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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-

ticipants to take action to address fraudulent or deceptive practices.

The amendment strikes the Senate provision to provide 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)

(3) Liaison with Department of Justice

The Senate amendment requires the Attorney General to designate a liaison between the Department of Justice and the Commission to coordinate civil and criminal investigations and prosecutions of violations of the CEA. (Section 13102)

The House bill contains no comparable provision.

The Senate recedes.

(4) Anti-fraud authority over principal-to-principal transactions

The Senate amendment amends section 4b of the CEA (7 U.S.C. section 6b) to clarify that the CEA gives the Commission the authority to bring fraud actions in off-exchange "principal-to-principal" futures transactions. Subsection 4b(a)(2) is amended by adding the words "or with" to address principal-to-principal transactions on the new markets and trading venues permitted under the CFMA. This new language clarifies that the Commission has the authority to bring anti-fraud actions in off-exchange principal-to-principal futures transactions, including exempt commodity transactions in energy under section 2(h), as well as transactions conducted on derivatives transaction execution facilities. The prohibitions in subparagraphs (A) through (D) of the new section 4b(a) would apply to all transactions covered by paragraphs (1) and (2).

Derivatives clearing organizations are not subject to fraud actions under section 4b in connection with their clearing activities.

The amendments to CEA section 4b(a) regarding transactions currently prohibited under subparagraph (iv) (found in new subparagraph (D)) are not intended to affect in any way the Commission's historical ability to prosecute cases of indirect bucketing of orders executed on designated contract markets. (See, e.g., Reddy v. CFTC, 191 F.3d 109 (2nd Cir. 1999); In re DeFrancesco, et al., CFTC Docket No. 02–09 (CFTC May 22, 2003) (Order Making Findings and Imposing Remedial Sanctions as to Respondent Brian Thornton)).

These amendments should not be interpreted or understood as calling into question the Commission's historical use of section 4b to address principal-to-principal trading in the retail context on regulated futures exchanges. (Section 13103)

The House bill contains no comparable provision.

The Conference substitute adopts the Senate provision. (Section 13102)

(5) Criminal and civil penalties

The Senate amendment amends the CEA to double the civil and criminal penalties available for certain violations of the CEA such as manipulation, attempted manipulation, and false reporting. The increased civil monetary penalties in the Reauthorization Act are intended to render the CEA's penalty provisions comparable to the penalty provisions that Congress enacted in the Energy Policy Act of 2005 for manipulation cases brought by the Federal Energy Regulatory Commission with respect to physical energy markets. (Section 13104)

The House bill contains no comparable provision.

The Conference substitute adopts the Senate provision with amendment. The amendment addresses technical drafting issues. (Section 103103)

(6) Authorization of appropriations

The Senate amendment authorizes such sums as may be necessary to carry out the Act for fiscal years 2008 through 2013. (Section 13105)

The House bill contains no comparable provision.

The Conference substitute adopts the Senate provision. (Section 13104)

(7) Technical and conforming amendments

The Senate amendment contains various amendments to correct statutory errors and other conforming changes. (Section 13106)

The House bill contains no comparable provision.

The Conference substitute Adopts the Senate provision with amendment. The amendment makes additional technical and conforming changes to the CEA.

The amendment amends section 1(a)(33) of the CEA (7 U.S.C. 1). The definition of "trading facility" under the CEA is a key criterion for defining a number of categories of regulated markets (e.g., designated contract markets, derivatives transaction execution facilities), exempt markets (e.g., exempt commercial markets, exempt boards of trade) and excluded markets (e.g., CEA section 2(d)(2)). By amending the definition of trading facility, the Managers address a concern where the Commission's jurisdiction could be compromised if novel auction systems which aggregate the market sentiments of multiple participants to derive a market price according to a pre-determined algorithm were to fall outside the agency's regulatory ambit. The definition of "trading facility" has been amended to anticipate and include, prospectively, markets which utilize automated trade matching and execution algorithms.

Section 4a(e) of the CEA provides, among other things, that it is a violation of the CEA, for any person to violate a speculative limit rule of a designated contract market, derivatives transaction execution facility, or other board of trade if that rule has been approved by the Commission. Section 5c(c) of the CEA, though, permits exchanges to certify such rules rather than submit them for prior Commission approval. The Managers amend section 4a(e) to bring it into harmony with the CEA provisions regarding certification of exchange rules. Specifically, the Managers amend section 4a(e) to provide that it is a violation of the CEA, for which the

Commission may bring an enforcement action, for any person to violate a speculative limit rule that has been certified by a registered entity.

The Managers are concerned that complainants seeking to enforce an award received through the Commission's reparations process are facing difficulties in obtaining relief from Federal District courts. Accordingly, the Managers include language in this amendment amending section 14(d) of the Commodity Exchange Act (7 U.S.C. 18) to provide that Commission reparations awards are directly enforceable in Federal District courts as if they were local judgments pursuant to 29 U.S.C. 1963. The Managers also provide that the amendment shall operate retroactively. (Section 13105)

(8) Portfolio margining and security index issues

Following enactment of the CFMA, the Commission and Securities and Exchange Commission (SEC) jointly promulgated rules relating to the margining of security futures products (SFP). Under those rules, SFPs have been subject to the same fixed-rate strategy-based margining scheme applicable to security options customer accounts, rather than the risk-based portfolio margining system typical in the futures industry. Many have argued that this has contributed to the low volume of trading in SFPs which, by contrast, have been successful in Europe. The Senate amendment directs the Commission and SEC to use their existing authorities by September 30, 2008, to allow customers to benefit from the use of a risk-based portfolio margining system for both security options and SFPs.

The detailed statutory test of a narrow-based security index was tailored to fit the U.S. equity markets, which are by far the largest, deepest and most liquid securities markets in the world. The amendment provides clarity in this area by requiring the Commission and the SEC to take action under their existing authorities to promulgate, by June 30, 2008, final rules providing criteria that will exclude broad-based indexes on foreign equities from the definition of narrow-based security index as appropriate. (Section 13107)

The House bill contains no comparable provision.

The Conference substitute adopts the Senate provision with an amendment to extend the deadlines to September 30, 2009 for implementing portfolio margining and June 30, 2009 for promulgating criteria for excluding broad-based indexes on foreign equities from the definition of narrow-based security index as appropriate. (Section 13106)

(9) Significant price discovery contracts

The Senate amendment provided for greater regulation of contracts traded on exempt commercial markets (ECM) that fulfill a price discovery function. It sets forth criteria for the Commission to consider in determining whether an ECM contract qualifies as a significant price discovery contract (SPDC). These criteria include: (i) price linkage; (ii) arbitrage; (iii) material price reference; and (iv) material liquidity and other such material factors as the Commission specifies by rule.

The amendment applies core principles to ECM contracts that are determined to perform a significant price discovery function by the Commission. These Core Principles are derived from selected DCM core principles and designation criteria set forth in CEA section 5. These core principles include those relating to: contracts not being readily susceptible to manipulation, monitoring of trading, the ability of the Commission to obtain information, position limitations or accountability limitations, emergency authority, daily publication of trading information, compliance with rules, and conflict of interest.

The amendment gives the electronic trading facility the explicit discretion to take into account differences between cleared and uncleared SPDCs only in applying the emergency authority and the position limits or accountability core principles and directs the Commission to take such differences into consideration when reviewing implementation of such principles by the electronic trading facility in (7)(D);

The amendment requires an electronic trading facility to notify the Commission whenever it has reason to believe that an agreement, contract or transaction conducted in reliance on the exemption provided in 2(h)(3) displays any of the factors relating to a significant price discovery function described in subparagraph (7)(B); and directs the Commission to conduct an evaluation at least once a year to determine whether any agreement, contract or transaction conducted on an electronic trading facility in reliance on the exemption in 2(h)(3) performs a significant price discovery function in (7)(E). (Section 13201)

The House bill contains no comparable provision.

The Conference substitute adopts the Senate provision with amendment. With the amendment the Managers make several changes to the Senate provision.

The Managers provide that the Commission shall promulgate rules and regulations to implement the authorities provided by this Act regarding significant price discovery contracts. The Senate provision had originally made such promulgation discretionary. The Managers also allow the Commission to consider the potential for arbitrage between a potential SPDC and an existing SPDC in making a determination whether a contract is a SPDC.

The Managers amend the Senate provision to make clear that an electronic trading facility shall have reasonable discretion to account for differences between cleared and uncleared contracts in complying with all the core principles applicable under this Act to SPDCs.

The Managers amend the Senate provision to make clear that in determining appropriate position limits or position accountability limits under this Act, an electronic trading facility shall consider cleared swaps transactions that are treated by a derivatives clearing organization as fungible with significant price discovery contracts. The Managers also amend the Senate language to apply the conflict of interest and antitrust considerations core principles to electronic trading facilities only with respect to SPDCs traded on such facilities.

Not all the listed factors must be present to make a determination that a contract performs a significant price discovery function.