



July 23, 2012

Chairwoman Debbie Stabenow  
Ranking Member Pat Roberts  
Senate Committee on Agriculture, Nutrition & Forestry  
328A Russell Senate Office Building  
Washington, DC 20510

Chairman Frank Lucas  
Ranking Member Collin Peterson  
House Committee on Agriculture  
1301 Longworth House Office Building  
Washington, DC 20515

Dear Chairwoman Stabenow, Chairman Lucas, and Ranking Members Roberts and Peterson:

We appreciate your oversight of the federal agencies that regulate the swaps and futures markets, especially in light of the massive customer losses at MF Global and Peregrine Financial Group.

As you explore opportunities for improving the regulation of these markets, we urge you to reconsider the government's reliance on private self-regulatory organizations (SROs) such as the National Futures Association (NFA).

The Project On Government Oversight (POGO) is a nonpartisan independent watchdog that champions good government reforms. POGO's investigations into corruption, misconduct, and conflicts of interest achieve a more effective, accountable, open, and ethical federal government. As such, POGO believes that industry regulation is most effective when carried out by a governmental agency that is transparent, independent, ethical, and accountable.<sup>1</sup>

Groups such as NFA are inherently conflicted because they are funded by the firms they oversee. They are less accountable than federal agencies because they do not have to comply with government ethics and transparency requirements. And they are costly because they must be supervised by government agencies such as the Commodity Futures Trading Commission (CFTC).

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<sup>1</sup> Project On Government Oversight, "POGO Opposes Self-Regulation of Investment Advisers," May 29, 2012. <http://www.pogo.org/pogo-files/letters/financial-oversight/fo-fra-20120529-finra-investment-advisers.html>

For these reasons, we urge you to reduce the CFTC's reliance on NFA and other SROs, and to ensure that the CFTC has the resources it needs to directly oversee the swaps and futures markets.

## **Inherent conflicts**

NFA collects assessments, fees, and membership dues from the firms it oversees while also assuming responsibility for regulating these firms. An industry-wide SRO such as NFA "could possibly have enhanced susceptibility to industry capture" because "it is not only funded by the industry it oversees, but also may include industry representatives in its governance structure or otherwise have a different relationship with industry than an independent government regulatory agency," according to a recent report by the Securities and Exchange Commission.<sup>2</sup>

Indeed, NFA's board is filled with industry representatives. W. Robert Felker, who was re-elected as chairman of the board in February 2011, is described on NFA's website as the chairman of JPMorgan Futures.<sup>3</sup> He was also a chairman of the Futures Industry Association (FIA), the "leading trade organization for the futures, options and OTC cleared derivatives markets,"<sup>4</sup> according to a biography posted on FIA's website.<sup>5</sup>

Board vice chairman Christopher K. Hehmeyer<sup>6</sup> is the CEO of HTG Capital Partners, according to HTG's website,<sup>7</sup> and also sits on FIA's board.<sup>8</sup>

Even some of the "public representatives" on NFA's board<sup>9</sup> have been closely affiliated with industry groups. Ronald H. Filler is described on NFA's website as a professor at New York Law School,<sup>10</sup> but he was also a managing director at Lehman Brothers and an FIA board member, according to a biography posted on the law school's website.<sup>11</sup> Charles P. Nastro was the head of

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<sup>2</sup> Securities and Exchange Commission, Division of Investment Management, *Study on Enhancing Investment Adviser Examinations*, January 2011, p. 33. <http://www.sec.gov/news/studies/2011/914studyfinal.pdf> (Downloaded July 23, 2012)

<sup>3</sup> National Futures Association, "NFA's Board of Directors re-elects Robert Felker to serve as Chairman," February 22, 2011. <http://www.nfa.futures.org/news/newsRel.asp?ArticleID=3762> (Downloaded July 23, 2012) (Hereinafter "NFA Board re-elects Robert Felker")

<sup>4</sup> Futures Industry Association, "Intro to FIA." <http://www.futuresindustry.org/about-fia-.asp> (Downloaded July 23, 2012)

<sup>5</sup> Futures Industry Association, "W. Robert Felker." <http://www.futuresindustry.org/w.-robert-felker.asp> (Downloaded July 23, 2012)

<sup>6</sup> "NFA Board re-elects Robert Felker"

<sup>7</sup> HTG Capital Partners, "Chris Hehmeyer." <http://www.htgcap.com/about-htg/leadership/chris-hehmeyer/> (Downloaded July 23, 2012)

<sup>8</sup> Futures Industry Association, "Board Members." <http://www.futuresindustry.org/board-members.asp> (Downloaded July 23, 2012)

<sup>9</sup> National Futures Association, "Board of Directors – Public Representatives." <http://www.nfa.futures.org/NFA-about-nfa/board-of-directors.HTML#PR> (Downloaded July 23, 2012) (Hereinafter "Board of Directors – Public Representatives")

<sup>10</sup> "Board of Directors – Public Representatives"

<sup>11</sup> New York Law School, "Ronald H. Filler." [http://www.nyls.edu/faculty/faculty\\_profiles/ronald\\_filler/](http://www.nyls.edu/faculty/faculty_profiles/ronald_filler/) (Downloaded July 23, 2012)

the futures division at Lehman Brothers<sup>12</sup> and was elected to the FIA Futures Hall of Fame, according to the FIA's website.<sup>13</sup> And Ronald S. Oppenheimer is described on NFA's website as the senior vice president and general counsel of oil and gas company Vitol, Inc.,<sup>14</sup> and as a former vice president and general counsel of futures and options at Merrill Lynch.<sup>15</sup>

In addition, NFA's advisory committees have included representatives of firms that were recently responsible for massive customer losses. NFA's winter 2011 newsletter lists Russell R. Wasendorf, Sr., the former head of Peregrine Financial Group, as a member of an advisory committee for futures commission merchants, along with Dennis A. Klejna, a former senior vice president at MF Global.<sup>16</sup>

POGO is concerned that the inevitable conflicts of interest between NFA and its members not only limit NFA's actual effectiveness, but also damage the public's confidence in the organization's enforcement activities, thereby further limiting its regulatory impact.

### **Lack of transparency, ethics, and accountability**

As a private organization, NFA does not have to comply with federal laws and regulations designed to make government agencies more transparent, ethical, and accountable. The Government Accountability Office (GAO) has noted that expanding self-regulation in the securities industry could potentially "limit transparency and accountability, as the SRO would be accountable primarily to its members rather than to Congress or the public."<sup>17</sup>

Even industry groups such as the Chamber of Commerce have pointed out that the Financial Industry Regulatory Authority (FINRA)—the largest existing SRO for the securities industry—is not bound by the system of checks and balances that applies to government agencies:

Transparency into FINRA's governance, compensation, and budgeting practices is extremely limited and superficial. Furthermore, FINRA is not subject to the Freedom of Information Act or the [Administrative Procedure Act], nor is it required to conduct a

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<sup>12</sup> Futures Industry Association, "Charles P. Nastro." <http://www.futuresindustry.org/charles-p.-nastro.asp> (Downloaded July 23, 2012)

<sup>13</sup> Futures Industry Association, "Futures Hall of Fame 2005." <http://www.futuresindustry.org/futures-hall-of-fame.asp> (Downloaded July 23, 2012)

<sup>14</sup> "Board of Directors – Public Representatives"; Bloomberg Businessweek, "Company Overview of Vitol Inc." <http://investing.businessweek.com/research/stocks/private/snapshot.asp?privcapId=51071237> (Downloaded July 23, 2012)

<sup>15</sup> National Futures Association, "NFA Board of Directors elects chairman, vice-chairman, public directors," February 25, 2002. <http://www.nfa.futures.org/news/newsRel.asp?ArticleID=69> (Downloaded July 23, 2012)

<sup>16</sup> National Futures Association, "Advisory Committees provide valuable communication channel between NFA and its membership," *News Facts Actions – Winter 2011* <http://www.nfa.futures.org/news/member-newsletter-2011/newsletterWinter2011.HTML#AdvisoryCommittee> (Downloaded July 23, 2012)

<sup>17</sup> Government Accountability Office, *Private Fund Advisers: Although a Self-Regulatory Organization Could Supplement SEC Oversight, It Would Present Challenges and Trade-offs* (GAO-11-623), July 2011, p. 20. <http://www.gao.gov/new.items/d11623.pdf> (Downloaded July 23, 2012)

cost-benefit analysis when it engages in rulemaking or exercises its policy-making functions.<sup>18</sup>

Much like FINRA, NFA does not have to comply with these basic requirements, even though it engages in significant regulatory and enforcement activities on behalf of the federal government.

### Oversight costs

At a recent hearing, Senator Tom Harkin (D-IA) remarked that “self-regulation only works if you have really tight controls from the regulatory body.” He raised concerns that the CFTC does not have enough resources to adequately oversee NFA<sup>19</sup>—concerns that are not unfounded.

Even though NFA is self-funded, the CFTC is still required to oversee the organization’s self-regulatory activities.<sup>20</sup> In addition, the CFTC will now need to monitor NFA’s expanded work as a front-line regulator of swaps dealers and major swap participants.<sup>21</sup>

Meanwhile, Congress has effectively frozen the CFTC’s budget.<sup>22</sup> The agency only has 20 full-time equivalent staffers who are “committed to conducting annual reviews of the financial surveillance programs of NFA and [the Chicago Mercantile Exchange],” according to a fiscal year 2013 budget request.<sup>23</sup> Last month, the House Appropriations Committee proposed cutting the CFTC’s budget by nearly \$25 million.<sup>24</sup>

POGO is concerned about the prospect of starving the CFTC while increasing NFA’s responsibility, especially given recent reports about NFA’s inexperienced auditors and its failed oversight of Peregrine Financial Group.<sup>25</sup>

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<sup>18</sup> Chamber of Commerce, Center for Capital Markets Competitiveness, *U.S. Capital Markets Competitiveness: The Unfinished Agenda*, Summer 2011, p. 23.

[http://www.uschamber.com/sites/default/files/reports/1107\\_UnfinishedAgenda\\_WEB.pdf](http://www.uschamber.com/sites/default/files/reports/1107_UnfinishedAgenda_WEB.pdf) (Downloaded July 23, 2012)

<sup>19</sup> Senate Committee on Agriculture, Nutrition & Forestry, “Dodd-Frank Wall Street Reform and Consumer Protection Act: 2 Years Later,” July 17, 2012. <http://www.ag.senate.gov/hearings/-dodd-frank-wall-street-reform-and-consumer-protection-act-2-years-later-> (Downloaded July 23, 2012)

<sup>20</sup> “Registered futures associations,” 7 U.S.C. § 21. <http://www.gpo.gov/fdsys/pkg/USCODE-2011-title7/pdf/USCODE-2011-title7-chap1-sec21.pdf> (Downloaded July 23, 2012)

<sup>21</sup> Commodity Futures Trading Commission, *President’s Budget and Performance Plan: Fiscal Year 2013*, February 2012, p. 95. <http://cftc.gov/About/CFTCReports/ssLINK/cftcbudget2013> (Downloaded July 23, 2012) (Hereinafter *President’s Budget and Performance Plan: Fiscal Year 2013*)

<sup>22</sup> Project On Government Oversight, “POGO and Allies Urge Congress to Provide Full Funding to CFTC,” May 4, 2012. <http://www.pogo.org/pogo-files/letters/financial-oversight/fo-fra-20120504-congress-funding-cftc.html>

<sup>23</sup> *President’s Budget and Performance Plan: Fiscal Year 2013*, p. 95

<sup>24</sup> House Committee on Appropriations, “Appropriations Committee Approves the Fiscal Year 2013 Agriculture Appropriations Bill,” June 19, 2012.

<http://appropriations.house.gov/news/documentsingle.aspx?DocumentID=299993>; and House Committee on Appropriations, *Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Bill, 2013*. <http://appropriations.house.gov/uploadedfiles/hrpt-112-ap-fy13-agriculture.pdf> (All downloaded July 23, 2012)

<sup>25</sup> Sarah N. Lynch, “Peregrine regulator scolded in past for taking brokers’ word,” *Reuters*, July 18, 2012. <http://www.reuters.com/article/2012/07/18/us-peregrine-nfa-cftc-idUSBRE86H1NJ20120718>; and Sarah N. Lynch, “National Futures Association, PFGBest Watchdog, Uses Auditors That Are ‘Not Experienced Enough,’” *Reuters*,

Instead of delegating additional authority to a private self-regulatory organization, Congress should reduce the CFTC's reliance on NFA; work to improve NFA's policies on ethics, transparency, and accountability; and provide sufficient funding to the CFTC so it can carry out its important regulatory duties on its own. If we have learned anything from the financial crisis of the past few years, it is that inadequate federal oversight and regulation of the financial industry leads to excessive risk and instability in our economy.

We would be pleased to discuss this issue in more detail with you or your staff. If you have questions or would like any additional information, please contact us at 202-347-1122 or [acanterbury@pogo.org](mailto:acanterbury@pogo.org) or [msmallberg@pogo.org](mailto:msmallberg@pogo.org).

Sincerely,

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Director of Public Policy

Michael Smallberg  
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cc: Senate Committee on Banking, Housing, & Urban Affairs  
House Committee on Financial Services