Commodity Futures Trading Commission
Office of Inspector General
Three Lafayette Centre
1155 21st St, NW
Washington, DC 20581
202.418.5110

Testimony

Written Testimony of Inspector General A. Roy Lavik before the House Subcommittee on Government Management, Organization and Procurement, Committee on Oversight and Government Reform

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Chairman Watson, Ranking Member Bilbray, and other Subcommittee Members, thank you for inviting me to testify before the Subcommittee. I am Roy Lavik, Inspector General for the Commodity Futures Trading Commission (CFTC or Commission). I appreciate the opportunity to discuss my role as the Inspector General at an Agency charged with regulating financial futures markets (among other markets), and to address both specific and strategic challenges facing my Office during the current economic crisis. I will also briefly address House Bill 885, which if adopted will convert my Office to a Presidential Appointment.

CFTC and OIG Mission

Congress created the CFTC in 1974 as an independent agency with the mandate to regulate commodity futures and options markets in the United States. Broadly stated, the Commission's mission is two-fold: to protect the public and market users from manipulation, fraud, and abusive practices and to ensure open, competitive and financially sound markets for commodity futures and options.

The CFTC Division of Enforcement investigates alleged violations of the Commodity Exchange Act and regulations, including allegations of fraud, market manipulation and other illegal activity by market professionals and participants. The Division of Enforcement currently has 141 employees.

If the CFTC is the watchdog for the futures industry, the OIG is watching the watchdog. My Office conducts and supervises audits and investigations of programs and operations of the CFTC, and recommends policies to promote economy, efficiency and effectiveness in CFTC programs and operations and to prevent and detect fraud and abuse. My Office has a full time professional staff of three, including myself.

The current economic crisis has presented both specific challenges and potential strategic challenges for my Office. During the summer my Office undertook an investigation into allegations of improper conduct by Agency employees related to the recent turmoil in the crude oil market. The passage of the Emergency Economic Stabilization Act in October 2008 and the revelation of the Bernard Madoff Ponzi scheme in December 2008 both raise important issues for my Office.

Investigation into the Interim Report on Crude Oil

In 2008, NYMEX Crude Oil futures prices rose from under $100.00 per barrel in January 2008 to over $145 per barrel in July. In the wake of these unprecedented price movements, allegations arose concerning an Interim Report on Crude Oil issued by Commission staff on July 22. My Office conducted an investigation into those allegations during August and September of last year.

Specifically, four United States Senators alleged that the report was based on flawed and incomplete information, was based on flawed analyses of the crude oil market, and was timed to influence a key Senate vote on a bill to regulate futures trading. The allegations stemmed from the fact that the report followed a significant reclassification of crude oil futures positions with potential to influence the report's analysis, and preceded the Senate vote by three days.

My Office interviewed 44 individuals representing the CFTC and other contributors to the report, and reviewed email and multiple drafts of the report and supporting documentation. All interviews and information we reviewed indicated that the report used the updated crude oil futures position data.

We also concluded that while the analytical method – Granger Causality – did have limitations, those limitations were clearly disclosed in the Interim Report. Finally, we concluded that because the Interim Report release date was delayed due to the position reclassification, the release date coincided with the Senate vote as a matter of coincidence rather than by design.

Nevertheless, we faulted the Agency for failing to disclose the position reclassification in an effective manner. The position reclassification was significant and the Commission did not publish a clear explanation of what the reclassification entailed, nor how it would be treated in the Interim Report and other studies. Instead, the position reclassification was announced in a manner consistent with other smaller reclassifications, meaning it was disclosed in a manner that only those familiar with the CFTC weekly Commitment of

Traders Reports would likely understand. This is a situation I strongly believe could have been avoided through greater transparency regarding the position reclassification.

The Emergency Economic Stabilization Act of 2008 and the CFTC OIG Strategic Mission

In October 2008 Congress passed the Emergency Economic Stabilization Act of 2008 and established the Troubled Asset Relief Program, which may impact the strategic mission and long term objectives of my Office.

While we have not received any allegations regarding the misuse of TARP funds or other improper conduct relating to TARP that involve matters or entities under CFTC jurisdiction, we have reached out to the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) and have made our Office available to assist wherever appropriate. We look forward to working cooperatively with SIGTARP in the future as the need arises.

The Bernard Madoff Ponzi Scheme

In the wake of the December 2008 revelation of the multi-billion dollar Ponzi scheme perpetrated by Bernard Madoff, I am concerned that similar allegations concerning entities falling under the CFTC's jurisdiction are investigated to the fullest extent possible, and are not ignored.

As far as Ponzi investigations are concerned, we are not aware of any allegations that have been ignored. The Commission filed 13 complaints last year in suspected Ponzi scheme cases. After the arrest of Mr. Madoff in December 2008, the Commission received an influx of similar allegations and filed 12 additional Ponzi cases between January and March 18 of this year.

Currently we have no allegations that the CFTC Division of Enforcement has ignored or refused to investigate allegations. We note with approval that in 2008 CFTC announced investigations into both the energy markets and the silver market. My Office had previously received allegations of illegal trading in both markets, as well as requests for investigative action.

My Office routinely reviews each investigative opening memo and each proposed complaint issued by the Division of Enforcement, and while we do not supervise Enforcement filings, we also do not hesitate to bring potential issues to the attention of relevant Agency officials. In addition, my Office has conducted several investigations of alleged wrongdoing by CFTC employees in connection with investigations and enforcement activities, including an investigation into improper post-employment conduct by a CFTC enforcement attorney.

The Agency's obligation to investigate credible allegations is one we take seriously, and we will continue to follow this issue.

HR 885

My final topic is HR 885. HR 885 will elevate the Inspector General at five financial market regulators to Presidential appointments. There is no doubt that a Presidential appointment may make the Inspector General more visible.

IG independence, however, is established under the IG Act and other statutes, and applies equally to the Agency- and President-appointed Inspector Generals. It is more important to ensure that the best qualified individuals are selected to serve.

HR 885 as written will terminate pay parity for the CFTC Inspector General relative to other CFTC employees and officers. I understand that the other Inspector Generals named in HR 885 will be similarly affected and in some instances the pay cut will be significant. HR 885 therefore offers the prospect of rendering the Inspector Generals at the prescribed five financial Agencies lesser status than other high ranking officials since their pay will be significantly less than the latter.

It is clear that Congress authorized the CFTC to achieve pay parity with the other financial market regulators in order to attract and retain the best and brightest. One of my goals has been to perform a review of the pay parity program at CFTC not only to determine its effect on employee retention, but also to determine whether new hires are appreciably more experienced or better qualified. During the past years the Agency's budget situation has resulted in hiring freezes and has not permitted a meaningful review. However, the Agency's recent budget increases will result in new hires and we are interested in reviewing the pay parity program in order to determine whether pay parity is achieving the intended results regarding both retention and better quality hires.

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