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FOOD, CONSERVATION, AND ENERGY ACT
OF 2008

CONFERENCE REPORT

TO ACCOMPANY

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essing of applications under the Disaster Loan Program. (Section 11161)

The House bill contains no comparable provision.

The Conference substitute adopts the Senate amendment and requires the SBA to submit to Congress a report on the Disaster Assistance Program performance during the previous fiscal year. This report will cover changes in staffing, technology, and a review of challenges encountered and overall results. Additionally, during any period for which the Administrator has declared eligibility for additional assistance, the SBA is required to make monthly reports to Congress with basic information on their disaster response. During a Presidential disaster declaration period, the SBA must submit weekly updates to Congress, as opposed to daily updates in the original Senate amendment. The Conference substitute changes the name to "Reports on Disaster Assistance". (Section 12091)

TITLE XIII—AMENDMENTS TO COMMODITY EXCHANGE ACT

(1) *Short title*

The Senate amendment cites this title as the "CFTC Reauthorization Act of 2008". (Section 13001)

The House bill contains no comparable provision.

The Conference substitute adopts the Senate provision. (Section 13001)

(2) *Commission authority over off-exchange retail foreign currency transactions*

The Senate amendment amends section 2(c)(2) of the Commodity Exchange Act (CEA) (7 U.S.C. 2(c)(2)) by clarifying that the Commodity Futures Trading Commission's (Commission) anti-fraud authority applies to retail off-exchange foreign currency (forex) transactions that are: (i) offered to, or entered into with, a person that is not an eligible contract participant (i.e., a retail customer); and (ii) offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty, on a similar basis.

If the test in new section 2(c)(2)(C) is met, courts will no longer have to decide whether forex transactions that meet these requirements are futures contracts in order to permit the Commission to pursue an action for fraud. But since CEA section 4b remains limited by its terms to futures, a new provision (section 2(c)(2)(C)(iv)) is added to ensure that section 4b applies to all covered forex transactions (e.g., "rolling spot" or other futures look-like products) "as if" they were futures contracts. Under this provision, the Commission need not prove that such transactions are futures in order to establish a fraud violation. However, this provision is not intended to suggest, nor does it create a negative inference, that such contracts are not futures contracts.

The phrase "leveraged or margined basis" is not limited to the same type of leverage or margin that exists for trading in on-exchange markets. The fact that off-exchange transactions are at issue means that they are likely to operate differently from exchange-traded instruments in this regard.

Excluded from new section 2(c)(2)(C) are: (i) transactions offered or entered into by certain otherwise-regulated entities, such as financial institutions, broker-dealers, and insurance companies; (ii) securities that are not security futures products; and (iii) transactions that create an enforceable obligation to deliver between a seller and buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business. The term "line of business" in new section 2(c)(2)(C)(i)(II)(bb)(BB) refers to any legitimate line of business, not just a foreign exchange business. The reference to "an enforceable obligation to deliver" in connection with a "line of business" emphasizes the commercial nature of this exclusion.

The Senate amendment explicitly reserves CEA sections 2(a)(1)(B) (principal-agent liability); 4(b) (foreign markets); 4o (fraud by commodity pool operators and commodity trading advisors); 13(a) (aiding and abetting liability); and 13(b) (controlling person liability) with respect to fraudulent forex activities.

While the secondary liability provisions of principal-agent, aiding-abetting, and controlling-person liability were implied in the Commodity Futures Modernization Act of 2000 (CFMA), these amendments make that reservation of Commission anti-fraud authority explicit. The amendments are not intended to suggest, nor do they create a negative inference, that these secondary liability provisions are not available in actions brought under other sections of the CEA where Commission anti-fraud or anti-manipulation authority is reserved, such as CEA sections 2(h)(2), 2(h)(4), and 5d(c).

The Senate amendment also provides authority to the Commission to issue rules proscribing fraud in connection with any agreement, contract or transaction in an exempt or agricultural commodity that is (i) offered to, or entered into with, a person that is not an eligible contract participant (i.e., a retail customer); and (ii) offered or entered into on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty, on a similar basis. (Section 13101)

The House bill contains no comparable provision.

The Conference substitute adopts the Senate provision with amendment.

With the amendment, the managers intend to address several additional problems currently resulting in consumers being the victims of fraud related to off-exchange foreign currency transactions. The CFMA permitted registered Futures Commission Merchants (FCM) to offer foreign currency trading to the public without requiring that they be substantially or primarily engaged in the business of exchange-traded futures.

Since passage of the CFMA, the Managers note that an inordinate number of fraudulent schemes are currently implemented through shell FCMs and their unregistered affiliates. These shell FCMs meet minimal requirements for FCMs and typically conduct little, if any, traditional on-exchange business of an FCM. Their purpose instead is to serve as the parent company for their unregistered affiliates. It is the unregistered affiliates that will typically conduct the retail sale of foreign currency contracts. Unregistered

affiliates of a shell FCM are subject to little if any regulatory oversight, making them harbors for fraudulent schemes.

The amendment addresses the problem of shell FCMs and unregistered affiliates by providing that only FCMs that are primarily or substantially or primarily engaged in the buying and/or selling of futures contracts on a Designated Contract Market or Derivatives Transaction Execution Facility, or a material affiliate of such an FCM are lawful FCM or FCM-affiliate counterparties for a retail transaction in foreign currency.

The Managers intend that the Commission will utilize the rulemaking authority provided in this section to define when a registered futures commission merchant is primarily or substantially engaged in the buying and/or selling of futures contracts as described in CEA section 1a(20) for the purposes of new provisions 2(c)(2)(B)(i)(II)(cc)(AA) and (BB).

A material affiliate is an affiliate for which an FCM is required to keep records relating to an affiliate's futures and financial activities under CEA section 4f(c)(2)(B). The amendment provides that FCMs and FCM-affiliates must maintain minimum net capital of \$20 million to be a lawful counterparty. This capital requirement is phased in over a period of one year.

The amendment provides for a new category of dealer known as a "retail foreign exchange dealer" (RFED). The amendment provides that RFEDs also must maintain a minimum of \$20 million in net capital to be a lawful counter party for a retail off-exchange foreign transaction. This capital requirement is phased in over a period of one year.

The purpose of imposing a \$20 million minimum capital requirement on FCMs, FCM-affiliates, and RFEDs is to ensure that forex dealers utilizing these classifications to conduct retail foreign currency business are sufficiently capitalized to ensure their financial soundness—especially given that many entities in this area run what are essentially off-exchange, retail forex markets.

In addition, to maintaining a minimum of \$20 million in adjusted net capital, the managers expect the Commission to use the rulemaking authority provided under this section to promulgate any other requirements necessary to ensure the financial soundness of RFEDs.

The rules and regulations issued under this section should appropriately address the level of financial risk posed by RFEDs and their operations. To the extent their risk profiles are similar, the managers intend for FCMs and RFEDs to be regulated substantially equivalently in terms of their off-exchange retail foreign currency business. The managers do not intend for the Commission to provide either FCMs or RFEDs with a more favorable regulatory environment over the other or create two significantly different regulatory regimes for similar business models—to the extent the financial risks posed by such operations are similar.

In addition to regulatory authority over FCMs and RFEDs, the amendment provides the Commission with greater authority over participants in the off-exchange foreign currency trading industry who are not the actual counterparty to the transaction to ensure that the Commission has authority needed over these industry par-

