

# COMMITTEE ON AGRICULTURE

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## CUSTOMER PROTECTION AND END-USER RELIEF ACT

*To reauthorize the Commodity Futures Trading Commission, and ensure robust markets, customer protections, and a balanced approach to regulations impacting job creators.*

### BACKGROUND

The Food, Conservation, and Energy Act of 2008, also known as the 2008 Farm Bill, reauthorized the Commodity Futures Trading Commission (CFTC) for a period of five years. The authority expired on September 30, 2013.

In advance of writing legislation to reauthorize the CFTC, the House Agriculture Committee, together with its Subcommittee on General Farm Commodities and Risk Management, held several hearings with a variety of stakeholders to examine the future of the agency.

The backdrop of this reauthorization process is the implementation of the Dodd-Frank Act and the impact of its regulations on multiple industries across various sectors of the U.S. economy. Many of these new rules have had the consequence of negatively impacting end-users, like farmers, hospitals, manufacturers, and government-owned utilities, which use derivatives to manage risks associated with their businesses.

Despite Congress' directive to exempt end-users from some of the most costly new regulations associated with using derivatives, the CFTC has narrowly interpreted the law, which has burdened businesses across the country and has threatened the ability of producers to affordably protect against risks associated with farming and ranching.

Additionally, market events like the failure of MF Global and Peregrine Financial have threatened confidence in the futures markets. Market regulators have implemented important changes to better protect customers, but improvements need to be made to their efforts and those improvements should be made permanent in law.

H.R. 4413, the Customer Protection and End-User Relief Act, is bipartisan legislation to reauthorize and improve the operations of the CFTC, as well as address concerns relating to protecting customers from another market failure such as MF Global and Peregrine Financial. The bill was introduced by Rep. Frank Lucas, Chairman of the House Agriculture Committee, Rep. Collin Peterson, Ranking Member of the House Agriculture Committee, Rep. K. Michael Conaway, Chairman of the Subcommittee on General Farm Commodities and Risk Management, and Rep. David Scott, Ranking Member of the Subcommittee on General Farm Commodities and Risk Management.

## TITLE I: FUTURES CUSTOMER PROTECTIONS

The Customer Protection and End-User Relief Act will better protect farmers and ranchers who use the futures markets by cementing several new regulatory customer protections into law. Added protections include mandates to:

- Require electronic confirmation of customer fund account balances held at depository institutions. No longer will the fraud that occurred at Peregrine Financial be allowed to occur due to forged paper documents.
- Require firms that move more than a certain percentage of customer funds from one account to another to follow strict reporting and permission requirements before doing so. No longer will a firm be able to move funds from one account to another, as happened during the MF Global bankruptcy, without regulators knowing about it.
- Require firms who become undercapitalized to immediately notify regulators so they can assess the firm's viability and move if needed to protect customer funds.
- Require firms to file an annual report with regulators from the chief compliance officer containing an assessment of a futures commission merchant's (FCM) internal compliance programs.
- Ensures farmers, ranchers, and other futures customers have an additional day to get their needed margin to an FCM, which mitigates the effect of pre-funding accounts.
- Provide legal clarity for futures customers that the assets of a bankrupt commodity broker would be used to help pay back any misappropriated or illegally transferred customer segregated funds.
- Require firms to calculate and report customer account balances electronically to regulators on a regular basis.
- Require the CFTC to complete a study on high frequency trading.

## TITLE II: COMMODITY FUTURES TRADING COMMISSION (CFTC) REFORMS

Since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203, the Dodd-Frank Act) in July of 2010, the CFTC has finalized more than 60 rules to enforce the new law and has issued an unprecedented 170 “no-action” letters in that same time span to delay, revise, or exempt application of these regulations upon various market participants. The rulemaking process has proven confusing given the lack of a comprehensive plan for setting a schedule for compliance. In addition, the prolific use of no-action letters by the Commission to revisit new Dodd-Frank Act regulations have been used in lieu of a more thorough rulemaking process. H.R. 4413 makes basic reforms to the CFTC to help make it more effective and ensures that all Commissioners’ voices are heard in the rulemaking process. These reforms include:

- Modifying the Commodity Exchange Act’s (CEA’s) cost-benefit analysis requirements for proposed rules, to closely track President Obama’s Executive Order 13563 for the entire executive branch.
- Making the Commission’s division directors answerable to the entire Commission, not just the Chairman’s office.
- Creating a new Office of the Chief Economist, answerable to the entire Commission, to provide objective economic data and analysis.
- Enhancing the CFTC staff procedures governing the issuance of “no-action” or interpretive letters to improve Commission oversight of the process and to prevent staff from being able to issue letters at the last moment in an attempt to regulate or deregulate markets outside of the official CFTC rulemaking process without the possibility of Commission review.
- Requiring the Commission and the Office of the Chief Economist to develop comprehensive internal risk control mechanisms to safeguard and govern all market data storage, all market data sharing agreements, and all academic research using market data.
- Creating a judicial review process similar to that of the SEC’s for rulemakings to ensure the two regulators charged with overseeing the derivatives markets have similar procedures in place to allow market participants to challenge Commission rules.
- Directing the Government Accountability Office (GAO) to conduct a study on the sufficiency of CFTC resources and examine prior expenditures of funds on market surveillance and market data collection, standardization, and harmonization.

## TITLE III: END-USER RELIEF AND MARKET CERTAINTY

Title III of H.R. 4413 was developed in response to the CFTC's implementation of the Dodd-Frank Act. Many of the CFTC's new rules have negatively impacted end-users, such as our farmers, ranchers, manufacturers, and utilities, by making it more difficult and costly to manage risks associated with their businesses. Despite America's end-users representing 94 percent of the job creators in the United States, they comprise only 10 percent of the swaps markets. Even though Congress intended to exempt end-users from some of the most costly new regulations associated with using derivatives during consideration of the Dodd-Frank Act, the CFTC has narrowly interpreted the law. As a result, the ability of producers to affordably protect against risks associated with farming and ranching has been threatened. This title addresses the following concerns:

- True commercial end-users should not be treated as financial entities. The bill amends the CEA to allow many end-users who are legitimate "commercial market participants" to avoid being inadvertently classified as financial entities.
- Certain non-financial end-users should not be disadvantaged in the marketplace if they use contracts that trade infrequently. This issue has cost certain end-users millions of dollars in fuel hedging costs because their identifiable positions in thinly-traded markets are immediately reported to the marketplace.
- The bill provides relief to grain elevators, farmers, agriculture counterparties, and commercial market participants from burdensome and unnecessarily costly recordkeeping rules that currently require the recording of all forms of communication that may possibly lead to a trade. Instead, the bill specifies that keeping searchable written records of the final material economic terms of an agreement will be sufficient.
- The bill provides relief for end-users who use contracts that result in actual physical delivery of a commodity that has a stand-alone or embedded option to change the amount of a commodity delivered. This impacts utilities that use natural gas to produce electricity, in addition to millions of consumers who use natural gas to heat their homes.
- The bill corrects an illogical and unworkable capital requirement imposed on non-bank swap dealers that would result in those entities holding much more capital than their bank counterparts, likely making the business too expensive, resulting in fewer participants in the marketplace. The CFTC now must consult with the other regulators in formulating workable capital requirement formulas and recognize formulas already approved by other regulators.
- The bill amends the CEA to simply require a vote by the CFTC before the swap dealer *de minimis* level automatically changes from the current level of \$8 billion established by the CFTC in regulations.

- The bill makes a conforming change to CFTC regulations to bring its rules in line with the Jumpstart Our Business Startups Act (JOBS Act) (P.L. 112-106). An oversight in the JOBS Act omitted funds that were also registered as Commodity Pools, and the bill allows those funds to also solicit certain potential new investors.
- The bill allows for end-users to continue to hedge against anticipated business risks by providing a more workable definition of bona fide hedging related to position limits.
- The bill also includes CEA portions of the following measures that passed the House Agriculture Committee and/or the U.S. House of Representatives with overwhelming bipartisan support:
  - H.R. 634, the Business Risk Mitigation and Price Stabilization Act that passed the House on June 6, 2013, by a vote of 441-12.
  - An amended bipartisan version of H.R. 677, the Inter-affiliate Swap Clarification Act, which originally was passed by House Agriculture Committee on March 20, 2013 by voice vote and by the Financial Services Committee on May 7, 2013, by a vote of 50-10.
  - H.R. 742, the Swap Date Repository and Clearinghouse Indemnification Act that passed the House on June 12, 2013, by a vote of 420-2.
  - H.R. 1038, the Public Power Risk Management Act that passed the House on June 12, 2013 by a vote of 423-0.
  - H.R. 1256, the Swap Jurisdiction Certainty Act that passed the House on June 12, 2013, by a vote of 301-124.

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