



***Keeping Pace with Change***  
***Commodity Futures Trading Commission***  
***Strategic Plan***  
***2004-2009***

*February 2004*

***KEEPING PACE WITH CHANGE***  
**STRATEGIC PLAN OF THE COMMODITY FUTURES TRADING COMMISSION**  
**FY 2004-FY 2009**

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## ***MESSAGE FROM THE CHAIRMAN***

Keeping pace with change has never been more significant than it is today at the Commodity Futures Trading Commission (CFTC or Commission). The unprecedented growth and complexity of the futures and options industry has not only been an exciting challenge, it has validated the last three years of hard work and dedication to providing the most flexible and responsive oversight structure possible.

When we last submitted our strategic plan, the Commission was hard at work with Congress to reauthorize the agency for another five years. Incorporating the new oversight regulatory vision into the reauthorization legislation was our primary goal. The Commodity Futures Modernization Act (CFMA), passed in December 2000, reflects this vision through three key objectives: 1) modernizing rules affecting trading platforms and market intermediaries; 2) permitting futures based on single stocks or narrow-based stock indices; and 3) providing legal certainty for over-the-counter derivatives.

Despite the unexpected challenges the industry and the Commission faced following the September 11, 2001 terrorist attacks, in the nearly three years since the passage of the CFMA, the Commission has successfully begun to implement the objectives of the CFMA by:

- Reorganizing and modernizing the structure of the CFTC to make the most effective use of our resources in overseeing these important and dynamic markets.
- Working with the U.S. Securities and Exchange Commission (SEC) to put into place the rules and other mechanisms to allow the launch of trading in domestic security futures.
- Designating six new contract markets and accepting the registration of five additional derivatives clearing organizations, including the London Clearing House.
- Moving from a compliance-based approach to conducting audits toward a risk-based approach and developing an appropriate oversight framework for futures clearinghouses.
- Achieving pay parity with other financial regulators.

Today, as we submit our strategic plan for FY 2004 through FY 2009, we recognize that the CFMA opened the door for great change in the markets as well. Total volume rose by more than 33 percent from 2000 to 2001, and again by more than a third from 2001 to 2002, as increasing numbers of companies and investors avail themselves of the risk management tools offered by these markets.

Financial contracts represent the largest portion of the market and continue to grow in volume. Of the 10 most widely traded contracts, which together represent more than 80 percent of U.S. futures volume, seven are financial contracts (based on Eurodollars, Treasury instruments, the S&P 500, and the Nasdaq 100). The other three top-10 contracts are crude oil, natural gas, and corn. (Soybeans are close behind corn in the eleventh spot.) While the traditional U.S. futures exchanges are enjoying record volumes, not all the growth is taking place there. Newly designated contract markets that have been approved by the Commission

since passage of the CFMA are achieving significant trading volumes with new products and platforms.

Other key trends in the futures markets include the continued migration of trading activity from open-outcry trading on the exchange floors to all-electronic trading from widely dispersed geographic locations, the transition from purely member-owned exchanges to publicly held trading facilities, continued globalization of all financial markets, and, of particular note since passage of the CFMA, the decoupling of the trading activities hosted by exchanges from the clearance and settlement functions performed by clearinghouses.

Keeping pace with these trends will be our challenge over the next five years. To be successful through 2009, the CFTC must ensure that keeping pace with change does not compromise the gains we have made in building a solid, yet flexible regulatory oversight structure. The Commission stands ready to work with the Congress, other regulators, and market participants to ensure that our regulatory structure keeps up with the marketplace.

Chairman James E. Newsome

## ***INTRODUCTION***

The Commodity Futures Trading Commission was created as an independent agency by Congress in 1974 under the authorization of the Commodity Exchange Act<sup>1</sup> (Act) with the mandate to regulate commodity futures and option markets in the United States. The agency's mandate was renewed and expanded under the Futures Trading Act of 1978, 1982, and 1986; under the Futures Trading Practices Act of 1992; and under the CFTC Reauthorization Act of 1995. The Commodity Futures Modernization Act of 2000 reauthorized the Commission through FY 2005.

Futures contracts for agricultural commodities have been traded in the U.S. for 150 years and have been under Federal regulation since the 1920s. In recent years, futures trading has expanded rapidly into many new markets, beyond the domain of traditional physical and agricultural commodities. Futures and option contracts are now offered on a vast array of financial instruments, including foreign currencies, U.S. and foreign government securities, and U.S. and foreign stock indices.

Today, as the futures industry experiences unprecedented growth and as trading instruments and mechanisms increase in complexity, the CFTC is responsible for overseeing the economic utility of futures markets by encouraging their competitiveness, efficiency, and integrity and by protecting market participants against manipulation, abusive trade practices, and fraud. Through effective oversight regulation, the CFTC enables the commodity futures markets to serve their important function in the Nation's economy by providing a mechanism for price discovery and a means of offsetting price risk.

### **Key Facts about Today's U.S. Futures Industry**

- There are 21 commodity exchanges and 13 derivatives clearing organizations located in eight cities in the United States and one city in the United Kingdom. Subject to CFTC oversight, these self-regulatory organizations (SROs) are responsible for the operation of the exchanges and the business conduct and financial responsibility of their member firms.
- For the first time in history in 2002, futures contract trading volume topped one billion contracts traded.
- CFTC regulates the activities of over 67,800 registered commodities professionals.
- In 2003, there are an estimated 500 actively traded futures and option contracts.

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<sup>1</sup> Commodity Exchange Act, as amended  
(7 U.S.C., Section 1, *et seq.*)

## ***MISSION STATEMENT, STRATEGIC GOALS & OUTCOMES***

### **Mission Statement**

In December 2000, the CFMA transformed the Commission from a front-line regulatory agency to an oversight regulator. Although the Commission's approach to regulation has consequently changed, its mission remains the same—to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity futures and options, and to foster open, competitive, and financially sound commodity futures and option markets.

### **Strategic Goals & Outcomes**

The mission of the Commodity Futures Trading Commission is accomplished through three strategic goals, each focusing on a vital area of regulatory responsibility. Accomplishing the three strategic goals results in a number of key outcomes.

#### **Strategic Goal One—Ensure the economic vitality of the commodity futures and option markets.**

In order for commodity futures and option markets to fulfill their vital role in the national and global economy, they must operate efficiently, accurately reflect the forces of supply and demand, and serve market users by fulfilling an economic need. Through direct market surveillance and through oversight of the surveillance efforts of the exchanges themselves, the Commission works to ensure that markets operate free of manipulation or congestion.

The heart of the Commission's direct market surveillance is a large-trader reporting system, under which clearing members of exchanges, futures commission merchants (FCMs), and foreign brokers electronically file daily reports with the Commission. These reports show all trader positions above specific reporting levels set by CFTC regulations. Because a trader may carry futures positions through more than one FCM and because a customer may control more than one account, the Commission routinely collects information that enables its surveillance staff to aggregate information across FCMs and for related accounts.

Using these reports, the Commission's surveillance staff closely monitors the futures and option market activity of all traders whose positions are large enough to potentially impact the orderly operation of a market. For contracts, which at expiration are settled through physical delivery, such as contracts in the energy complex, staff carefully analyze the adequacy of potential deliverable supply. In addition, staff monitor futures and cash markets for unusual movements in price relationships, such as cash/futures basis relationships and inter-temporal futures spread relationships, which often provide early indications of a potential problem.

The Commissioners and senior staff are kept apprised of market events and potential problems at weekly surveillance meetings and more frequently when needed. At these meetings, surveillance staff briefs the Commission on broad economic and financial developments and on specific market developments in futures and option markets of particular concern.

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<sup>2</sup> Commodity Exchange Act, as amended  
(7 U.S.C., Section 1, *et seq.*)

If indications of attempted manipulation are found, the Commission investigates and prosecutes alleged violations of the Act or regulations. Subject to such actions are all individuals who are or should be registered with the Commission, those who engage in trading on any domestic exchange, and those who improperly market commodity futures or option contracts. The Commission has available to it a variety of administrative sanctions against wrongdoers, including revocation or suspension of registration, prohibitions on futures trading, cease and desist orders, civil monetary penalties, and restitution orders. The Commission may seek Federal court injunctions, restraining orders, asset freezes, receiver appointments, and disgorgement orders. If evidence of criminal activity is found, matters may be referred to state authorities or the Department of Justice for prosecution of violations not only of the Act but also of state or Federal criminal statutes, such as mail fraud, wire fraud, and conspiracy. Over the years, the Commission has brought numerous enforcement actions and imposed sanctions against firms and individual traders for attempting to manipulate prices, including the well-publicized attempted manipulation cases by several energy companies and the market power manipulation of worldwide copper prices.

Outcomes for Strategic Goal One are:

- Markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.
- Markets that are effectively and efficiently monitored so that the Commission receives early warning of potential problems or issues that could adversely affect their economic vitality.

### **Strategic Goal Two—Protect market users and the public.**

The focus of the second goal is protection of the firms and individuals—market users—who come to the marketplace to fulfill their business and trading needs. Market users must be protected from possible wrongdoing on the part of the firms and commodity professionals with whom they deal to access the marketplace, and they must be confident that the marketplace is free of fraud, manipulation, and abusive trading practices.

The Commission has promulgated requirements that mandate appropriate disclosure and customer account reporting, as well as fair sales and trading practices by registrants. The Commission has also sought to maintain appropriate sales practices by screening the fitness of industry professionals and by requiring proficiency testing, continuing education, and supervision of these persons. Extensive record-keeping of all futures transactions is also required. The Commission also monitors compliance with those requirements and supervises the work of the exchanges and National Futures Association (NFA) in enforcing the requirements.

The Commission also plays an important role in deterring behavior that could affect market users' confidence by investigating and taking action against unscrupulous commodity professionals who engage in a wide variety of fraudulent sales practices against the public.

Outcomes for Strategic Goal Two are:

- Violations of Federal laws concerning futures and option contracts are detected and prevented.
- Commodity professionals meet high standards.

- Customer complaints against persons or firms registered under the Act are handled effectively and expeditiously.

**Strategic Goal Three—Ensure market integrity in order to foster open, competitive, and financially sound markets.**

In fostering open, competitive, and financially sound markets, the Commission's two main priorities are to avoid disruptions to the system for clearing and settling contract obligations and to protect the funds that customers entrust to FCMs. Clearing organizations and FCMs are the backbone of the exchange system—together, they protect against the financial difficulties of one trader becoming a systemic problem for other traders. Several aspects of the oversight framework help the Commission achieve this goal with respect to traders: 1) requiring that market participants post margin to secure their ability to fulfill obligations; 2) requiring participants on the losing side of trades to meet their obligations, in cash, through daily (sometimes intraday) margin calls; and 3) requiring FCMs to segregate customer funds from their own funds.

The Commission also works with the exchanges and the NFA to monitor closely the financial condition of the FCMs themselves, who must provide the Commission, exchanges, and NFA with various monthly, quarterly, and annual financial reports. The exchanges and NFA also conduct annual audits and daily financial surveillance of their respective member FCMs. Part of this financial surveillance involves looking at each FCM's exposure to losses from large customer positions that it carries. As an oversight regulator, the Commission reviews the audit and financial surveillance work of the exchanges and NFA but also monitors the health of FCMs directly, as appropriate. The Commission also periodically reviews clearing organization procedures for monitoring risks and protecting customer funds.

The Commission investigates and prosecutes FCMs alleged to have violated financial and capitalization requirements or to have committed other supervisory or compliance failures in connection with the handling of customer business. Such cases can result in substantial remedial changes in the supervisory structures and systems of FCMs and can influence the way particular firms conduct business. This is an important part of fulfilling the Commission's responsibility for ensuring that sound practices are followed by FCMs and that markets remain financially sound. The Commission also seeks to ensure market integrity by investigating a variety of trade and sales practice abuses. For example, the Commission brings actions alleging unlawful trade allocations, trading ahead of customer orders, misappropriating customer trades, and non-competitive trading.

Outcomes for Strategic Goal Three are:

- Clearing organizations and firms holding customer funds have sound financial practices.
- Commodity futures and option markets are effectively self-regulated.
- Markets are free of trade practice abuses.
- Regulatory environment is flexible and responsive to evolving market conditions.

## ***KEEPING PACE WITH CHANGE: PRIORITIES FOR 2004 – 2009***

The Commission has identified the following priorities<sup>3</sup>, which will serve as key indicators of its success in its effort to keep pace with the many changes affecting the futures and option markets:

***Complete energy investigations.*** Since the fall of Enron, the Commission has conducted a number of investigations concerning potential misconduct by participants in the energy markets. To date, the Commission has filed 10 matters. Eight of those cases have been settled and resulted in a total of \$130 million civil monetary penalties and other sanctions. The other two cases are currently in active litigation in Federal district court. We remain actively engaged in other energy sector investigations, which may result in further charges being filed. The Commission's aggressive enforcement actions in the energy sector reflect an approach to market oversight that emphasizes tough enforcement actions against wrongdoers without creating overly burdensome regulations. The Commission is fully committed to resolving the ongoing energy investigations as expeditiously as possible so that, in addition to identifying the wrongdoers, we can exonerate those who were not involved and allow these important risk management markets to work toward restoring the confidence of market participants and the public.

***Finalize rules for intermediaries.*** The Commission is well underway with efforts to modernize the rules affecting futures commission merchants, managers of pooled investment vehicles or individual accounts, and other intermediaries in the futures markets. Through hearings, studies, and roundtables, the Commission has, as directed by Congress, undertaken a concerted examination of the rules currently imposed on intermediaries, and we have adopted several rule changes—such as 1) providing financial institutions that are primarily overseen by another regulator (such as banks, insurance companies, and mutual funds) with an opportunity to use the risk management tools offered in the futures markets without subjecting themselves to unnecessary duplicative regulation; 2) providing appropriate registration relief to managers of pooled investment vehicles that restrict participation to highly sophisticated persons who use futures on a limited basis; and 3) affording FCMs greater operational flexibility so that they can provide their customers with more efficient trade executions. The Commission will continue with efforts to enhance an effective oversight framework for intermediaries, as envisaged by the CFMA.

***Implement risk-based oversight program for DCOs.*** The Commission will continue to refine its risk-based approach to the oversight review of derivative clearing organizations (DCOs). The oversight reviews will assess the DCOs' continued compliance with core principles with particular focus on risk management and financial integrity. The Commission will monitor changes in the pronouncements and accounting practices of the American Institute of Certified Public Accountants (AICPA), the Financial Accounting Standards Board (FASB), and other related organizations; developments within the industry; and comments from the public that may affect the operations of DCOs.

***Implement risk-based oversight of DSROs.*** The Commission will fully implement its risk-based approach to the oversight of designated self-regulatory organizations (DSROs) in which Commission staff approach the cyclical review of

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<sup>3</sup> The priorities listed herein are also referred to as "general goals," which are described in OMB Circular A-11 as one that allows a future assessment to be made on whether or not the goal was or is being achieved.

each DSRO with an identification of its activities and the risks arising therefrom, followed by an assessment of the appropriateness and adequacy of the systems, procedures, and practices that the DSRO relies upon to fulfill its responsibilities under the core principles set forth in the CFMA. This risk-based approach, already being utilized by other Federal financial regulators and international counterparts such as the U.K. Financial Services Authority, promises to make more effective use of Commission resources by tailoring oversight efforts to the relative probability and severity of potential risks to market integrity and to market participants.

***Continue collaborative regulatory efforts regarding security futures products (SFPs).*** The Commission will continue in its efforts to coordinate with the Securities and Exchange Commission (SEC) in implementing those sections of the CFMA related to the trading of SFPs. These areas include SFP definitions, registration requirements and functions, treatment of customer funds, margin rules, the offering of foreign SFPs to U.S. customers, possible further exemptions for notice registrants, the listing of options, and coordinated clearing. The Commission also will respond to inquiries from intermediaries, their counsel and accountants, and the general public concerning operational issues as the market for SFPs develops. Further, the Commission will work with the exchanges in developing sound business, financial, and sales practices surrounding the trading of SFPs.

***Complete SRO Study.*** The industry has long relied on self-regulation, with exchanges and the NFA performing direct regulation of participants and intermediaries. With so many fundamental changes in recent years, including new technologies, demutualization of exchanges and clearing organizations, and the advent of new models of competition, the Chairman directed Commission staff to undertake a study of the roles, responsibilities, and capabilities of SROs. Staff are obtaining input from a wide variety of sources, including conducting interviews of exchanges, clearing organizations, NFA, and a number of intermediaries, academics, and others. Staff are moving expeditiously to complete the information gathering and analysis portions of this process and are scheduled to present a report to the Commission in the first quarter of FY 2004.

***Implement USA PATRIOT Act.*** The Commission has actively supported and assisted the U.S. Treasury Department in developing anti-money laundering (AML) rules to implement the mandate of the USA PATRIOT Act with respect to the futures industry. These include various proposed and final rules requiring, among other things: 1) futures commission merchants (FCMs), introducing brokers (IBs), unregistered investment companies (such as commodity pools and hedge funds), and commodity trading advisors to establish AML compliance programs; 2) FCMs and IBs to report suspicious transactions; and 3) FCMs and IBs to establish customer identification and verification programs (CIPs). In addition to finalizing AML rules that already have been proposed, the Commission and Treasury will continue to effectuate the full extent of the protections against money laundering mandated by Congress (for example, extending the CIP rules to cover other futures firms as well). To assure consistency throughout the financial services industry, AML rules are being developed by an inter-agency working group with representatives from Treasury, the CFTC, the SEC, and several Federal banking agencies. The Commission's role includes making sure that futures industry registrants are not placed at a disadvantage relative to other financial service providers. Moreover, Treasury recently proposed to delegate its AML examination authority to the Commission with respect to futures entities. While much of the front-line examination work may be performed by NFA and other SROs, this delegation, when it becomes effective, will require the development and implementation of an appropriate audit and compliance program. The Commission

repeatedly has requested, and Treasury is considering, a similar delegation of Treasury's AML enforcement authority to the Commission with respect to futures firms. This delegation would bring additional responsibilities to the Commission for investigating and pursuing charges against those who do not have proper supervision, reporting, and record-keeping programs in place to combat money laundering and terrorist financing.

***Prepare for Commission reauthorization.*** Legislative activities in FY 2005 will include ongoing proceedings conducted by Congress to reauthorize the Commission for the seventh time. The current authorization for the Commission's appropriations extends through the end of FY 2005. This reauthorization will raise particularly complex issues since it will be the first reauthorization after the enactment of the CFMA and comes as the industry is undergoing rapid development in innovative trading systems, new business models, and novel products. The reauthorization process requires a comprehensive review of the Act, including its underlying purposes and objectives, and the regulatory structure implementing the Act. It also requires analysis of proposals to amend the Act advanced by industry participants, as well as analysis of legislation proposed by members of Congress. The Commission will evaluate the legal and programmatic implications of such legislative initiatives and prepare legislative proposals of its own for submission to Congress.

***Coordinate with foreign regulatory authorities.*** The inter-linkage of securities and derivatives firms on a worldwide basis creates, in the words of one former financial regulator, "operational liquidity and credit interdependences that stagger the imagination." In addition, the increased use of electronic markets means that national boundaries are largely irrelevant to the owners, users, and products of such markets. Such international linkages, while beneficial overall, create a number of challenges, including greater inter-connectedness that can exacerbate or amplify poor policy or risk management decisions. In addition, the fact that regulators must continually revise and refine their regulatory structures in order to keep up with industry practices requires that they have the expertise and ability to keep apprised of ongoing developments amongst the large international securities and derivatives firms.

While regulatory issues related to financial crises and market abuse (such as market manipulation and money laundering), cannot be eliminated, the number, duration, and spread of such episodes can be mitigated through the enhancement of international cooperation amongst regulators and market authorities. It is therefore critical that the CFTC continue to foster productive and cooperative working relationships with its foreign counterparts. In particular, the Commission will: 1) facilitate cross-border transactions through the removal or lessening of any unnecessary legal or practical obstacles; 2) endeavor to enhance international supervisory cooperation and emergency procedures; 3) strengthen international cooperation for customer and market protection; 4) improve the quality and timeliness of international information sharing; and 5) promote the development of internationally accepted regulatory standards of best practice. The CFTC will also continue to undertake measures to ensure that it maintains a high visibility in the international community and undertake a leading role in the development of international financial policy affecting the futures and option markets.

***Develop and implement a new Commission trade surveillance system.*** The Division of Market Oversight has two electronic oversight systems—one to monitor for trading abuses (such as trading ahead of customers and trading against customers) and one to monitor for market manipulation

(utilizing the large trader reports). The first of these two systems is woefully out of date, and the Commission has concluded that the demands of today's futures marketplace require development and implementation of a new trade surveillance system (TSS). By supporting the Commission's efforts to protect market participants from abusive trading practices and the integrity of the markets as a price discovery mechanism, the Commission's trade practice investigation (TPI) program helps the Commission maintain public confidence in the markets and in the Commission as their regulator. The TSS identifies possible trading abuses for referral to exchanges and the Division of Enforcement, supports Commission investigations and litigation involving manipulation and trade practice abuses, and is an important adjunct to Commission rule enforcement reviews of contract markets. A new, robust Commission TSS will allow identification of inter-exchange violations that individual exchanges lack the capacity to detect, allow quicker access to and more sophisticated and customizable analysis of the full range of data supplied by exchanges with respect to electronic as well as open outcry trading, and enable meaningful Commission evaluation of the exchanges' own electronic surveillance systems. In designing and implementing the new TSS, Commission staff will combine custom-built components with available off-the-shelf software to give the Commission unqualified, immediate, and confidential access to all exchange-supplied data. The new TSS will cost an estimated \$3.5 to \$4.5 million, take approximately two and one-half years to implement fully, and be rolled out incrementally. The necessary funding has already been appropriated. After completion, the new system will reduce ongoing maintenance costs by approximately \$100,000 per year as compared with the current system.

***Re-engineer both the Commission's trade surveillance and market surveillance systems so that they remain effective and robust as trading migrates from floors to electronic platforms.*** Markets regulated by the Commission have experienced a dramatic shift from floor to screen-based trading over the past several years. The Chicago Board of Trade's and Chicago Mercantile Exchange's screen-based volume currently accounts for almost 50 percent of total exchange volume. While electronic trading brings certain regulatory benefits, such as very precise audit trails, it also increases the opportunity for certain types of abuses, such as trading ahead of customers. In order to re-engineer our systems, we are first embarking on a study of the various effects the growth of electronic trading is having on market participants' ability to engage in trading abuses and market manipulations. The Commission will examine the electronic trading systems and automated surveillance systems used by U.S. designated contract markets, as well as those used by foreign futures exchanges with significantly more experience in electronic trading. The Commission will also interview foreign regulatory officials in the jurisdictions visited with respect to their mechanisms for oversight of electronic markets. Once this analysis is complete, we will incorporate changes in Commission oversight systems and, where necessary, recommend alterations to systems of our designated contract markets to ensure that customers continue to be protected against trading abuses and manipulations.

***Establish a financial surveillance unit and fully implement financial surveillance information system (FSIS).*** The Commission will establish within the Division of Clearing and Intermediary Oversight an enhanced capability to monitor market information, evaluate the impact of market moves on the financial integrity of market participants, and anticipate and act upon indications of financial difficulty. This capability will be built upon a dedicated team and the use of new FSIS component systems, including the RSR Express system that compiles FCM financial statements and the SPARK system that

utilizes large trader information to allow the tracking of risk at market, firm, and account levels and permit “what if” analyses.

***Design and implement Project eLaw.*** The Commission will continue its efforts to design and implement Project eLaw, an automated law office that seamlessly integrates technology and work processes to support managers and staff across the Commission in their investigative, trial, and appellate work. Driven by the Commission’s continued reliance on manual processes and automated tracking systems to manage cases and the approximately one million paper documents received or created annually, Project eLaw will provide the automated tools to assist staff in performing their work more efficiently and effectively, both in the office and in the courtroom facing opposing counsel. Specifically, Project eLaw will enable staff to: efficiently query and retrieve information about investigations and litigation provided to the Commission by outside parties; develop documents in a collaborative electronic work environment across geographically dispersed locations; improve management of investigation leads and trial schedules; track time and resources expended on investigations and cases; and access and present documentary and analytic evidence in court settings. Now that the Commission has secured the integration support and technical expertise to assist with Project eLaw, the plans are in place to complete a requirements analysis, a technology assessment, a business impact analysis, the identification and installation of hardware and software, and pilot implementation followed by full implementation of Project eLaw.

***Increase staffing.*** The arrival of pay parity authority promises to greatly enhance the Commission’s opportunity to have planned organizational change, rather than reacting to the undesired loss of staff with the most mission-critical competencies. The Commission is moving to utilize the newest flexibilities in Federal staffing, including category ranking, so that priority recruitments for any shift in program emphasis or unexpected losses begin immediately and conclude rapidly. At the same time, our pay rates now allow us to compete for a broader range of experience levels, such as among new graduates. This is allowing the Commission to address issues such as our workforce demographics through succession planning. By developing revised competencies on a job function or series basis, such as with auditors moving to risk-based reviews, we are building a revised foundation of job requirements and skills analysis that makes both our near-term recruitment more targeted and our long-range workforce planning more efficient. Performing this agency-wide review of our staffing efforts is producing complementary effects in the form of a workforce with a broader range of the most needed training and skills, resulting in the most efficient and responsive market oversight activities presently feasible.

***Upgrade training for Enforcement investigators.*** Expert enforcement investigators are vital to the effectiveness of the Commission’s Enforcement program. The Commission will upgrade the training of its enforcement investigators in order to ensure that their level of expertise keeps pace with the challenges posed by technological advancements, increasing cross-border participation in the financial markets, and new or growing markets. Training will include advanced investigative techniques, especially with respect to trade practice investigations of electronic exchanges and the tracking of international money flows, and in-depth analysis of growing markets, with emphasis on the over-the-counter energy markets.

***Achieve full funding for pay parity.*** With the implementation of a new pay schedule on April 20, 2003, CFTC closed the major part of the gap between its

pay rates and those of the other Federal financial regulators. This transitional step has resulted in a substantive improvement in the agency recruitment and retention trends, including evident indicators of employee morale. To begin a corresponding upgrade in its benefits program, the Commission expects to implement an employee dental benefit in FY 2004. In terms of total compensation, the Commission's conservative initial approach to using its authority to make these pay and benefits changes has, as expected, closed just under 80 percent of the gap in aggregate compensation relative to the benchmark agencies' practices. With most of those agencies adjusting their rates in the first quarter of the calendar year, we expect the gap to grow without funding for appropriate pay and benefits increases, including variable compensation centered on the concept of pay for performance. Commission senior staff will continue to seek appropriate funding through discussions with oversight committees and OMB.

## ***ACHIEVING SUCCESS: BUSINESS PROCESSES, EXPERTISE & TECHNOLOGIES***

### **Business Processes**

Commission staff perform key business processes—collections of specific activities and strategies—in order to produce the desired outcomes and achieve the Commission’s strategic goals.

While each outcome of the Commission’s three strategic goals is supported by a specific set of business processes, there are instances in which the same business processes are executed in order to reach more than one outcome. For example, the business process, “Investigate, file, and prosecute cases” is executed for the Goal Two outcome, “Commodity professionals meet high standards” as well as for the Goal Three outcomes, “Clearing organizations and firms holding customer funds have sound financial practices” and “Markets free of trade practice abuses.” Below are detailed explanations of each business process.

#### *Conduct Economic Research*

- Maintain a current understanding of market functions and developments through studies and research.
- Collect data from futures and option large traders, intermediaries, and SROs and for all actively traded contracts to support dissemination of information to the public, and futures market studies and research by Commission staff and others.

#### *Conduct Financial Surveillance*

- Monitor and address the financial effects of unusual or prolonged market moves on customers, firms, and clearing organizations.
- Identify possible violations of the Act and/or regulations involving record-keeping, financial, capitalization, and segregation requirements for investigation and possible prosecution.
- Collect data from futures and option large traders, intermediaries, and SROs and for all actively traded contracts to support financial surveillance by Commission staff and others.
- Conduct direct audits of clearing organizations and intermediaries to ensure compliance with capitalization, segregation, disclosure, record keeping, and reporting rules.

#### *Conduct Market Surveillance*

- Monitor the markets to detect and respond quickly to potentially disruptive situations, such as market congestion and/or potential price manipulation.
- Collect data from futures and option large traders, intermediaries, and SROs and for all actively traded contracts to support market surveillance, enforcement of speculative position limits, and dissemination of information to the public by Commission staff and others.

#### *Conduct Trade Practice Surveillance*

- Monitor the markets to detect possible abusive trading practices.

- Collect data from futures and option large traders, intermediaries, and SROs and for all actively traded contracts to support trade practice surveillance by Commission staff and others.

Cooperative Enforcement

- Cooperate with SROs, other Federal agencies, state governmental agencies, law enforcement entities and foreign authorities to gain information for law enforcement purposes, coordinate prosecutions, share technical expertise and provide enforcement assistance as necessary and appropriate.

Coordinate with Domestic Regulators

- Participate in the President's Working Group on Financial Markets to ensure coordination of information and efforts among U.S. financial regulators.

Coordinate with Foreign and International Regulators

- Coordinate and cooperate with foreign financial services regulators to develop appropriate global standards and arrangements in the commodities industry as markets emerge and evolve and to share vital information concerning markets, intermediaries and regulatory structure.
- Participate in IOSCO and represent the commission at international meetings concerning financial services regulation.

Investigate Violations

- Identify and investigate possible instances of fraud, manipulation, and abusive trading practices, and other violations of the Act and or regulations including those relating to registration, financial, capitalization, segregation, and supervision requirements.

File and Prosecute Cases

- Bring administrative and injunctive cases involving fraud, manipulation, abusive trading practices, and other violations of the Act and/or regulations including those relating to financial, registration, capitalization, segregation, and supervision requirements.
- Where appropriate, use "quick-strike" efforts to protect assets and to stop egregious conduct.
- Impose sanctions and collect civil monetary penalties against violators.

Draft, Review, and Comment on Legislation

- Draft, review, and comment on pending legislation.

Manage Reparations Program

- Manage a reparations program for commodity futures and option market users to make claims relating to violations of the Act.

Regulate Business, Financial and Sales Practices

- Promulgate regulations to ensure sound business, financial, and sales practices by persons participating in the commodity futures and option industry.

Represent Commission in Litigation or Other Disputes

- Represent the Commission in disputes or litigation in which the Commission has an interest.

Resolve Administrative Cases

- Hear and resolve administrative enforcement cases.

Resolve Appeals

- Resolve appeals in administrative enforcement matters, self-regulatory organization adjudicatory actions, and reparation cases.
- Inform the public and the industry of the reasons for the Commission's decisions concerning allegations of wrongdoing through published opinions describing the alleged violations and the Commission's legal and policy analysis.

Review Exchange Applications, Contracts and Rules

- Conduct timely reviews of applications for new contract markets, DTEFs, and clearing organizations to determine if they comply with the Commission's approval criteria, core principles, and regulations.
- Conduct timely reviews of requests for approval of products and rules.
- Conduct reviews of submissions filed under certification procedures to determine if they comply with statutory and regulatory requirements and do not pose a likelihood of disruption of the cash, futures, or option markets.

Review SRO Enforcement

- Conduct rule enforcement reviews of self-regulatory organizations (including financial practices, sales practices, trade practices, market surveillance, arbitration programs, and audit trail).

Share Information Externally

- Manage requests for information from Congress and responses to those requests.
- Provide materials and information on the functions and utility of the markets to the public through public Commission meetings, public roundtables and panels, advisory committee meetings, symposia, U.S. Department of Agriculture publications, routine reports on large trader activity, consumer advisories and alerts, news releases, and the Commission's Web site.
- Manage requests for information from the public and responses to those requests (includes FOIA and Officer of the Day programs).

Take Appropriate Remedial or Punitive Action

- Utilize a broad range of tools and strategies for procuring compliance with the Act and regulations.
- Provide exemptive, interpretive, or other relief as appropriate to foster the development of innovative transactions, trading systems, and similar arrangements.

## **Expertise**

The Commission's principal resource is the expertise of its staff. The complexity of the work demands highly skilled employees, many of whom have advanced educational degrees. This is especially true of the Commission's two regulatory units—the Division of Market Oversight and Division of Clearing and Intermediary Oversight—and the Commission's Division of Enforcement. The Division of Market Oversight's highly trained economists and attorneys conduct ongoing market surveillance to detect and prevent price distortion and manipulation and perform other key functions, such as processing applications from new exchanges and reviewing new contracts and exchange rules. The Division of Clearing and Intermediary Oversight's expert auditors and attorneys monitor the financial and operational integrity of the clearing organizations and intermediaries to protect customer funds and prevent the financial problems of a single entity from spreading throughout the system. The Division of Enforcement's specially trained attorneys and investigators are charged with investigating potential violations of the Act and regulations and with prosecuting wrongdoers in either administrative actions before the agency or in Federal court proceedings.

Supplementing the expertise of these three divisions are the Chief Economist's Office, whose staff economists and visiting economic academicians conduct highly complex research on important policy issues facing the Commission and provide sophisticated expert economic analysis to the Commission and the other divisions; and the Office of General Counsel, the Office of External Affairs, and the Office of the Executive Director, all of whose staff expertise in legal, managerial, and information technology areas contribute to the successful achievement of Commission priorities.

To keep pace with industry trends, Commission staff will continue to invest in improving their knowledge of developing economic trends, new trading instruments, trading strategies, technological advancements, and the interrelationship of domestic and global markets. Without such continued investment in skill and information building, staff may not be fully capable of understanding the marketplace, the economic influences on it, and its changing needs and uses. The level of skill and knowledge will need to increase over the next five years as new markets emerge around the world and market users seek new hedging and risk management strategies.

## **Technologies**

Perhaps more so than many other Federal agencies, the Commission is dependent on a significant level of advanced technology to manage the volume and complexity of financial information it collects and analyzes. Data are voluminous, require timely handling, and must be thoroughly analyzed for anomalies in trading patterns, relationships, and strategies.

Over the years, the Commission has developed and maintained an impressive technological infrastructure and has employed automation when feasible to enhance its work product and to enhance productivity in light of a static level of staffing.

The sophisticated market surveillance and market analyses the Commission performs are accomplished through the use of databases and econometric modeling. Fact patterns for enforcement investigations are supported by computer programs, and many other critical tasks could not be accomplished without the significant level of information technology at the CFTC. In addition, the design and implementation of Project eLaw, the automated law office that seamlessly integrates technology and work processes to support managers and staff across the Commission in their investigative, trial, and appellate work, will further enhance the Commission's ability to apply technology to its efforts. The need for this level of support will increase over the coming five years as technology continues to evolve and to offer new capabilities.

Commission staff must be knowledgeable as to current technologies in order to perform adequate oversight and investigations of the exchanges as they increase their use of technology. This technological trend has been reflected in the increasing linkage of global markets and the introduction of overnight trading capabilities by major U.S. exchanges linked to foreign counterparts. Advances in technology will improve the ability of the exchanges to handle their work electronically. The Commission must be knowledgeable in these technologies to fulfill its mission of fostering innovation and a flexible and responsive regulatory environment.

## ***KEY FACTORS AFFECTING SUCCESS: EXTERNAL CHALLENGES***

The Commission faces challenges external to the organization that may significantly alter its ability to meet its mission, goals, and outcomes, depending on the weight of their influence and the timing of their occurrence. There are three broad areas of external challenges that may impact the Commission's achievement of its strategic goals and planned accomplishments for FY 2004 through FY 2009:

### **Challenges in the Marketplace**

The continuing growth in the number of actively traded contracts on U.S. exchanges—nearly triple the number available just a decade ago—poses a significant external challenge. In the last decade, 815 new futures and option contracts were approved or certified. In FY 2003 alone, 351 new futures and option contracts were approved or certified. Since the passage of the CFMA, the Commission has designated six new contract markets and approved five additional derivatives clearing organizations.

For the first time in history last year, over 1 billion contracts were traded on futures and option exchanges. The CFTC must monitor the increases in volume and the complexity of trading activity in order to ensure that market users are able to trust the safety, fairness, and transparency of trading on U.S. exchanges.

Events that could destabilize commodity markets in particular and financial markets in general, such as attempts to manipulate prices and the loss of investor confidence caused by recent events in the energy and financial sectors, also present significant challenges to the Commission.

### **Legislative Challenges**

The Commission's mission performance continues to be affected by changes in Federal laws and policies, such as the deregulation of the energy industry and changes in farm subsidy policies, spawning change and innovation, new types of crop insurance, structural changes permitted in the financial services industry, the diversification into overseas markets and the convergence of the securities, commodities, insurance, and banking industries.

### **Technological Challenges**

The advancements in technology continue to introduce challenges in many areas: alternatives to the "open-outcry" method of trading commodity futures on the exchange floor; enhanced methods for timing and tracking trading transactions; online filing of financial information by market users; solicitations to the retail market via the Internet; electronic marketing and trading of financial and risk-hedging products; and trading commodity futures and options on a global, 24-hour real-time basis. The extraordinary increase in electronic trading systems and Internet trading has allowed markets to respond to information and the needs of their users 24 hours a day, but also has presented new opportunities for fraudulent activity.

## ***COORDINATION ON CROSS-CUTTING ISSUES***

The Commission benefits from established intergovernmental partnerships, sharing information and consulting on issues of importance to the Commission and other Federal organizations.

### **President's Working Group on Financial Markets**

The PWG is a forum for the coordination of Federal financial regulation across markets. It brings together the leaders of the Federal financial regulatory agencies, including the Secretary of the Treasury, who chairs the group, and chairs of the FRB, the CFTC, and the SEC. In addition to the four primary financial regulators, the PWG also includes the heads of the National Economic Council (NEC), the Council of Economic Advisors, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Bank of New York, and the Office of Thrift Supervision (OTS). Issues considered by the PWG and its staff have included individual and coordinated agency initiatives concerning risk assessment, capital requirements, internal controls, disclosure, accounting, market practices relating to trading in derivative instruments, bankruptcy law revisions, and contingency planning for market emergencies.

During FY 2002, the PWG met regularly to share information regarding certain market events, implementation of the CFMA, pending bankruptcy reform, and financial netting legislation. Beginning on the morning of September 11, 2001, the principals met frequently throughout the day and subsequent days to monitor and assist the financial markets as they recovered from the terrorist attacks and resumed trading.

In support of Goal One, Commission staff coordinate initiatives on contingency planning for market emergencies and participate in biweekly conference calls with the staff of the PWG. In support of Goal Three, the group coordinated initiatives concerning risk assessment, capital requirements, internal controls, disclosure, accounting, market practices relating to derivatives instruments, hedge funds, bankruptcy law revisions, and contingency planning for market emergencies, and participated in Joint Report on Retail Swaps.

### **The Securities and Exchange Commission**

Title II of the CFMA repeals the longstanding ban on single-stock futures and directs the CFTC and the SEC to implement a joint regulatory framework for security futures products, which include single-stock and narrow-based stock index futures. Trading of such futures products began during the first quarter of FY 2003, and trading of options on these futures could begin three years after enactment of the CFMA if the CFTC and the SEC jointly determine to permit such trading. The CFTC and the SEC have worked together to promulgate rules, including: 1) notice registration procedures for exchanges; 2) notice registration procedures for intermediaries; and 3) rules related to offering and execution of SFPs.

### **The Federal Energy Regulatory Commission**

The CFTC and FERC have worked together to monitor trading activity in the natural gas and electricity cash and futures markets. During FY 2003, the CFTC and FERC issued a joint statement finding no evidence of manipulation as the cause of a spike in natural gas prices that occurred in late February 2003. The CFTC and FERC also jointly participated in three technical conferences

concerning clearing and credit issues and price reporting issues in the natural gas and electricity markets.

#### **U.S. Department of Agriculture**

Consistent with the mandate of the Federal Agricultural Improvement & Reform (FAIR) Act of 1996, the Commission and its staff have been working with the U.S. Department of Agriculture's (USDA) Risk Management Agency, the USDA Cooperative State Research, Education, and Extension Service, and the USDA Office of Outreach in a risk management education effort. The FAIR Act initiated a phase-out of the price support programs that had provided a safety net for American agriculture since the 1930s. Recognizing that the disappearance of these programs would force producers to become more self-reliant in risk management, the FAIR Act required the Secretary of Agriculture, "in consultation with the Commodity Futures Trading Commission," to provide producers with appropriate "...education in management of the financial risks inherent in the production and marketing of agricultural commodities...."

This risk management education effort has continued despite subsequent farm legislation that has partially reestablished an agricultural "safety net." The effort continues to be broad in scope and content, focusing on integrating basic information from all relevant sectors, including crop insurance, futures, and options. Recent initiatives include development of educational materials and programs for ultimate delivery to farmers through the funding of a number of grants for risk management education projects as well as planning and conducting a number of regional risk management education conferences and seminars. Longer term strategies for the delivery of educational materials to producers currently are being developed and implemented and include the establishment of Web site tutorials, the use of television and radio infomercials, and local meetings and seminars. Chairman Newsome serves as the Commission's principal contact point to this risk management education effort and periodically meets with the Administrators of the previously mentioned USDA offices in order to exchange information of relevance to the effort. In addition, Commission staff provide frequent assistance to those offices in carrying out risk management education initiatives.

#### **U.S. Department of Energy**

In recent years with the continued development of trading in energy-related derivatives, the Commission and its staff have established working relationships with the staff of the U.S. Department of Energy. Most recently, Commission staff have been assisting the Energy Information Administration of the U.S. Department of Energy with a study of energy markets. The study will generally describe the structure and activity in the cash and derivative markets for oil, gas, and electricity and will describe the nature of Federal oversight of firms in these industries and the markets for these commodities.

#### **Corporate Fraud Task Force**

By Executive Order signed by President Bush on July 9, 2002, the CFTC was named as a member of the Corporate Fraud Task Force. This task force was established with the objective of strengthening the efforts of the Department of Justice, Federal, state, and local agencies to investigate and prosecute significant financial crimes, recover the proceeds of such crimes, and ensure just and effective punishment of those who perpetrate financial crimes. Recent efforts of this inter-agency cooperative task force have included the investigations of the alleged improprieties in the energy markets.

### **Agricultural Advisory Committee**

The Agricultural Advisory Committee (AAC) represents a vital link between the Commission, which regulates agricultural futures and option markets, and the agricultural community, which depends on those markets for hedging and price discovery. The 25 member organizations of the AAC represent a major portion of the American agricultural community. Since 1985, the meetings of the AAC have fostered an ongoing dialogue between that community and the Commission.

### **Technology Advisory Committee**

The Technology Advisory Committee (TAC) advises the Commission on the impact and implications of technological innovation in the financial services and commodity markets. Its objectives include: 1) identifying new technologies utilized by financial services and commodity markets and their participants; 2) analyzing the application of new technologies in financial services and commodity markets as well as by market professionals and market users, particularly in the areas of system capacities and readiness, order flow practices, and clearing and payment activities; 3) reviewing the CEA, as amended by the CFMA, and the regulations promulgated thereunder in light of new technologies employed by market participants and ensuring the Commission's ability to exercise appropriate fraud and manipulation authority; and 4) examining ways that the Commission may respond to the use of technology in financial services and commodity markets through appropriate legislative proposals and/or regulatory reform.

### **Global Markets Advisory Committee**

The Global Markets Advisory Committee (GMAC) was created by the Commission on February 25, 1998, for the purpose of obtaining input on international market issues that affect the integrity and competitiveness of U.S. markets and firms engaged in global business. As stated in GMAC's charter, "[t]he objectives and scope of activities of [GMAC] shall be to conduct public meetings and to submit reports and recommendations on matters of concern to the exchanges, firms, market users, and the Commission regarding the regulatory challenges of a global marketplace ... including ... avoiding unnecessary regulatory or operational impediments faced by those doing global business." Membership of GMAC consists of 23 individuals representing U.S. futures exchanges, self-regulators, financial and commodity intermediaries, market users, and traders.

## ***MEASURING SUCCESS: NEW PERFORMANCE STRUCTURE***

In developing this strategic plan, the Commission worked in consultation with an strategic planning expert, who assisted us in determining the best measures of operational success. The process involved reexamining the outdated output-based measures of past strategic plans in order to develop more outcome-based measures. The new performance structure, a combination of meaningful output and outcome measures listed below, reflects the Commission's best effort to date at measuring its effectiveness as an oversight regulator.

### **Goal One Performance Measures**

The following performance measures were designed to demonstrate the Commission's success in reaching the Goal One desired outcomes of markets that: 1) accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity; and 2) are effectively and efficiently monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.

- Percentage growth in market volume (*Growth in market volume*)
- Increase in number of exchanges and clearinghouses (*Expanding infrastructure*)
- Percentage increase in number of products traded (*Expanding number of products*)
- Percentage of new exchange and clearinghouse clearing organization applications completed within the statutory timeframe
- Percentage of new contract certification reviews completed within three months to identify and correct deficiencies in contract terms that make contracts susceptible to manipulation
- Percentage of rule change certification reviews completed within three months, to identify and correct deficiencies in exchange rules that make contracts susceptible to manipulation or trading abuses or result in violations of law
- Length of advance warning of significant economic trends and patterns that require CFTC intervention (*Quick and efficient identification*)
- Measure of technological currentness of surveillance tools, information, and technology baselined against other similar surveillance organizations
- Percentage of DCO applications demonstrating compliance with core principles
- Ratio of contracts surveilled per economist
- Percentage of contract expirations without manipulation

### **Goal Two Performance Measures**

The following performance measures were designed to demonstrate the Commission's success in reaching the Goal Two desired outcomes of detection and prevention of violations of Federal commodities laws concerning futures and

options violations; commodity professionals meeting high standards; and effective and expeditious handling of customer complaints against persons or firms registered under the Act.

- Number of enforcement investigations opened during the fiscal year
- Number of enforcement cases filed during the fiscal year
- Percentage of enforcement cases closed during the fiscal year in which the Commission obtained sanctions (e.g., civil monetary penalties, restitution and disgorgement, cease and desist orders, permanent injunctions, trading bans, and registration restrictions)
- Cases filed by other criminal and civil law enforcement authorities during the fiscal year that included cooperative assistance from the Commission
- Percentage of SROs that comply with core principles
- Percentage of DCOs that comply with core principles
- Percentage of professionals compliant with standards regarding testing, licensing, and ethics training (*Professional compliance*)
- Percentage of self-regulatory organizations that comply with requirement to enforce their rules
- Percentage of total requests receiving CFTC responses for guidance and advice
- Percentage of filed complaints resolved within one year of the filing date
- Percentage of appeals resolved within six months

### **Goal Three Performance Measures**

The following performance measures were designed to demonstrate the Commission's success in reaching the Goal Three desired outcomes of sound financial practices of clearing organizations and firms holding customer funds; effectively self-regulated commodity futures and option markets; markets free of trade practice abuses; and a regulatory environment that is flexible and responsive to evolving market conditions.

- Lost funds:
  - a) Percentage decrease in number of customers who lose funds
  - b) Amount of funds lost
- Number of rulemakings to ensure market integrity and financially sound markets
- Percentage of self-regulatory organizations that comply with requirement to enforce rules
- Percentage of intermediaries who meet risk-based capital requirements
- Percentage of clearing organizations that comply with requirement to enforce their rules

- Percentage of exchanges deemed to have adequate systems for detecting trade practice abuses
- Percentage of exchanges that comply with requirement to enforce their rules
- Percentage of CFMA Section 126(b) objectives addressed
- Number of rulemakings, studies, interpretations, and guidances to ensure market integrity and exchanges' compliance with regulatory requirements
- Percentage of requests for no-action or other relief completed within six months related to novel market or trading practices and issues to facilitate innovation
- Percentage of total requests receiving CFTC responses for guidance and advice

The Commission is in the process of collecting baseline data for each measure that will serve as the basis for future projections of performance.

## ***PROGRAM EVALUATIONS: PAST, PRESENT & FUTURE***

Program evaluations to determine how well the Commission is reaching its desired outcomes are necessary to measure the effectiveness and efficiency of its work. Many program priority and resource allocation decisions hinge on the knowledge of program successes and failures. For the first three years of this plan, the Commission will continue to use methods and processes already in place to evaluate how we are progressing in our efforts to achieve the strategic goals and outcomes as well as the priorities for FY 2004 through FY 2009 outlined in this strategic plan.

### **Management Accounting Structure Code System**

Information concerning the distribution of labor at the Commission is captured through the financial reporting system called MASC—Management Accounting Structure Code System. This input data, provided by every employee on a bi-weekly basis, reflects the hours they dedicate to various Commission activities and projects. The information is intended for use by agency program managers in their resource management activities, as well as to provide a database for documentation and support of the CFTC fee structure for such fee-generating activities as the designation of contract markets for trading on exchanges and rule enforcement reviews of the exchanges.

The MASC system is being reengineered to conform to the strategic goal, outcome, and business process structure defined by this strategic plan. The revamped system will serve as an evaluation tool by enabling managers to assess distribution of labor costs and realign resources as needed to contribute to the successful achievement of Commission priorities.

### **Status of Funds Reporting Process**

The Status of Funds, a financial management reporting process, executed from the Commission's automated financial management system and presented to executive management, is the basis for periodic reports of the agency's financial condition and usage of staff-years. Beginning in FY 2004, the Commission will begin to realign the status of funds reporting process to facilitate the reporting of resource usage under the new framework of the strategic plan, i.e., by strategic goal, outcome, and business process.

## ***APPENDIX***

### **U.S. Commodity Exchanges & Derivatives Clearing Organizations**

There are 21 commodity exchanges and 13 derivatives clearing organizations located in eight cities in the United States and one city in the United Kingdom. These SROs are responsible, subject to CFTC oversight, for the operation of the exchanges and the business conduct and financial responsibility of their member firms.

#### **History**

As the economy of the United States expanded during the early part of the nineteenth century, the commodity exchanges evolved from unorganized club-like associations into formalized exchanges. In 1848, the first formal exchange, the Chicago Board of Trade, was established with 82 members. And on March 13, 1851, the first contract was traded on this exchange, encouraged by the trading standards, inspections system, and weighing system prescribed by the board members.

Trading on the Chicago Board of Trade was considerable, and by 1870 futures trading also began on the New York Produce Exchange and the New York Cotton Exchange. By 1885, the New York Coffee Exchange was actively trading futures contracts. Since the second half of the nineteenth century, the growth of these exchange institutions has been steady and continuous—evolving into the 21 U.S. commodity exchanges, designated as contract markets by the CFTC, that are used today.

The total volume of futures contract and option trading on all exchanges in the United States now has a notional value of billions of dollars per day. The commodity exchanges have become an indispensable financial tool for the world's markets.

## **CFTC-Regulated Commodity Exchanges\***

### Amarillo, TX

- *FutureCom (FCOM)*

### Cambridge, MA

- *OnExchange Board of Trade (ONXBOT)*

### Chicago, IL

- *Chicago Board of Trade (CBT)*
  - *MidAmerica Commodity Exchange (MCE)*
- *Chicago Mercantile Exchange (CME)*
- *Merchants' Exchange (ME)*
- *OneChicago Futures Exchange (OCX)*

### Jersey City, NJ

- *BrokerTec Futures Exchange (BTEX)*

### Kansas City, MO

- *Kansas City Board of Trade (KCBT)*

### Minneapolis, MN

- *Minneapolis Grain Exchange (MGE)*

### New York, NY

- *Cantor Financial Futures Exchange (CFFE)*
- *Island Futures Exchange (IFE)*
- *Nasdaq LIFFE, LLC Futures Exchange (NQLX)*
- *New York Board of Trade (NYBT)*
  - *Coffee, Sugar, and Cocoa Exchange (CSCE)*
  - *New York Cotton Exchange (NYCE)*
  - *New York Futures Exchange (NYFE)*
  - *Citrus Associates of the New York Cotton Exchange (CANYCE)*
- *New York Mercantile Exchange (NYMEX)*
  - *Commodity Exchange Division (COMEX)*

### Philadelphia, PA

- *Philadelphia Board of Trade (PBT)*

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\* CFTC-regulated commodity exchanges include only exchanges with non-dormant contracts.

## **CFTC-Registered Derivatives Clearing Organizations**

### Cambridge, MA

- *OnExchange Clearing Corporation*

### Chicago, IL

- *Board of Trade Clearing Corporation (BOTCC)*
- *Chicago Mercantile Exchange (CME) Clearinghouse*
- *The Options Clearing Corporation (OCC)*
- *Chicago Board of Trade (CBOT)*

### Houston, TX

- *EnergyClear Corporation*

### Jersey City, NJ

- *BrokerTec Clearing Company LLC (BCC)*

### Kansas City, MO

- *Kansas City Board of Trade (KCBT) Clearing Corporation*

### Minneapolis, MN

- *Minneapolis Grain Exchange (MGE) Clearinghouse*

### New York, NY

- *New York Clearing Corporation (NYCC)*
- *New York Mercantile Exchange (NYMEX) Clearinghouse*

### Philadelphia, PA

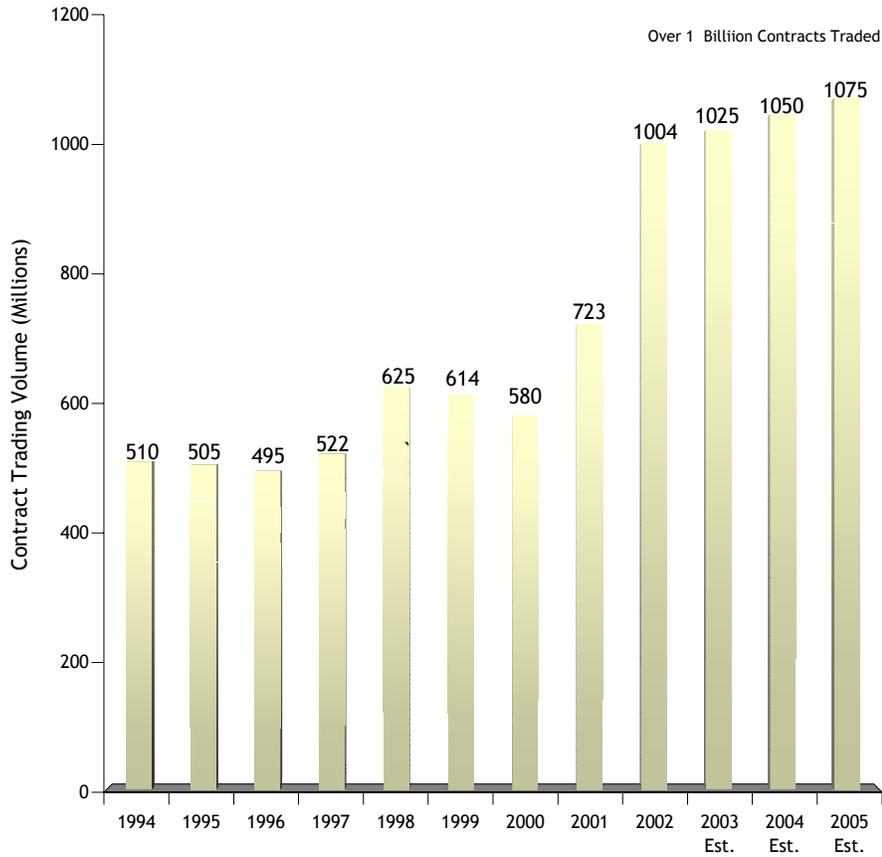
- *Intermarket Clearing Corporation (ICC)*

### United Kingdom

- *London Clearing House (LCH)*

## Volume of Trading

Volume of trading is measured in number of contracts traded. The volume of trading on the U.S. exchanges reached 1 billion contracts traded for the first time in history in 2002.



## Number of Registered Commodities Professionals

Companies and individuals who handle customer funds or give trading advice must apply for registration through the NFA, an SRO to which the Commission has delegated that responsibility subject to CFTC oversight.

The Commission regulates the activities of over 67,800 registrants:

<b>Type of Registered Professional</b>	<b><u>Number in Sept 2003</u></b>
<i>Associated Persons (AP) (Sales People)</i>	50,900
<i>Commodity Pool Operators (CPOs)</i>	2,059
<i>Commodity Trading Advisors (CTAs)</i>	2,812
<i>Floor Brokers (FBs)</i>	8,756
<i>Floor Traders (FTs)</i>	1,452
<i>Futures Commission Merchants (FCMs)</i>	205 <sup>4</sup>
<i>Introducing Brokers (IBs)</i>	1,646 <sup>5</sup>
<b>TOTAL</b>	<b><u>67,830</u></b>

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<sup>4</sup> Includes 18 notice-registered FCMs.

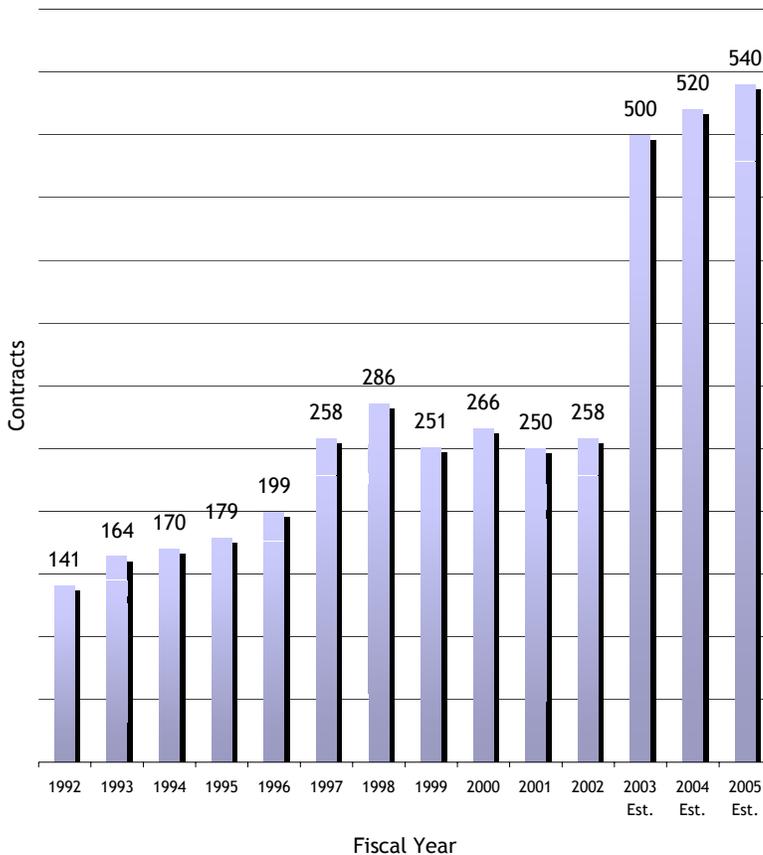
<sup>5</sup> Includes 42 notice-registered IBs.

## Actively Traded Futures & Option Contracts

The Commission reviews the terms and conditions of proposed contracts, as well as subsequent amendments to the terms and conditions of contracts, to ensure their economic viability. Improperly designed contracts can increase the chance of cash, futures, or option market disruptions and undermine the usefulness and efficiency of a market.

The Commission has seen the introduction of new and novel trading instruments to handle a variety of financial risks, such as currencies, inflation-indexed debt instruments, contracts based on various domestic and foreign stock indices, as well as the risks inherent in the agricultural, metals, mining, and energy sectors of the economy. It is expected that this innovation will continue as firms, companies, producers, processors, and others turn to the commodity futures markets for hedge protection against financial risk.

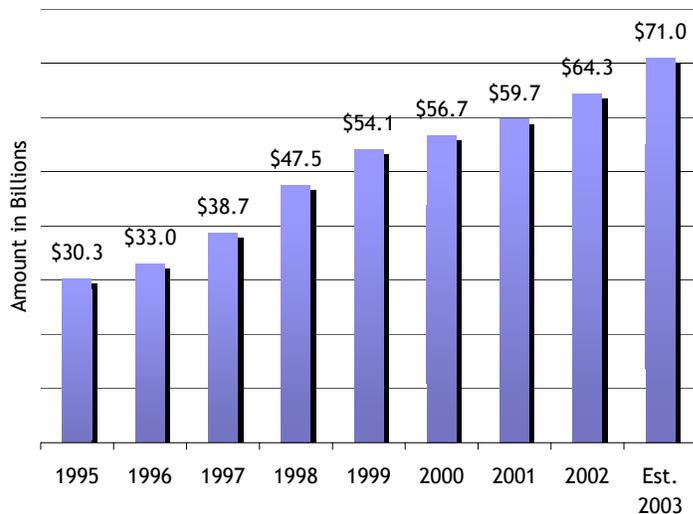
There are currently over 250 separate actively traded contracts on the United States exchanges. This number has nearly doubled over the number of contracts traded just a decade ago and is expected to double yet again, reaching an estimated 540 contracts by FY 2005.



## Managed Funds

Investment management professionals have been using managed futures for more than 30 years. Recently, there has been a surge in pooled and managed money and an increasingly large segment of the population has money invested in the futures markets, either directly through pension funds or indirectly through other investment vehicles that participate in the markets. Institutional investors such as corporate and public pension funds, insurance companies, and banks are increasingly using managed futures to diversify their portfolios.

From 1995 through 2002, the amounts of money under management has more than doubled from just over \$30 billion to nearly \$65 billion, with an estimated increase to over \$70 billion in 2003.



Over the past 15 years, the profile of the typical commodity pool has changed significantly. Fifteen years ago, commodity pools were offered with the expectation that maximum contributions would be \$1 million. Most pools were single-advisor pools, with the CPO acting as CTA for the pool. Pools were designed for speculative trading, and there were no tiered pools or dynamically managed pools.

Today, the pool universe is comprised of:

- Single and multiple advisor pools;
- Multi-media pools—that is, pools that invest in securities and futures as well as other investments, including “hot issues” of U.S. securities, off-exchange instruments, and international markets;
- Pools that use leverage and isolate particular forms of return, such as the mortgage pre-payment option; and
- Pools that invest in other pools.

## Outcomes & Business Processes by Strategic Goal

<b>Goal One: <i>Ensure the economic vitality of the commodity futures and option markets.</i></b>	
<b>Outcome</b>	<b>Business Process</b>
<b>1.1 Markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.</b>	<ol style="list-style-type: none"> <li>1. Conduct financial surveillance</li> <li>2. Conduct market surveillance</li> <li>3. Conduct trade practice surveillance</li> <li>4. Conduct economic research</li> <li>5. Review trading facility filings and clearing organization contracts and rules</li> <li>6. Conduct cooperative enforcement</li> <li>7. Investigate violations</li> <li>8. File and prosecute cases</li> <li>9. Take appropriate remedial or punitive action</li> </ol>
<b>1.2 Markets are effectively and efficiently monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.</b>	<ol style="list-style-type: none"> <li>1. Conduct financial surveillance</li> <li>2. Conduct market surveillance</li> <li>3. Conduct trade practice surveillance</li> <li>4. Conduct economic research</li> <li>5. Review trading facility filings and clearing organization contracts, and rules</li> <li>6. Investigate violations</li> <li>7. File and prosecute cases</li> <li>8. Share information externally</li> <li>9. Coordinate with domestic regulators</li> </ol>
<b>Goal Two: <i>Protect market users and the public.</i></b>	
<b>Outcome</b>	<b>Business Process</b>
<b>2.1 Violations of Federal commodities laws are detected and prevented.</b>	<ol style="list-style-type: none"> <li>1. Conduct financial surveillance</li> <li>2. Conduct cooperative enforcement</li> <li>3. Investigate violations</li> <li>4. File and prosecute cases</li> <li>5. Resolve administrative enforcement cases</li> <li>6. Resolve appeals</li> <li>7. Share information externally</li> <li>8. Take appropriate remedial or punitive action</li> <li>9. Represent Commission in litigation or other disputes</li> <li>10. Collect monetary penalties from violators.</li> </ol>
<b>2.2 Commodity professionals meet high standards.</b>	<ol style="list-style-type: none"> <li>1. Provide guidance, advice, and regulate business, financial, and sales practices</li> <li>2. Review self-regulatory organizations and clearing organizations</li> <li>3. Investigate, file, and prosecute cases</li> </ol>
<b>2.3 Customer complaints against persons or firms registered under the Act are handled effectively and expeditiously.</b>	<ol style="list-style-type: none"> <li>1. Manage reparations program</li> <li>2. Resolve appeals</li> <li>3. Represent Commission in litigation or other disputes</li> </ol>

<b>Goal Three: <i>Ensure market integrity in order to foster open, competitive, and financial sound markets.</i></b>	
<b>Outcome</b>	<b>Business Process</b>
<b>3.1 Clearing organizations and firms holding customer funds have sound financial practices.</b>	<ol style="list-style-type: none"> <li>1. Conduct financial surveillance</li> <li>2. Provide guidance, advice, and regulate business, financial, and sales practices</li> <li>3. Review self-regulatory organization enforcement</li> <li>4. Investigate violations</li> <li>5. File and prosecute cases</li> <li>6. Take appropriate remedial or punitive action</li> </ol>
<b>3.2 Commodity futures and option markets are effectively self-regulated.</b>	<ol style="list-style-type: none"> <li>1. Conduct financial surveillance</li> <li>2. Provide guidance, advice, and regulate business, financial, and sales practices</li> <li>3. Review exchange applications, contracts, and rules</li> <li>4. Review self-regulatory organization enforcement</li> </ol>
<b>3.3 Markets are free of trade practice abuses.</b>	<ol style="list-style-type: none"> <li>1. Investigate violations</li> <li>2. File and prosecute cases</li> </ol>
<b>3.4 Regulatory environment is flexible and responsive to evolving market conditions.</b>	<ol style="list-style-type: none"> <li>1. Coordinate with domestic regulators</li> <li>2. Coordinate with foreign and international regulators</li> <li>3. Draft, review, and comment on legislation</li> <li>4. Provide guidance, advice, and regulate business, financial, and sales practices</li> </ol>

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## **Publications & Information**

For a list of other CFTC publications or for more information on the CFTC, please visit the CFTC's home page on the World Wide Web. The Commission's Web address is <http://www.cftc.gov>.

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