

CFTC Reauthorization
Section-by-Section To Chairman's Mark
December 11, 2007

To reauthorize and amend the Commodity Exchange Act to promote legal certainty, enhance competition, and reduce systemic risk in markets for futures and over-the-counter derivatives, and for other purposes.

Section 1. Short Title.

This Act may be cited as the CFTC Reauthorization Act of 2007.

TITLE I—GENERAL PROVISIONS

Section 101. Commission Authority over Agreements, Contracts or Transactions in Foreign Currency.

Current law makes sales of certain foreign exchange futures contracts to retail investors subject to Commodity Futures Trading Commission (CFTC) jurisdiction. In June 2004, the Seventh Circuit ruled that certain types of transactions that the CFTC considered to be “futures” transactions, and therefore subject to CFTC jurisdiction, were in fact “spot sales” that are not subject to CFTC jurisdiction.

To address the issue of fraud in the retail foreign exchange market, section 101 clarifies that CFTC regulations on fraud apply to agreements, contracts, or transactions in foreign currency that are:

1. offered by a Futures Commission Merchant, a retail foreign exchange dealer, or an entity not registered under the Commodity Exchange Act (Act);
2. *(NOT offered by a bank, broker, insurance company, financial holding company, or investment bank holding company.)*
3. offered to a retail customer; and
4. offered or entered into on a leveraged or margined basis, or financed by either party.

“Retail foreign exchange dealer” is a newly defined term under this bill. Under the bill, retail foreign exchange dealers must register with the CFTC and are subject to CFTC rules and to the same anti-fraud authority as are Futures Commission Merchants that engage in retail foreign exchange transactions.

In addition, the bill would apply new requirements to Futures Commission Merchants, to affiliates of Futures Commission Merchants, and to the newly defined retail foreign exchange dealers, each of which would have to maintain adjusted net capital of at least \$20 million in order to qualify for certain regulatory exemptions under the Act. Futures Commission Merchants would also have to be primarily or substantially engaged in on-exchange business to qualify.

New registration requirements would also apply to Commodity Trading Advisors, Commodity Pool Operators, and Solicitors who deal in contracts in retail foreign currency transactions with Futures Commission Merchants or retail foreign exchange dealers.

Section 102. Antifraud Authority.

Amends section 4b of the Act to clarify that unlawful actions between principals, in addition to statutory violations resulting from the activities of brokers, are subject to the anti-fraud provisions of this section.

A clarification in this section recognizes that a person transacting business under the Act with another person may have material nonpublic information pertaining to the transaction and that such person is not obligated to disclose that information to counterparties to the transaction except as necessary to make any statement already made to the counterparty not misleading.

Section 103. Authorization of Appropriations.

Authorizes such sums as may be necessary to carry out the Act for fiscal years 2008 through 2013.

Section 104. Technical and Conforming Amendments.

Makes various amendments to correct statutory errors and other conforming changes.

Section 105. Criminal and Civil Penalties.

Section 105(a) increases civil penalties for manipulation under the Act from the greater of “\$100,000 or triple the monetary gain” to the greater of “\$1,000,000 or triple the monetary gain”.

Section 105(b) increases penalties for registered entities that fail to enforce rules made as a condition of its registration. The criminal penalty is increased from a misdemeanor to a felony for officers of a registered entity who fail to comply with cease and desist orders in connection with manipulation. Civil penalties in such cases are doubled from \$500,000 to \$1,000,000.

Section 105(c) increases penalties for violations of injunctions or restraining orders involving manipulation under the Act. Civil penalties are increased from the greater of “\$100,000 or triple the monetary gain” to the greater of “\$1,000,000 or triple the monetary gain.”

Section 105(d) increases the criminal penalty for violations of the Act in general from 5 to 10 years imprisonment, and increases the civil penalty for individual persons from \$500,000 to \$1,000,000.

TITLE II—EXEMPT COMMERCIAL MARKETS

Section 201. Significant Price Discovery Contracts Defined.

Section 201(a) defines a “significant price discovery contract” as an Exempt Commercial Market (ECM) contract that is subject to new principles-based oversight standards.

Section 201(b) sets forth criteria for the CFTC to consider in determining whether an ECM contract qualifies as a significant price discovery contract. (new section 2(h)(7)(B) of the Act). The criteria include:

1) Price linkage – whether the relevant ECM contract either relies upon the price of a contract on a Designated Contract Market (DCM) or other specified market, or is sufficiently related to that other contract to permit traders to effectively arbitrage between the two markets. (new section 2(h)(7)(B)(i) of the Act).

2) Material price reference – whether bids, offers, or transactions in a commodity, on a frequent and recurring basis, are based on or determined by referencing the prices of the relevant ECM contract. (new section 2(h)(7)(B)(ii) of the Act).

3) Material liquidity – whether the volume of trading in the relevant contract is sufficient to have a material impact on other contracts listed for trading on regulated exchanges or other ECMs. (new section 2(h)(7)(B)(iii) of the Act).

This Section also enables the CFTC to exercise limited discretion to consider such other material factors specified in rules and regulations, as relevant to determine whether an ECM contract performs a significant price discovery function. (new section 2(h)(7)(B)(iv) of the Act).

Section 201(b) further implements the CFTC’s recommendations by specifying the Core Principles that would apply to an ECM significant price discovery contract. The CFTC has identified the following authorities as appropriate to such contracts: 1) large trader position reporting; 2) position limits or accountability standards; 3) emergency authority; and 4) self-regulatory oversight. The proposal includes ECM core principles to implement the four authorities identified in the CFTC’s Report. The proposed Core Principles are derived from selected DCM Core Principles and Designation Criteria set forth in Section 5 of the Act. Each of these proposed Core Principles is necessary for an ECM to effectively fulfill its self-regulatory responsibilities under the Act. (new section 2(h)(7)(C) of the Act).

In addition, Section 201(b) adopts a certification procedure for ECM rules and rule amendments relating to significant price discovery contracts that is patterned on the existing certification process for DCMs in Section 5c of the Act. (new section 2(h)(7)(D) of the Act).

Section 201(b) also authorizes the CFTC to promulgate rules to implement these new statutory provisions concerning ECM significant price discovery contracts. (new section 2(h)(7)(A) of the Act).

Section 202. Large Trader Reporting.

Section 202 amends sections 4g and 4i of the Act to apply the CFTC's large trader reporting authority to significant price discovery contracts traded on ECMs. Section 4g of the Act establishes recordkeeping requirements applicable to Futures Commission Merchants with respect to contracts that are cleared, while section 4i establishes those requirements for large traders in ECM significant price discovery contracts.

Section 203. Commission Emergency Authority.

Section 203 amends section 8a of the Act to apply the CFTC's emergency authority to ECM significant price discovery contracts. These amendments permit the CFTC to act directly by: 1) altering or supplementing the ECM's rules; 2) making appropriate disclosures to the ECM as needed; and 3) taking emergency action necessary to maintain or restore orderly trading in or liquidation of the contract. These are the same authorities that the CFTC can exercise when it becomes aware of potential manipulation on a DCM.

Section 204. Conforming Amendments.

Section 204 makes conforming amendments that: 1) apply the Act's grant of exclusive jurisdiction to the CFTC to significant price discovery contracts traded on ECMs because of their potential implications for contracts traded on regulated futures exchanges; 2) provide the CFTC with special call authority to obtain information from an ECM necessary to determine whether a particular contract is a significant price discovery contract; and 3) apply certain existing provisions with respect to Core Principles for DCMs to the proposed Core Principles for ECMs.

Section 204 also deletes existing ECM price discovery provisions in section 2(h)(4)(D) of the Act, which require timely dissemination of ECM price and trading volume, and are no longer necessary in light of the new Core Principles for significant price discovery contracts.