

**Review of Compliance with the Federal Managers' Financial Integrity Act, FMFIA**

In support of OMB Circular A-123 (Revised), the Inspector General will evaluate, provide technical assistance and advise the agency head as to whether the agency's review and evaluation process was conducted in accordance with the circular's requirements.

**Evaluation of the CFTC Information Security Management Act, FISMA**

The Federal Information Security Management Act requires the Inspector General or his designee to perform annual independent evaluations of the information security program and practices of the agency.

**d. Other Audits, Inspections, Evaluations, Reviews and Projects**

Looking to the long term, the OIG intends to focus the balance of its resources on the review of the management and operation of the agency and compliance with Congressional mandates. OIG plans to concentrate its efforts in reviewing activities relating to the most serious management challenges facing the CFTC.

In addition, OIG is aware of the immense regulatory undertaking required under the Dodd-Frank Act. OIG will seek to identify issues and to conduct inspections, reviews, investigations and other activities relating to these management and regulatory challenges. Finally, OIG will stand ready to respond to issues and requests as they are received from Congress, the Agency and members of the public or any other source.

At the close of the last reporting period, OIG reported that a previously intended examination of communications between CFTC staff and large traders had been tabled due to our workload during this prior reporting period. This review continues to be tabled.

**e. Resources Required**

OIG estimates that approximately one staff year of effort will be devoted over each of the next five years to the annual audit, the annual review, and the annual evaluation described above. However, OIG is updating its audit universe in view of CFTC's increased responsibilities under the Dodd-Frank Act and will reevaluate its staffing needs once the update is complete. Revision of the CFTC OIG audit procedures and other remediation-related tasks, and all other investigations, inspections, evaluations, review and other projects will consume up to two and a half staff years. Because OIG resources can be diverted at any time to an investigation or audit, inspection, evaluation, review or project that responds to current concerns or allegations, and must be completed in a timely fashion in order to be of assistance to the Agency or Congress, it is impossible to forecast with complete accuracy how resources will be utilized from year to year. In accordance with a recommendation contained in the recent peer review, we have hired an experienced auditor to assist with remediation and supervise all audit activity, including audits performed by independent public accountants obtained on a contract basis. Due to staff size, we will continue to utilize outside independent auditors to perform OIG audits as necessary.

<p style="text-align: center;"><b>CONTACTING THE OFFICE OF THE INSPECTOR GENERAL</b></p>
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OIG is located at 1155 21st Street, N.W., Washington, D.C. 20581. Regular business hours are between 8:30 AM and 5:00 PM, Monday through Friday, except Federal holidays. The telephone number is (202)418-5110. The facsimile number is (202)418-5522. The hotline number is (202)418-5510. The OIG web page is located at: <http://www.cftc.gov/About/OfficeoftheInspectorGeneral/index.htm>.

<b>Table 1</b>
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**Reports Issued with Questioned Costs  
(April 1, 2011 – September 30, 2011)**

	Number	<u>Dollar Value Thousands</u>	
		Questioned	Unsupported
A. For which no management decision has been made by the commencement of the reporting period	0	0	0
B. Which were issued during the reporting period	0	0	0
Subtotals (A + B)	0	0	0
C. For which a management decision was made during the reporting period	0	0	0
(I) dollar value of disallowed costs	0	0	0
(ii) dollar value of costs not disallowed	0	0	0
D. For which no management decision has been made by the end of the reporting period	0	0	0

<b>Table 2</b>
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**Reports Issued with Recommendations  
That Funds be Put to Better Use  
(April 1, 2011 – September 30, 2011)**

	<u>Number</u>	<u>Dollar Value Thousands</u>
A. For which no management decision has been made by the commencement of the reporting period	0	0
B. Which were issued during the reporting period	0	0
Subtotals (A + B)	0	0
C. For which a management decision was made during the reporting period	0	0
(i) dollar value of recommendations that were agreed to by management	0	0
(ii) dollar value of recommendations that were not agreed to by management	0	0
D. For which no management decision has been made by the end of the reporting period	0	0



**THE INSPECTOR GENERAL  
NEEDS YOUR HELP TO ASSURE  
THE INTEGRITY OF CFTC'S  
PROGRAMS AND OPERATIONS.**

**Report FRAUD, WASTE or ABUSE  
in connection with  
CFTC Programs and Operations  
to the Office of the  
INSPECTOR GENERAL.**

**You may report ANONYMOUSLY.**

**HOTLINE  
(202) 418-5510**

**Office of the Inspector General  
Commodity Futures Trading Commission  
1155 21st Street, N.W.  
Washington, D.C. 20581**