

COMMITTEE ON AGRICULTURE

FRANK D. LUCAS, CHAIRMAN

1301 Longworth House Office Building | Washington, DC | 202-225-2171

agriculture.house.gov

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 internal compliance programs.
- Require firms to calculate and report customer account balances electronically to regulators on a regular basis.

Unfortunately for many farmers and ranchers who use futures to hedge their operating risks, a part of the recent CFTC "customer protection" rule could result in significant harm to these core constituencies of the Agriculture Committee.

- The new rule will require farmers and ranchers to pre-fund their margin accounts due to onerous new requirements that force futures commission merchants (FCMs) to hold large amounts of cash in order to pay clearinghouses at the start of trading the next business day.
- The increased costs of pre-funding margin accounts will likely drive many small and medium-sized agricultural producers out of the marketplace.
- When the small players are forced out of the markets, the small and medium-sized FCMs will be forced to consolidate, giving customers fewer choices.
- The Customer Protection and End-User Relief Act provides futures customers with an additional day to get their needed margin to an FCM, which mitigates the effect of pre-funding accounts.

The bill requires 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 Act, the CFTC has finalized over 60 new rules and has issued an unprecedented 170 “no-action” letters to enforce the new regulations. The CFTC’s rulemaking process has been less than ideal. The rulemaking process has proven confusing given the lack of a comprehensive plan for setting a schedule for compliance. The bill reforms the CFTC to make it more efficient and effective; and it ensures that all Commissioners have a voice in the rulemaking process. These reforms include:

- Requiring cost-benefit analysis requirements for each proposed rule, which closely tracks 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” letters to prevent staff from being able to issue letters that are not legally binding at the last moment in an attempt to regulate markets outside of the official CFTC rulemaking process.
- Requiring the Commission to direct staff 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 to mirror that of the SEC’s for rulemakings to ensure the two regulators charged with overseeing the derivatives markets have the same procedures to allow market participants to challenge their rules.
- Directing the Government Accountability Office (GAO) to conduct a study on 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

- End-users should not be treated as financial entities. The bill amends the Commodity Exchange Act (CEA) to allow many end-users who are legitimate “commercial market participants” to avoid being unfairly treated 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 an imbedded 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 formula by the CFTC for non-bank swap dealers (NBSDs) that would result in those entities holding much more capital than their bank counterparts, likely making the business too expensive to continue, resulting in fewer participants in the marketplace. The CFTC now must at least consult with the other regulators in formulating a workable capital requirement formula.
- 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 JOBS Act that allows certain funds to generally solicit for new investors. 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 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.
 - H.R. 677, the Inter-affiliate Swap Clarification Act as 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.

###