Commodity Futures Trading Commission
Office of External Affairs
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
202.418.5080

Testimony

Written Testimony of Walter L. Lukken, Acting Chairman, Commodity Futures Trading Commission Before the United States Senate

Subcommittee on Financial Services and General Government Committee on Appropriations

May 7, 2008

Thank you, Mr. Chairman and Members of the Subcommittee. I am pleased to be here to testify before you on behalf of the Commodity Futures Trading Commission.

Background and Current Market Events

The CFTC is the agency charged with overseeing and regulating the U.S. commodity futures and options markets. These markets play a critical role in the U.S. economy by providing risk management tools that producers, distributors, and commercial users of commodities use to protect themselves from unpredictable price changes. The futures markets also play a price discovery role as participants in related cash and over-the-counter markets look to futures markets to discover prices that accurately reflect information on supply, demand, and other factors.

As you are well aware, these are extraordinary times for our markets with commodity futures prices at unprecedented levels. In the last three months, the agricultural staples of wheat, corn, soybeans, rice and oats have hit all-time highs. We have also witnessed record prices in crude oil, gasoline and other related energy products. Both macro-economic factors as well as micro fundamentals for specific markets are at play in these prices. Broadly speaking, the falling dollar, strong demand from the emerging world economies, Mideast political unrest, detrimental weather and ethanol mandates have driven up commodity futures prices across-the-board.

On top of these trends, the emergence of the sub-prime crisis last summer led investors to increasingly seek portfolio exposure in commodity futures. As the federal regulator of these products, the CFTC is monitoring these growing markets to ensure they are working properly for farmers, investors, and consumers. To date, CFTC staff analysis indicates that the current higher futures prices are generally not a result of manipulative forces. That said, we continue to gather information from the entire marketplace – and welcome outside analysis and perspectives – so that we can ensure that we have an accurate and full view.

For example, the agency recently convened an agriculture forum two weeks ago in which we brought together a diverse group of market participants to have a full airing of views and opinions as to the driving forces in these markets. The comment period for that event ends today and we hope to announce in the near future agency initiatives to address the concerns we heard at the forum. The CFTC also recently announced the creation of an Energy Markets Advisory Committee and named the public members of the Committee just last week. Our first meeting is scheduled for June 10th to look at issues related to the energy markets and the CFTC's role in these markets under the Commodity Exchange Act. I am confident that these public forums will benefit our ability to make informed decisions as we strive to improve our oversight of these important markets.

Despite this tumultuous time in our markets, the agency continues to make advancements on several important policy initiatives. Last September, the Commission held a public hearing on the regulation of exempt markets, resulting in an extensive Report to Congress recommending additional authorities for the agency in overseeing this type of trading. Through bipartisan efforts, these recommendations became a part of the CFTC's reauthorization legislation, which is contained in the Farm Bill conference report now being debated. The enactment of that legislation will mean increased responsibilities for the agency – and accordingly, will mean a need for additional CFTC staff to carry out the new authorities. The President's FY09 budget for the $130 million funding level does not take into account the new authorities included in the Farm Bill. The legislation would also raise penalties for market manipulation violations and close a legal loophole that has developed due to adverse court decisions that are hindering the CFTC's efforts to combat retail off-exchange foreign currency fraud.

The CFTC has also worked to strengthen its relationship with the Securities and Exchange Commission (SEC) over the last year, given our shared responsibilities over certain products that affect the regulatory interests of both agencies. In March, our respective agencies entered into a memorandum of understanding (MOU) that will help the agencies share information as well as coordinate our review of novel derivative products that have attributes of both securities and futures. Two Chicago exchanges, the Chicago Board Options Exchange and OneChicago, are the first beneficiaries of this new framework as both seek to list for trading derivative products based on gold ETF products.

Last year was busy on the enforcement front as well with the agency assessing record penalties against those seeking to manipulate the markets and defraud the public, culminating in the CFTC and Department of Justice reaching a record settlement against British Petroleum for manipulating the propane market. I am confident that the CFTC's dedicated staff will continue this productive effort in the coming year.

Evolution of the Markets

Congress created the CFTC in 1974 as an independent agency. The CFTC's primary mission under our governing statute, the Commodity Exchange Act, is to ensure that the commodity futures and options markets operate in an open and competitive manner, free of price distortions. In December 2000, Congress reauthorized the Commission with passage of the Commodity Futures Modernization Act of 2000 (CFMA). This landmark legislation established a flexible, principles-based regulatory regime. Today, the CFTC is the only U.S. principles-based financial regulator. This flexible approach has allowed the regulated futures industry to flourish. The same flexibility also allows alert and responsive oversight by the CFTC to fulfill the agency's mission.

The U.S. futures and options markets of today bear little resemblance to the industry of 1976 in terms of complexity, globalization, volume, and economic importance – and these differences will continue in FY 2009. Yet, staff resources and operating funds over time have not kept pace.

For example, ***Figure 1*** shows the growth in trading volume on U.S. futures exchanges from 1996 to present. Trading volume has increased six-fold during the last decade, while at the same time, Commission staffing levels have fallen to 447 full-time employees. That's 50 fewer staff today than the agency had 30 years ago in 1976 – the Commission's first year of operation.

Figure 1: **Growth in Volume of Futures & Option Contracts Traded & FTEs**

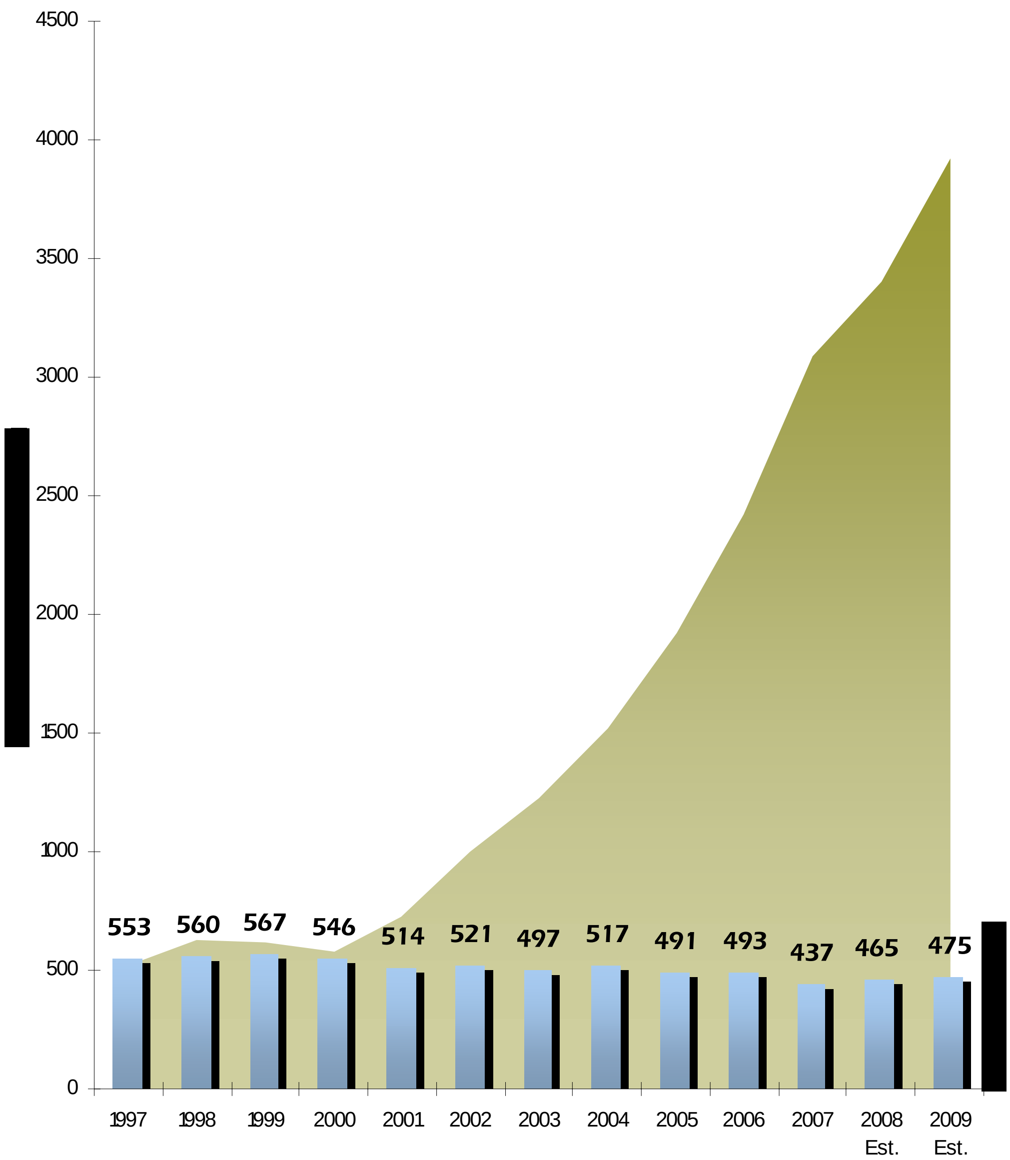

Figure 2 lists the many different components of the futures industry, including the number of contracts traded, the volume of trading, the number of futures industry participants, the number of exchanges and other trading facilities, and the overall notional value of these markets.

Indicator	1976	2007	Percent Change
CFTC Staff	497	437	-12%
Overhead Expenses as a % of Budget	34%	29%	-5%
Total Contract Volume	37 M	3.085B	+8,238%
Types of Contracts Traded	66	1,365	+1,968%
Commodity Trading Advisors	447	2,601	+482%
Commodity Pool Operators	544	1,416	+160%
Floor Brokers	2,591	8,038	+210%
Associated Persons (Sales Persons)	25,579	53,844	+110%
CFTC-Regulated Exchanges	10	12	+20%
CFTC- Registered Clearing Organizations	0	11	NA
Exempt Boards of Trade	0	9	NA
Exempt Commercial Markets	0	20	NA
Notional Value of Contracts Traded (Per Day)	$4B	$4.78T (est.)	119,400%
Customer Funds in FCM Accounts	$577M	$155B	26,763%

Figure 2: **Indicators of Industry Growth**

As you can see from the chart, the growth in these categories from 1976 to present is stunning – with percentage increases in the triple, quadruple and quintuple digits. For instance, total contract volume has increased more than 8,000% in thirty years. Contrast that with the CFTC staffing and overhead expenses over time, which have decreased -12% and -5% respectively. Looking at the growth in all sectors, it's clear that CFTC is doing a lot more with a lot less.

FY08 Budget

On behalf of the entire Commission, I would like to express my appreciation for the support provided to the CFTC in the FY08 budget. The $111 million appropriated by Congress for the current calendar year was the first substantial increase for the Commission in recent years and is already being put to good use. It is important to explain how the CFTC is using the FY08 funding to address critical needs in two major areas – experienced professionals and a modern technology infrastructure – because the FY09 funding will build on that foundation.

Additional Staff Hires

The Commission is implementing an intensive hiring program for the first time since October 2005. This program seeks to fill the loss of experienced, long-time Commission employees, as well as address new skill sets required by the rapidly evolving industry we regulate. The Commission employs highly-trained, expert staff who works within three major program divisions – Market Oversight, Clearing and Intermediary Oversight, and Enforcement. These divisions are complemented and supported by the Offices of the Executive Director, General Counsel, Chief Economist, International Affairs, and External Affairs.

The Division of Market Oversight ensures that the markets are operating efficiently and without manipulation and fraud. One of the keys to Market Oversight is market surveillance. The Commission's staff economists utilize the Commission's large trader reporting system and one of the Commission's main technology systems, the Integrated Surveillance System (ISS), to detect and deter market manipulation and disruption. As you can see in ***Figure 3***, the current atmosphere of rising futures prices across a wide range of products makes these anti-manipulation efforts all the more important.

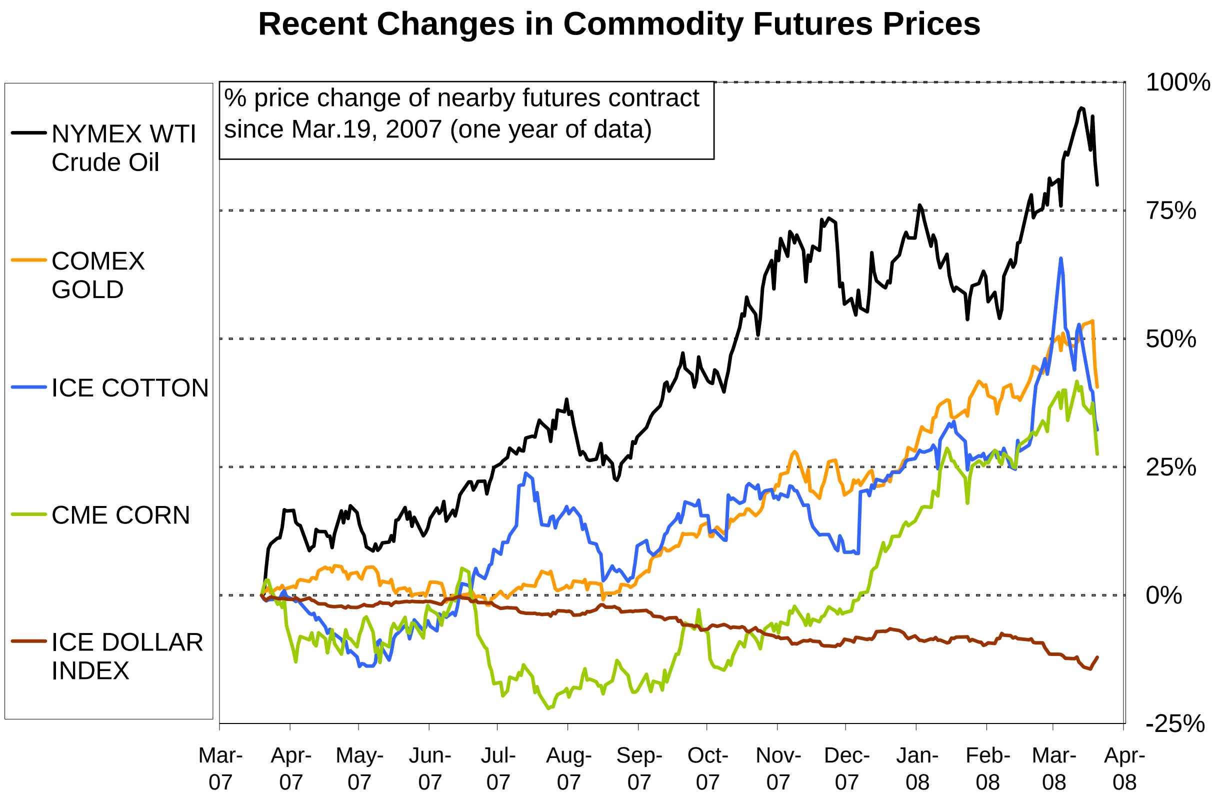

Figure 3: **Recent Commodity Price Changes by Percent Change**

The Division of Clearing and Intermediary Oversight ensures the financial integrity of the futures industry as a whole. Futures and options trading on U.S. contract markets increased by approximately 27% in 2007 over the prior year and remains at consistently high levels. Not only has the volume of trading increased and the futures prices of some commodities increased to record levels, the amount of funds handled by the clearing houses has increased as well. In this regard, all exchanges have experienced record settlements during this time period, including one day in January 2008 in which the Chicago Mercantile Exchange cleared and settled more than $12 billion of transactions—nearly six times its normal load. Despite these spikes in cash flow, the clearing system has worked extraordinarily well. Nevertheless, with the rising need for risk management by businesses and the rising importance of futures markets to the nation's economy, the Commission's financial integrity programs must be continually strengthened. A key component of the Commission's financial integrity program is the required segregation of all customer funds from those funds of Futures Commission Merchants (FCM). As shown in ***Figure 4,*** the level of required segregated customer funds has more than doubled since the end of 2000.

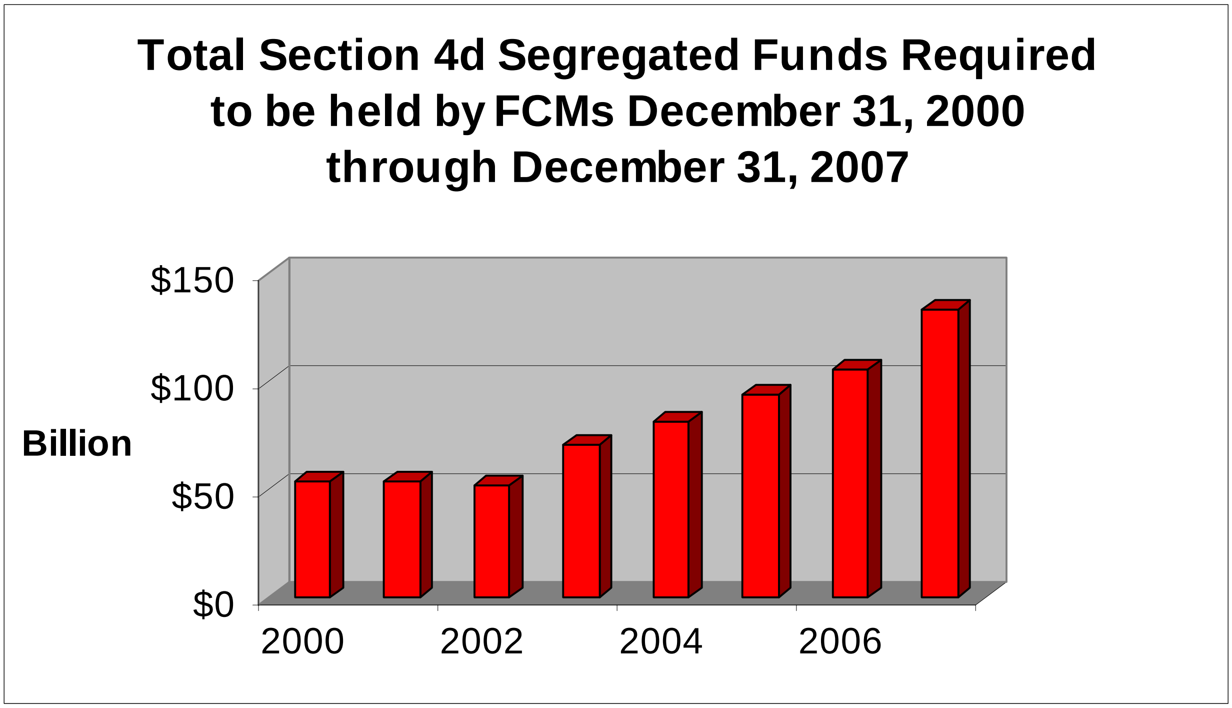

Figure 4: **Segregated Funds Required**

When a manipulation or fraud occurs in the marketplace, it is the job of the Enforcement Division to gather information, build a case and prosecute the offenders. In the foreign currency or FOREX markets, the CFTC has filed 98 cases involving 374 entities or persons with more than $562 million in civil monetary penalties levied and more than $453 million in restitution awarded. Since the collapse of Enron, CFTC has brought 39 cases involving energy markets and charged 64 entities or persons with manipulation, attempted manipulation, and/or false price reporting. The collective civil monetary penalties levied in these energy market enforcement actions exceed $444 million.

As our financial markets become more complex, global and interwoven, the Commission is increasingly called upon to co-ordinate and co-operate with other agencies domestically and world wide. Internationally, these activities involve the Commission's participation in multilateral bodies, such as the International Organization of Securities Commissions (IOSCO), as we strive to raise global regulatory standards. This is complemented with specific bilateral information sharing arrangements with other nations as we try to coordinate our enforcement and oversight efforts. Domestically, the Commission staff works with several Federal and state agencies, including USDA, FERC and DOJ, to harmonize our mutual regulatory efforts. The Commission recently signed an MOU with the SEC to further co-ordinate our efforts, given the additional convergence of the futures and equities markets. In addition, our agency has an information sharing MOU with FERC to enhance cooperation in the policing of the energy markets.

All of these important responsibilities and priorities require qualified personnel in their execution. Unfortunately, recent turnover at the agency has been significant. Throughout the agency and its divisions, the Commission lost 58 experienced employees in FY 2006, 49 in FY 2007 and 15 to date in FY 2008. The Commission currently has 447 full-time employees onboard and with the recent increased funding, we are actively recruiting toward a target of 465 FTEs for FY 2008. Such personnel additions are critical if this agency is to continue to meet its responsibilities in overseeing the futures markets.

Technology Investments

The other focus of the FY08 budget allocation is technology. The CFTC primarily uses technology in the surveillance of the markets and the monitoring of the financial integrity of the clearing organizations and firms. The Commission's FY 2008 appropriation enables the agency to undertake a long-delayed modernization of capital investments in Information Technology (IT) software and hardware, such as computers, servers, routers, switches and other critical communications components. The modernization of our surveillance systems will pay off with enhanced transparency and detection tools for the oversight of our markets.

The CFTC receives and analyzes millions of data points everyday that come in from the exchanges and firms, which allow us to monitor the marketplace. Once aggregate position levels are determined, CFTC staff not only monitors daily positions of all large traders, but also has the ability to analyze the minute-by-minute trades of these market participants, including hedge funds and other speculators, during times when there is a heightened risk of manipulation. To do this job, the CFTC's market surveillance staff uses its ISS system to organize and group the information into meaningful categories.

With the exponential growth of these global electronic markets, the CFTC must continue to devote significant portions of its budget to technology in order to stay on top of this sector. This year the agency will increase its technology budget by almost 37% with the hope of almost doubling the overall technology budget by FY 2009. These resources will be primarily used to enhance the agency's surveillance tools—making these programs faster, more functional and better able to detect wrongful activities across markets and jurisdictional borders.

Clearly, technology and personnel investments are keys to the agency's success and the FY 2009 budget builds on the foundation that has been enhanced this year. I am grateful for the Administration's and Appropriators' recognition of the need for increased funding for our agency in these two key areas.

FY09 Budget

The FY 2009 President's Budget request, as seen in ***Figure 5,*** is for an appropriation of $130 million and 475 full time staff, an increase of approximately $18.7 million and 10 staff over the FY 2008 appropriation.

FY 2009 President's Budget & Performance Plan

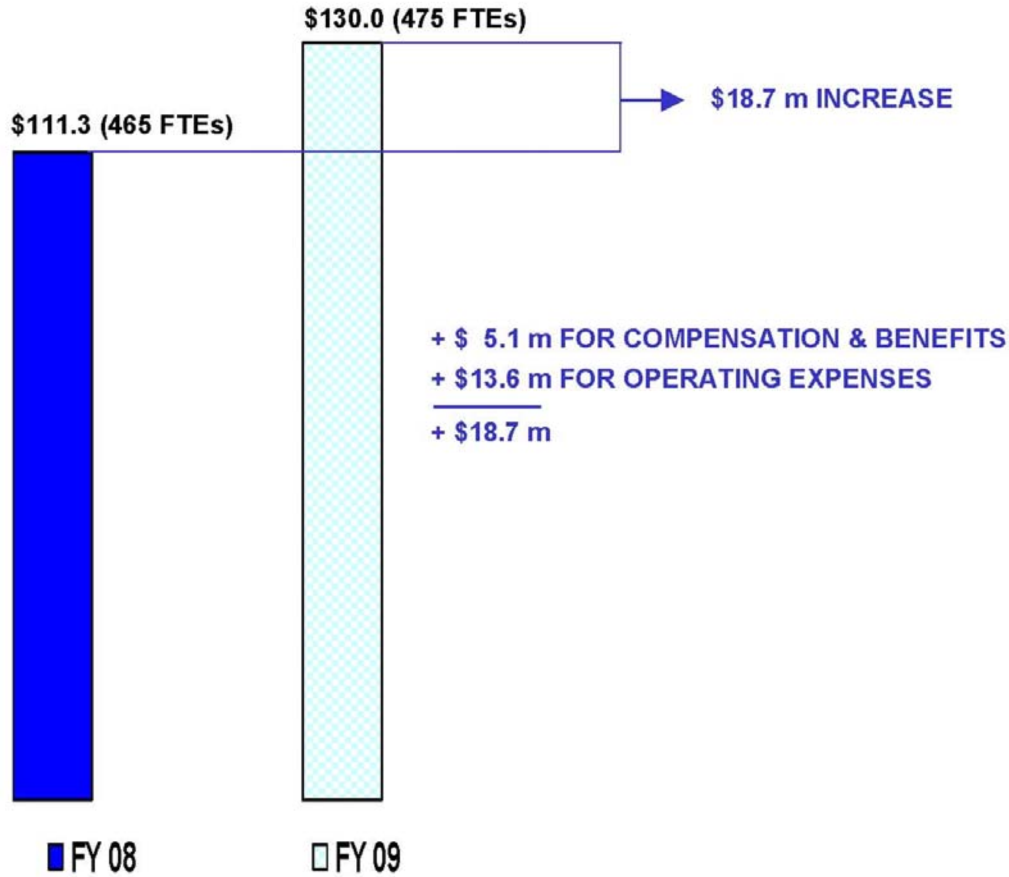

Figure 5: **FY 2009 Budget Request Provides for an increase of $18.7 million and additional 10 FTEs**

Compared to the FY 2008 appropriation, key changes in the FY 2009 Budget are:

- $3.2 million to provide for increased compensation and benefit costs for a staff of 465 full time employees;

- $1.9 million to provide for salary and expenses of 10 additional full-time employees. This portion of the budget also includes $200,000 to establish a student loan program that is designed to help with retention and recruitment of young, qualified professionals. The agency has not had the resources in previous years to be able to support this program and we're pleased to have this program planned for in our budget.

- $13.6 million to provide for increased operating costs for information technology modernization, lease of office space, and all other services.

This funding increase provides the Commission with the financial wherewithal to build on the FY08 investments by continuing to hire additional staff and make critical investments in technology.

Additional Staff Hires

For FY 2009 the Commission is requesting ten additional positions. This increase – although modest compared to industry growth – will allow us to build on the hiring we are undertaking as a result of the FY 2008 appropriation. The ten positions requested for FY 2009 are spread throughout the Commission because our needs cut across all of our responsibilities. For example, in the Division of Market Oversight, we will allocate an additional surveillance economist to focus principally on the complex issues and changing practices in the energy cash and derivatives market. In the Division of Clearing and Intermediary Oversight, we will allocate two additional staff to enhance the expanding financial and risk surveillance functions. In the Enforcement program, two additional staff will focus mainly on allegations of manipulation, trade practice violations, and false reporting, but the additional staff will also enhance our ability to address a wide range of violations of Federal commodities law. One additional staff is planned for the Office of the Chief Economist to conduct market research and analysis commensurate with the growth in new types of exchanges, new trading execution methods, and the role of speculators in our markets. For the Office of Proceedings, we are requesting one addition position to fill the long vacant directorship. For the Office of General Counsel, we are seeking one additional position to replace a loss in expertise among senior staff in areas such as bankruptcy and anti-trust law. Finally, in the Office of Information Technology, we are requesting two additional positions to enhance in-house expertise to assist the major program Divisions in monitoring, auditing, and investigating increasingly sophisticated technologically driven markets.

Technology Investments

In FY 2009, additional funding would permit the Commission to upgrade telecommunications systems and to expand and improve existing critical systems, such as the Integrated Surveillance System and eLaw. Also in FY 2009, funds requested would permit continued development of the new Trade Surveillance System (TSS), which will be used for trade practice surveillance on all exchanges, including new and emerging electronic exchanges. TSS will use state-of-the-art, commercially available software to enhance both intra-exchange and inter-exchange trade practice surveillance. We can now obtain and analyze the trading activity of our large traders in a mere fraction of the time it used to take – minutes instead of days. Soon, with these investments, we will have the capability to monitor and analyze even more quickly and efficiently a trader’s intraday trading activity.

The Commission’s ability to fulfill its mission depends on the collection, analysis, communication and presentation of information in forms useful to Commission employees, the regulated industry, other Federal, state, and international agencies, the Congress, and the American public. The resources allocated in FY 2008 and FY 2009 to Information Technology will permit a secure modern information technology infrastructure and the development of a Document Management System to modernize, centralize and automate the management of the Commission’s information resources.

These comprehensive enhancements will enable the Commission to serve these stakeholders effectively.

The FY09 budget, if approved, will largely enable completion of the CFTC's technology modernization initiative—barring unforeseen industry developments or new statutory requirements. The Commission is making a concerted effort to use commercial best practices in developing and maintaining its IT systems and ensuring that our IT staff is focused on increasing efficiency and controlling costs.

All of the technology improvements have one commonality; they help increase the availability of one of our most critical resources – time. That is, technology allows our growing staff to become more productive by spending additional time on qualitative analysis rather than quantitative processing and compilation.

Conclusion

I am very proud of the agency and our highly-skilled staff. Everyday, they carry out the agency's mission of protecting the public and market users from manipulation, fraud, and abusive practices and promoting open, competitive and financially sound markets. If the futures markets fail to work properly, all Americans are impacted.

When looking at the increased volume of activity across all areas of the CFTC mission and the scope of the industry changes, the resulting increase in specialized workload is demonstrable. Accordingly, it is critical that the CFTC have sufficient resources to hire and maintain skilled talent, as well as provide a steady stream of technology investment commensurate with the agency's expanding and evolving global mission.

Thank you for the opportunity to appear before you today on behalf of the CFTC. I would be happy to answer any questions you may have.