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## Plenary 4

### Combating Financial Crime Globally

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**Introduction and Overview**

I would like to first thank the Financial Supervisory Commission and the Financial Supervisory Service for hosting this year's Annual Conference in Seoul. The panels and meetings have been very productive and informative, and the program of events has truly allowed all of us to experience the beauty and culture of Korea. I am truly honored to appear here today with my other distinguished panelists to share in the discussion of a number of international regulatory initiatives put in place to combat financial crime and market abuse and to explore some new ones. As Chairman Lee mentioned in his invitation letter, as the inter-connectedness of global financial markets continues to increase, international cooperation is necessary to restore investor confidence and to lay the groundwork for future growth. In my remarks today I plan to give you a brief overview of how NFA operates, some of the regulatory issues we are facing and share with you some of the regulatory tools that help us be better regulators. I hope this information will lead to further discussion today and the development of ideas of how National Futures Association can contribute its knowledge and resources in helping other regulators fulfill their responsibilities.

First, let me provide a brief overview of NFA. NFA is the industrywide self-regulatory organization for the U.S. futures industry. NFA occupies a unique position in the futures industry. Like the exchanges, we are a self-regulatory body, but, unlike the exchanges NFA does not operate a marketplace. Self-regulation is not part of what we do - it is all that we do. We are first, foremost and only a regulatory body devoted to customer protection.

NFA is subject to oversight by the CFTC and has four Congressionally-mandated areas of responsibility:

- NFA screens and registers all firms and individuals who want to conduct business with the trading public.
- NFA audits the business operations of its Members to ensure they are complying with its rules and takes disciplinary actions against any Members who violate those rules.

- NFA produces several publications to help investors better understand the opportunities and risks of futures trading. It also produces several guides to assist NFA Members in meeting their regulatory obligations.
- Through its arbitration program, NFA offers an easy, affordable and prompt system for resolving futures-related disputes.

Any firm or individual who conducts business on any U.S. futures exchange on behalf of the investing public is required to register with the CFTC and be a Member of NFA. Our 4,000 Members include futures commission merchants ("FCMs"), introducing brokers ("IBs"), commodity pool operators ("CPOs") and commodity trading advisors ("CTAs"). We also regulate the activities of approximately 50,000 registered account executives who work for those Members. Our mission is to work as a partner with the CFTC to provide the industry with regulation that is effective. In the twenty-one years since NFA began operation, trading volume on U.S. futures exchanges has increased by over 400%. During that same time, customer complaints have actually dropped by over 70%.

We all know, though, that a successful past does not ensure a successful future. The need for regulation that is both effective and efficient has never been greater. Effective regulation is the best way to assure public confidence, and we have all seen what happens to markets that lose the public's confidence. The best way to preserve that confidence is to deserve it - to ensure that the highest levels of integrity are demanded of all market participants and intermediaries.

Efficient regulation is not just a question of how you write the rules - it also involves making the best use of regulatory resources. For the last twenty years the CFTC has delegated certain of its frontline regulatory responsibilities to NFA to avoid duplication of effort and to direct its own resources where they are most needed. That trend has continued and accelerated since the passage of the Commodity Futures Modernization Act of 2000 (CFMA).

What else can we do to combat financial crime globally? We need to change the mindset that all regulators can lapse into—reacting to the last problem instead of anticipating the next one. The members of the SRO have to be partners in that process. Senior staff from NFA try to visit as many of our members as we can for one-on-one meetings, not to talk about the last audit but to talk about what's going on in the industry. What we are working on and, more importantly, what we should be working on. As I mentioned before, the U.S. futures industry has been relatively scandal free in recent years, but we cannot kid ourselves into a false sense of security. We work with both our members and with the Commission staff to try to think about any ticking time bombs that could be out there. We need to do more of that.

## **Retail Forex Transactions**

There are a number of important customer protection issues facing us today. I would like to explain those issues and what steps we are taking to address them. The first area relates to off-exchange foreign currency transactions with retail customers. The CFMA makes clear the Commission's authority and jurisdiction to investigate and take action to close down entities selling illegal off-exchange foreign currency futures and option contracts to retail customers. Since the CFMA became effective in December 2000, the CFTC has been very active in applying the statute to retail forex activities and has filed numerous cases against forex entities, involving hundreds of millions taken from thousands of victims.

The CFMA provides that firms can offer off-exchange foreign currency (forex) transactions to retail customers if they qualify as "otherwise regulated entities", such as FCMs, broker-dealers and insurance companies. However, a number of firms that have never done any futures trades and never intend to do any futures trades have recently registered as FCMs and become NFA Members. They have done this for the sole purpose of qualifying as 'otherwise regulated entities' so they can do retail forex trades outside of the Commodity Exchange Act. From NFA's perspective, these firms are not really otherwise regulated because all of our rules apply to exchange-traded futures and options transactions and do not generally apply to off-exchange forex transactions.

Another issue related to the language in the CFMA is that, although the "counter party" to the forex trade must be an "otherwise regulated entity", the person actually working the phones selling the product can be completely unregulated. Hundreds of unregulated entities currently solicit business on behalf of Forex Dealer Members. In fact, NFA has received information that several individuals either disciplined or expelled from the futures industry have been linked to these soliciting firms.

To address these problems, we created a special Forex Dealer membership category for firms that register as FCMs so they can act as a counterparty to retail forex transactions. NFA currently has seventeen active Forex Dealer Members and several more registered or pending firms that have indicated they intend to become Forex Dealer Members. In the aggregate, Forex Dealer Members hold approximately \$190 million in retail customer funds, with the minimum retail account size ranging from \$500 to \$10,000. In the last eighteen months, we have reviewed over one hundred customer complaints relating to these firms' forex activities. NFA has also taken several emergency actions against Members for forex activities within the last twenty months. Due to the disproportionate number of complaints we have received relating to these transactions, forex clearly has demanded a lot of our regulatory resources during the last year.

NFA also developed rules which will go into effect on December 1 designed to protect retail forex customers against unethical business practices and loss of funds due to insolvency or related problems.

As a result of these rules, Forex Dealer members will be subject to the type of regulatory oversight that Congress intended. As well, one of the key provisions in NFA's rules gives NFA authority to discipline Forex Dealer Members for the activities of unregulated persons or entities who introduce accounts to them or who manage accounts for their customers. We will continue to monitor this area and may propose additional rules to protect investors.

### **Anti-Money Laundering**

Another regulatory issue I wanted to address is anti-money laundering ("AML"). All of the financial regulators have adopted or are adopting all of the anti-money laundering rules required by the USA Patriot Act. The question now becomes how best to monitor all of the affected firms for compliance. As always, NFA's goal is make the most efficient use of the regulatory resources that are available.

The USA Patriot Act imposes significant new AML requirements on all financial institutions. In April 2002, NFA adopted requirements necessitating that FCMs and IBs have an AML program. NFA worked very closely with the Commission, U.S. Department of Treasury, and the industry in adopting these requirements. At the present time, NFA examines FCM and IB Member firms for compliance with these requirements and has worked with firms to ensure that they fully understand the elements of an effective AML program.

We also expect that Treasury in the near future will issue final AML rules for CTAs and unregistered investment companies, including commodity pools. At that time, we will adopt AML requirements for these Members and add steps to our audit programs to check for compliance with those rules. The fact is, though, that many of our CPO members operate other types of investment funds, either directly through our Member firm or through an affiliate of our Member firm. For example, 18 of the top 25 (55 of the top 100) hedge fund complexes are operated by NFA Member CPOs or their affiliates. Since we will already be auditing our Member firms for AML compliance, it only makes sense that we should examine their other funds and their affiliates for AML compliance as well. That's an allocation of resources that makes sense, and we have informed the Treasury Department that we would be willing to take on that additional responsibility.

## **Investor Education, Information-Sharing, and Training**

I would now like to focus on customer protection issues and the continuing need to increase information sharing among regulators around the world.

Investors are now confronted with a multitude of trading opportunities from around the globe. They can obtain trading recommendations, open an account, place orders on an electronic market, receive confirmation statements and transfer funds-all from their home computers.

How must we as regulators adapt to this new environment? How do we protect market integrity and provide customer protection to customers who are trading on multiple marketplaces around the world?

First and foremost, regulatory organizations must make a stronger commitment to investor education. Education is the first line of defense against fraud. Investors must understand the product they intend to trade, know that the marketplace has a strong reputation for market integrity, and have knowledge of any disciplinary history of the intermediaries and brokers with whom they are doing business. No investor, big or small, can avoid doing rigorous due diligence, and we as regulators must do everything we can to help investors get this information quickly and easily.

At National Futures Association, we have always had a strong investor education program. We have published several brochures on investing in general and on the specific opportunities and risks associated with trading derivatives. Recognizing the need to make this information easily accessible to investors around the globe, NFA also provides the same information free of charge on its web site.

We have also found other ways to provide information to investors. In 1996, we introduced the Background Affiliation Status Information Center (BASIC). BASIC, which can be accessed through NFA's web site. BASIC contains current and historical registration information concerning all current and former CFTC registrants. It also provides information concerning disciplinary actions taken by NFA, the CFTC and all the U.S. futures exchanges. Investors and regulatory bodies around the world use this system. The success of BASIC is reflected in the fact that the system receives more than 50,000 inquiries each month.

As a result of the success of BASIC, the CFTC approached us to help them develop a system that will provide international regulators with the information they need regarding U.S. registrants that conduct business in other jurisdictions.

This new system, called the International Regulators Alert System, will incorporate elements of the BASIC system and NFA's new Online Registration System. If an U.S. firm intends to do business in another jurisdiction, a regulator can request via e-mail all regulatory information relevant to that firm. That regulatory information will include registration status and history and all disciplinary actions taken against a firm by

a U.S. futures exchange, the CFTC and NFA. Once the initial request is made, the system will automatically send the regulator quarterly notices. More urgent information regarding the firm (e.g., withdrawal from membership, disciplinary actions, etc.) will be sent to the regulator immediately. If anyone in today's audience is interested in getting more information about this system, please give me your card today or send me an e-mail.

As part of our ongoing commitment to share our regulatory knowledge and expertise, NFA provides focused training courses to foreign exchanges and regulators. NFA staff has visited Singapore, we have trained a delegation from KOFEX in Chicago, and last month we provided a very successful two-week training program to the China Futures Association and the China Securities Regulatory Commission. As well, earlier this year NFA participated in a training course in Lithuania with the Financial Services Volunteer Corps, a not-for-profit organization whose mission is to help build the sound banking and financial systems required by countries seeking to develop transparent market-oriented economies.

It seems we are always hosting small delegations from all the corners of the world who visit NFA to meet with our compliance staff or our general counsel's office. Often they come with specific research goals, other times they simply want to get to know how we do our jobs at NFA. If anyone is interested in this training resource, just let me know or send an email.

## **Closing Comments**

Technological advances have transformed our markets by making it possible for investors to conduct almost any kind of financial transaction on any market around the world. We, as regulators, must use the same technological advances to devise creative solutions to preserve the integrity of a truly international marketplace.

NFA's mission today is the same as it was twenty-one years ago. Everything we do is designed to protect customers, protect market integrity and protect the public's confidence in these vital markets. The industry we regulate is changing rapidly and dramatically and we as regulators will have to respond to those changes.