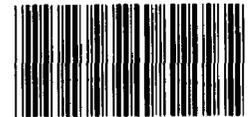


FOR RELEASE ON DELIVERY  
Expected at 11:00 a.m.  
February 24, 1982

Statement of  
Henry Eschwege, Director  
Community and Economic Development Division  
before the  
Senate Permanent Subcommittee on Investigations  
of the  
Committee on Governmental Affairs  
on  
Customer Protection Activities of the  
Commodity Futures Trading Commission



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Mr. Chairman and Members of the Subcommittee:

We welcome your invitation to be here today to discuss our work relating to the Commodity Futures Trading Commission (CFTC). We have recently reviewed CFTC's major programs for ensuring the integrity of futures markets and protecting futures customers. I will direct my remarks to the programs of greatest interest to the subcommittee--the reparations program, registration of commodity professionals, and audit and financial surveillance.

REPARATIONS AND OTHER FORUMS  
FOR RESOLUTION OF CUSTOMER CLAIMS  
NEED TO BE MADE MORE EFFECTIVE

In 1974 the Congress amended the Commodity Exchange Act to establish a reparations program to serve as a forum to resolve the claims of commodity customers against industry professionals

involving such matters as excessive or unauthorized trading, and fraud. The program was intended to provide an avenue for customer relief analogous to a small claims court, and midway in complexity between arbitration and court litigation, the traditional forums used in the futures industry. The program was to provide an expeditious, inexpensive, and easy-to-use process for handling cases.

Our work revealed that the reparations program is not meeting its objectives. Available statistics compiled by CFTC on the reparations program are not up-to-date or complete; however, the most recent data CFTC could supply us indicates that a reparations claim filed in 1978 took almost 3 years to complete the entire process. In fact, as of August 1981, only 53 individuals had actually received money as a result of reparations decisions. Our discussions with complainants and commodity attorneys indicated that complainants had considerable difficulty understanding important aspects of the program including how to enforce decisions and collect judgments. Reparations can be expensive, with commodity attorneys citing fees ranging from \$1,000 to \$10,000 for handling relatively small reparations claims.

Arbitration is potentially an effective and attractive alternative to reparations, especially for smaller claims. However, several factors have limited its use. Because arbitration panels include industry officials, both customers and commodity attorneys perceive these panels as having a pro-industry bias. Just as significant, many customers are not even aware that arbitration exists. Commodity exchange arbitration programs have additional drawbacks. For example, their jurisdiction is limited to disputes which concern their members' actions on their exchange.

Further, the act places an unrealistically low \$15,000 ceiling on the size of a claim which customers can compel exchange members to arbitrate.

The relatively high cost of court litigation makes it a useful alternative to reparations only for claims involving large amounts or difficult and complex issues. However, the Supreme Court now has under review the question of whether the Congress intended commodity customers to have a right of action under the act to sue CFTC registrants in Federal court.

To provide for more effective resolution of customer claims, CFTC needs to (1) improve reparations program management, (2) simplify its operation, and (3) support the development of arbitration at the exchanges and the National Futures Association as an effective alternative to reparations.

The Congress can assist in making available complaint resolution forums work better. To improve the potential of arbitration, the Congress should raise from \$15,000 to \$25,000 the dollar limit for claims which customers can compel exchange members to arbitrate or arbitrate through the National Futures Association. To resolve the issue of whether commodity customers can take their claims to Federal court, the Congress should clarify its intent regarding whether customers have a private right of action to adjudicate commodity related claims in this forum.

A MORE COMPREHENSIVE  
REGISTRATION PROGRAM  
IS NEEDED

The Commodity Exchange Act protects the trading public by requiring certain firms and individuals dealing in commodities

to register with CFTC. To provide an effective registration program, CFTC needs to register industry professionals, screen them initially and on a continuing basis to remove unfit individuals, and assure a minimum level of competence. CFTC's registration program has weaknesses in each of these areas.

At present, registration is not required in an important area of the futures business, salespersons and supervisors of Commodity Trading Advisors and Commodity Pool Operators. Commodity Trading Advisors advise the public on trading strategies, while Commodity Pool Operators function in a manner analogous to mutual funds, investing the combined resources of many individual traders. Although the principals of these firms must register with CFTC, we believe that registration should also be required of the salespersons and supervisors who actually solicit business.

CFTC can take additional action to assure registrants' fitness. It can require Futures Commission Merchants to sponsor and review the registration application of persons associated with their firms. It can also fingerprint registrants and submit their fingerprints to the FBI for review. While CFTC has adopted rules to require sponsorship and fingerprinting, it has not adequately developed the automatic data processing support needed to administer the rules and has deferred their implementation until July 1, 1982.

Once a person is registered with CFTC, reregistration is relatively automatic. CFTC does not periodically check registrants against FBI or Securities and Exchange Commission files, or its own records to determine whether the registrant has committed acts which would make him no longer fit for registration.

Because futures trading requires substantial knowledge and is highly complicated, qualification standards and proficiency testing could also help CFTC protect futures customers. CFTC has proposed but has not finalized, rules which would require a proficiency examination as a condition of registration for persons associated with Futures Commission Merchants.

CFTC needs to take action in each of the areas I have highlighted. The newly created National Futures Association can address some of the weaknesses in the registration program since it is expected to assume many of CFTC's responsibilities. CFTC, however, needs to take a more active role in planning for the transfer of registration functions to the Association. Further, to overcome existing limitations on the Association's registration authority and allow a more complete transfer of responsibility, the Congress should amend the Act to authorize the Association to register all futures professionals; screen them through appropriate checks such as fingerprints; test them for their proficiency in futures; and allow professionals to appeal Association registration decisions.

CFTC CAN ALLOCATE AUDIT  
RESOURCES MORE EFFICIENTLY

CFTC has overall responsibility for ensuring that customer funds are properly safeguarded. Through enforcement of segregation of funds, recordkeeping, and minimum financial requirements, CFTC attempts to deter financial failures and detect improper financial practices which could result in the loss of customer funds. CFTC shares this responsibility with the commodity exchanges,

which establish and enforce minimum financial requirements for their members. CFTC oversees the exchanges' implementation of their audit and financial surveillance programs.

CFTC has not efficiently used its audit resources for these purposes. During the past 2 years it has devoted considerable audit effort to firms which were exchange members, and therefore subject to exchange surveillance. At the same time, CFTC has devoted only a small amount of its effort to Commodity Pool Operators, a growing segment of the industry. In addition, CFTC has not taken all the steps it could--such as more frequent reviews and more specific program guidelines--to improve exchange audit and financial surveillance programs. CFTC has also not planned adequately for the transfer of audit functions to the National Futures Association.

CFTC needs to shift more of the audit responsibilities to the exchanges and the National Futures Association when it becomes operational. In doing so, however, CFTC needs to improve its own program for monitoring exchange audit and financial surveillance activities. This shifting of focus will allow CFTC to devote more audit resources to areas of the industry, for which it is primarily responsible.

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That concludes my prepared statement. I will gladly respond to questions about any aspect of our work.