THE REPUBLICAN STUDY COMMITTEE
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Legislative Bulletin……………………………………..……….……June 19, 2014

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H. R. 4413 – Customer Protection and End User Relief Act
(Rep. Lucas, R-OK)

Order of Business: The bill is scheduled to be considered on June 19, 2014, under a structured rule which provides one hour of general debate equally divided and controlled by the chair and ranking minority member of the House Committee on Agriculture, and one motion to recommit with or without instructions.

Summary: H. R. 4413 would authorize appropriations for the Commodity Futures Trading Commission (CFTC) through 2018. The bill intends to protect customers from market failures such as in cases like MF Global and Peregrine Financial scandals, and from certain regulations implemented after the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203) that the CFTC is tasked with implementing.

Title I of the legislation mandates a series of provisions that aim to protect farmers and ranchers who use the futures markets by adding several new regulatory customer protections into law by:

- Requiring electronic confirmation of customer fund account balances held at depository institutions.
- Requiring 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.
- Requiring firms who become undercapitalized to immediately notify regulators so they can assess the firm’s viability and move if needed to protect customer funds.
- Requiring 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.
- Ensuring 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.

- Providing 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.

- Requiring firms to calculate and report customer account balances electronically to regulators on a regular basis.

- Requiring the CFTC to complete a study on high frequency trading.

Title II of the legislation addresses reforming the Commodity Futures Trading Commission by:

- 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. The Administration's implementation of this EO has received mixed reviews.
- Making the Commodity Futures Trading 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 U.S. Securities and Exchange Commission's (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.

- Providing for basic protections for proprietary information submitted to the CFTC that is similar to protections provided for in the Dodd-Frank Act, subject to CFTC review and approval.

Title III responds to the CFTC's implementation of the Dodd-Frank Act (Public Law 111-203). Studies by the American Action Forum and others have found that many of the CFTC's new rules have negatively impacted end-users by making it more difficult and costly to manage risks associated with businesses. The bill:

- Amends the Commodity Exchange Act to allow many end-users who are legitimate "commercial market participants" to avoid being inadvertently classified as financial entities.

- Addresses the classification of non-financial end-users who are disadvantaged in the marketplace if they use contracts that trade infrequently. According to the House Committee on Agriculture, 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.

- Seeks to provide 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.

- Intends to provide 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.

- Aims to to correct 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 and resulting in fewer participants in the marketplace. The bill would mandate that the CFTC consult with other regulators in formulating workable capital requirement formulas and recognize formulas already approved by other regulators.

- 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.

- 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.

- 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.

- Includes Commodity Exchange Act 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.

Additional Information: The CFTC was last authorized in the Food, Conservation, and Energy Act of 2008 (H. R. 2419), also known as the 2008 Farm Bill. That authority expired on September 30, 2013. The legislative bulletin for H. R. 2419 can be found here. H. R. 4413 (H. Rept. 113-469) intends to address issues related to the implementation of the Dodd-Frank Act and the impact of its regulations on multiple industries across the United States. According the House Committee on Agriculture, the CFTC has narrowly interpreted the law, which has threatened the ability of producers to affordably protect against risks associated with farming and ranching. The CFTC has finalized more than 60 rules to enforce the Dodd-Frank Act, and has issued an unprecedented 170 "no-action" letters 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. A section-by-section guide and summary of the bill provided by the House Committee on Agriculture can be found here.

Glossary:

Swap: In general, the exchange of one asset or liability for a similar asset or liability for the purpose of lengthening or shortening maturities, or otherwise shifting risks. This may entail selling one securities issue and buying another in foreign currency; it may entail buying a currency on the spot market and simultaneously selling it forward. Swaps also may involve exchanging income flows; for example, exchanging the fixed rate coupon stream of a bond for a variable rate payment stream, or vice versa, while not swapping the principal component of the bond. Swaps are generally traded over-the-counter.

Swap Dealer: An entity such as a bank or investment bank that markets swaps to end users. Swap dealers often hedge their swap positions in futures markets.

Commodity Swap: A swap in which the payout to at least one counterparty is based on the price of a commodity or the level of a commodity index.

Commodity: (1) A commodity, as defined in the Commodity Exchange Act, includes the agricultural commodities enumerated in Section 1a(4) of the Commodity Exchange Act, 7 USC 1a(4), and all other goods and articles, except onions as provided in Public Law 85-839 (7 USC 13-1), a 1958 law that banned futures trading in onions, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in; (2) .A physical commodity such as an agricultural product or a natural resource as opposed to a financial instrument such as a currency or interest rate.

Derivative: A financial instrument, traded on or off an exchange, the price of which is directly dependent upon (i.e., "derived from") the value of one or more underlying securities, equity indices, debt instruments, commodities, other derivative instruments, or any agreed upon pricing index or arrangement (e.g., the movement over time of the Consumer Price Index or freight rates). They are used to hedge risk or to exchange a floating rate of return for fixed rate of return. Derivatives include futures, options, and swaps. For example, futures contracts are derivatives of the physical contract and options on futures are derivatives of futures contracts.

More information on the Commodities Future Trading Commission can be found here.

Committee Action: On April 7, 2014, the bill was introduced and was referred to the House Committee on Agriculture. The Committee held a mark-up of the bill and passed the bill by voice vote on April 9th, 2014.

Administration Position: No Statement of Administration Policy is available.

Cost to Taxpayers: The Congressional Budget Office (CBO) estimates that implementing H.R. 4413 would cost $207 million in 2015 and $948 million over the 2015-2019 period, assuming appropriation of the necessary amounts. CBO expects that enacting H.R. 4413 would affect direct spending and revenues; therefore, pay-as-you-go procedures apply. However, CBO estimates that those effects would not be significant.

Does the Bill Expand the Size and Scope of the Federal Government?: Based on information from the CFTC, CBO estimates that the agency would require 25 additional personnel annually to handle the increased workload under these provisions, an increase of about 4 percent over the agency's 2013 staffing level. CBO estimates that salaries, benefits, and overhead for those additional staff, as well as new administrative expenses, would cost $36 million over the 2015-2019 period, assuming appropriation of the necessary amounts.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: H.R. 4413 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA).

Constitutional Authority: Congress has the power to enact this legislation pursuant to the following: The ability to regulate interstate commerce and with foreign Nations pursuant to

Article 1, Section 8, Clause 3 includes the power to regulate commodity prices by insuring fair, open and transparent commodity futures and swap markets and the practices affecting them.

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AMENDMENTS MADE IN ORDER

1. ***DeFazio (D-OR)***. This amendment would add one requirement to the study on high frequency trading: Whether such trading increases market volatility, including short term market swings such as the "flash crash."

2. ***Jackson Lee (D-TX)***. This amendment requires a study on entities regulated by Commodities Futures Trading Commission regarding the entities' size, practice models, assets under management, and entities rendered defunct via bankruptcy or obsolescence.

3. ***DelBene (D-WA)*, Gibson (R-NY), *Vargas (D-CA)***. This amendment requires that the Commodities Futures Trading Commission's assessment of costs and benefits regarding rules and orders will be affirmed by a court unless that assessment is found to be an abuse of discretion.

4. ***Waters (D-CA)***. This amendment prohibits judicial review of any consideration by the Commodities Futures Trading Commission of the costs and benefits of its rules and orders. Without judicial review, the ability to appeal a CFTC rule based off of a cost benefit analysis would not be permitted, thereby removing the ability of affected parties to appeal CFTC rules on these grounds.

5. ***Moore, Gwen (D-WI)***. This amendment strikes Section 203, and replaces it with the Sense of Congress that the Commodities Future Trading Commission is already required by law to consider costs and benefits when promulgating rules and issuing orders, and is held accountable to this requirement by courts. Section 203 of the bill amends section 15(a) of the Commodity Exchange Act to harmonize the cost benefit requirements of the CFTC with those of executive order 13563. The section requires that the cost benefit analysis be performed by the Chief Economist and published within the proposed rule along with the rule's statutory justification.

6. ***Jackson Lee (D-TX)***. This amendment strikes "United States Court of Appeals for the District of Columbia Circuit or the United States Court of Appeals for the circuit," and

replaces with "United States District Court for the District of Columbia or the United States District Court for the district."

7. **Fincher (R-TN)**. This amendment directs the Comptroller General of the United States to conduct a study of the efficiencies in leasing and rental costs at the Commodity Futures Trading Commission. The report would include:
    - Average occupancy rates and leasing costs of buildings across the Federal Government compared to those currently in effect with respect to buildings and locations occupied by the CFTC;
    - Changes to leasing authority that could achieve efficiencies, including the revocation of independent leasing authority and transfer of authority to the Administrator of General Services;
    - The recommendations and responses contained in the report by the CFTC Inspector General, dated June 4, 2014;
    - Other related recommendations that would achieve efficiencies in leasing and rental costs of buildings currently occupied by the CFTC;
    - A determination whether the CFTC is violating any laws, including the Anti-Deficiency Act, by entering into these leases, particularly those with more than 5-year terms, and if so, how they can avoid violating Federal law in the future;

8. **Garrett (R-NJ)**. This amendment exempts Registered Investment Companies (RICs) that are currently registered with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940 from duplicative registration requirements with the Commodity Futures Trading Commission. The SEC will continue to have full regulatory oversight and enforcement authority over RICs. The amendment does not remove the jurisdiction and regulatory authority that the CFTC has over all futures, options, and swaps transactions that the RICs invest in on behalf of their customers who are pensioners, retirees, and savers.