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Commodity Futures Trading Commission
COMMODITY FUTURES TRADING COMMISSION ACT OF 1974

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93D CONGRESS
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HOUSE OF REPRESENTATIVES

REPORT
No. 93-975

COMMODITY FUTURES TRADING COMMISSION ACT OF 1974

REPORT

Together With

MINORITY VIEWS AND ADDITIONAL MINORITY VIEWS

ON

H.R. 13113

A BILL TO AMEND THE COMMODITY EXCHANGE ACT TO STRENGTHEN THE REGULATION OF
FUTURES TRADING, TO BRING ALL AGRICULTURAL AND OTHER COMMODITIES TRADED ON EX-
CHANGES UNDER REGULATION, AND FOR OTHER PURPOSES

APRIL 4, 1974. -- Committed to the Committee of the Whole House on the State of the Union and ordered to be
printed

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"The exchanges in many parts of the country which deal in securities and commodities conduct, of course, a national business because their customers live in every part of the country. The managers of these exchanges have it is true, often taken steps to correct certain obvious abuses. We must be certain that abuses are eliminated, and to this end a broad policy of national regulation is required.

"It is my belief that exchanges for dealing in securities and commodities are necessary and of definite value to our commercial and agricultural life. Nevertheless, it should be our national policy to restrict, as far as possible, the use of these exchanges for purely speculative operations."

Franklin D. Roosevelt

78 Cong. Rec. 2264 (1934.)
(Message from the President)

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93D CONGRESS
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COMMODITY FUTURES TRADING COMMISSION ACT OF 1974

APRIL 4, 1974. -- Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. POAGE, from the Committee on Agriculture, submitted the following

REPORT

together with

MINORITY VIEWS AND ADDITIONAL MINORITY VIEWS

[To accompany H.R. 13113]

The Committee on Agriculture to which was referred the bill (H.R. 13113) to amend the Commodity Exchange Act to strengthen the regulation of futures trading, to bring all agricultural and other commodities traded on exchanges un-

der regulation, and for other purposes, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

PURPOSE OF THE LEGISLATION

H.R. 13113 is major legislation strengthening the federal regulation of the nation's 400 billion dollar commodity futures trading industry. It provides the first complete overhaul of the Commodity Exchange Act since its inception, and proposes a comprehensive regulatory structure to oversee the volatile and esoteric futures trading complex.

H.R. 13113 is a considered approach toward solving both immediate and readily perceivable problems besetting futures markets, and makes several major changes in the role of the Federal Government in regulating all futures trading enterprises.

H.R. 13113 is the result of a labor by the Committee on Agriculture that began in August 1973, proceeded through two complete sets of Committee hearings, and the formation of a special ad hoc subcommittee for the drafting of a predecessor bill (H.R. 11955). H.R. 13113 is a so-called "clean" bill, embodying the more than fifty changes made by the Committee in H.R. 11955.

The Committee believes that, properly implemented, the bill will provide the basis for a stronger futures industry and a stronger economy,

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where producer, merchant, trader, businessman and ultimate consumer of commodities will have access to or benefit from a powerful and responsible economic phenomena that commands deserved respect for the role it plays in the lives of businessmen, producers and consumers in every nation of the world.

SUMMARY OF THE MAJOR PROVISIONS OF H.R. 13113, A BILL TO AMEND THE COMMODITY EXCHANGE ACT, MARCH 1974

The bill is drafted in the form of amendments to the Commodity Exchange Act (*7 U.S.C. 1 et seq.*) and contains four titles.

Title I creates a new five man regulatory commission with certain administrative ties to the Department of Agriculture to be called the "Commodity Futures Trading Commission" -- consisting of four public members and the Secretary of Agriculture or his designee. The four public members of the Commission will be appointed by the President from the general public and confirmed by the Senate. Any of the five members of the Commission can be separately nominated by the President as Chairman of the Commission, although such nomination would be subject to separate Senate approval. No more than two of the public members shall be of the same political party. The public members will be appointed for staggered five-year terms and will be compensated at Executive Level IV on a per diem basis for the time they spend in the performance of their official activities. Commission members and staff of the Commission are prohibited from participating directly or indirectly in any market operation or transaction subject to regulation by the Commission. The Commission will be allowed to utilize the facilities and services of the Department of Agriculture, at cost, including adequate office space if available. The Commission will be required to meet as often as necessary but not less than one regular meeting per month. Additional meetings may be called by the Chairman or any two members of the Commission.

All existing authority under the Commodity Exchange Act presently delegated to the Secretary of Agriculture and the Commodity Exchange Commission will be transferred to the new CFTC. All existing personnel of the CEA will be transferred to and become employees of the CFTC. Provision is made for a Secretary to the Commission, who will be responsible directly to the Commission members. The CFTC is authorized to hire consultants and to contract on its own authority with respect to matters necessary to effectuate the purposes and provisions of the Act. Certain responsibilities of the Commission may be delegated to CFTC staff, including an Executive Director who will perform the day to day functions of the operation of the Commission under the direction of the members of the Commission. In addition, the Commission will have its own General Counsel and legal staff as well as independent budgeting capability and its own Administrative Law Judges. Commission budgets are to be independent products of the Commission (subject to OMB) but will be forwarded to the Secretary of Agriculture for transmittal purposes only in the Department of Agriculture's budget requests. Provision is made for GAO access to books and records of the Commission.

A customer reparation proceeding before the Commission will be authorized one year after date of enactment of the Act for handling

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customer complaints which arise from violations of the Act, particularly those which result in monetary damages to the customer. The Commission will have original jurisdiction to consider all such complaints which have not been resolved through the informal settlement procedure required of the contract markets and registered futures associations under the bill. Formal hearings will be held in those cases involving amounts in controversy which exceed \$ 2,500 and will be in accordance with the Administrative Procedure Act. Initially, complaints would be considered by an Administrative Law Judge and then reviewed by the Commission before a final order is entered. A special judicial review of Commission decisions will be established for these proceedings which will allow either party adversely affected to appeal to the U.S. District Court.

The Commission will be directed to take into consideration the public interest designed to be protected by the anti-trust laws of the United States before issuing any order, rule or regulation under the Act and before requiring or approving any bylaw, rule, regulation or resolution of a contract market or registered futures association.

Title II provides broad new authority to the new Commission over futures trading in a number of areas. All commodities trading in futures will be brought within federal regulation under the aegis of the new Commission, however, provision is made for preservation of Securities Exchange Commission jurisdiction in those areas traditionally regulated by it. "Commodity Trading Advisors" and "Commodity Pool Operators" will be brought within the purview of the Act and will be required to register with the Commission annually. Whether trading by floor brokers and futures commission merchants for their own accounts and at the same time trading for their customers will be allowed will be determined by the Commission after a hearing within six months after enactment and if allowed, the circumstances under which it shall be conducted will be determined by the Commission. The existing registration and examination for fitness requirement will be expanded to include all individuals handling customer accounts. Contract markets will be required to demonstrate that the futures contracts for the commodities for which they are designated or seek designation serve an economic purpose. The Commission will be given authority to require contract markets, after hearing and comments procedure and after giving the contract market 60 days to suggest changes, to permit delivery of the commodity at additional geographical locations if it finds that this will tend to diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce. Contract markets will be required to establish their own customer claims settlement procedures complementing the Commission's procedures for the handling of customer complaints which involve claims up to \$ 5,000 and which will result in a voluntary informal settlement between the parties. Contract markets will be required to submit their bylaws, rules, regulations or resolutions which relate to the terms and conditions of futures contracts or other trading requirements to the Commission for its approval or disapproval.

The Commission will be given authority through the Attorney General to seek injunctions to stop any person from violating the Act or

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regulations thereunder and to stop any trader from controlling a commodity futures contract to the extent that he is effectively restraining trading in such contract but no injunction or mandamus will be issued *ex parte*. The Commission will have authority to impose monetary penalties up to \$ 100,000 in both administrative and criminal proceedings for violations of the Act. The Commission will be authorized to require a contract market, after notice and hearings to effectuate changes in its rules and practices which the Commission determines to be necessary for the protection of the public interest. The Commission will have authority to promulgate special rules and regulations for persons registered under the Act but who are not members of a contract market which may reasonably be required to protect the public interest. The Commission will have special emergency authority to direct contract markets to take such actions as it may deem necessary in "market emergency" situations, such as war, price controls, export embargoes, or significant intervention of a foreign government in the futures market, in order to facilitate the orderly trading in or liquidation of any futures contract.

Title III provides enabling authority at the discretion of the Commission for persons registered under the Act and in the commodity trading business to establish a voluntary futures association or associations which would have authority

to regulate the practices of its members in the public interest. Such an association would register with the Commission and establish a uniform code of professional conduct for those in the commodities business and have disciplinary authority over its members. It would also be required to establish a procedure for the settlement of claims and complaints against its members similar to that required of contract markets. Association rules and actions would be subject to review by the new Commission. Association activity would serve solely as a complement rather than a displacement to the authority of the new Commission.

Title IV makes it a felony for Commissioners, employees, or agents of the Commission to participate, directly or indirectly, in any transaction in either futures, options, or an actual commodity and it also makes it a felony for these same people to impart confidential information to others for the purpose of assisting them in participating in such transactions. The bill continues the ban on trading in options in commodities now subject to CEA regulation, and prohibits options trading contrary to rule or regulation of CFTC with respect to all other commodity futures, i.e., those being brought under regulation for the first time by the bill. "Arbitrage" is added to discretionary authority of CFTC to allow exceeding speculative limit, and is defined to mean the same as a "spread" or "straddle". The "mechanical" test of hedging in present law is repealed and the Commission is given new latitude to define legitimate hedging, including anticipatory hedging for processor.

The "crossing of trades" authority is expanded to include all commodities, and provides authority over such transactions to CFTC. A new requirement is added to the present Act that U.S. standards be specifically adopted by the Commission. The final provisions prescribe the manner of transfer of authority, organization of the new Commission, and the effective date.

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SECTION-BY-SECTION ANALYSIS

The preamble of the bill recites, "That this Act may be cited as the 'Commodity Futures Trading Commission Act of 1974'." The bill is divided into four titles:

Title I -- Commodity Futures Trading Commission.

Title II -- Regulation of Trading and Exchange Activities.

Title III -- Enabling Authority for Creation of National Futures Associations.

Title IV -- Miscellaneous Provisions.

TITLE I -- COMMODITY FUTURES TRADING COMMISSION

Section 101 amends section 2 of the Act to establish a Commodity Futures Trading Commission (CFTC), consisting of the Secretary of Agriculture or his designee, and four other commissioners "selected from the general public," appointed by the President with the advice and consent of the Senate. Not more than two of the "public" commissioners could be members of the same political party. The Secretary (or his designee) would serve during the time the Secretary continues in office; the other commissioners would be appointed for staggered terms of five years each.

The Chairman could be any one of the five commissioners, nominated by the President "for appointment by and with the advice and consent of the Senate," to serve during his term as a commissioner, or in the case of the Secretary, during the time he continues in office.

Commissioners and employees are forbidden to engage in transactions "of the character subject to regulation." Provision is made for removal by the President for neglect of duty or malfeasance in office, for exercise of all powers by the CFTC during a vacancy on the CFTC, and for office space and secretarial and clerical help for commissioners.

Compensation of commissioners: If the Secretary designates another to act in his behalf, the other must be an official of the Department of Agriculture who is serving at not less than executive level IV; the "public" commissioners would be compensated at that level per diem for each day or part thereof spent in the performance of official duties. There would be a provision for payment of commissioners' expenses, including transportation expenses.

The CFTC would have a Secretary, a General Counsel, and an Executive Director, all of whom report directly to the CFTC.

The CFTC is authorized to cooperate with others, including agencies, to employ a staff including Administrative Law Judges, to employ experts and consultants, to make and enter into contracts, to utilize "partially or jointly" facilities and services of employees of the Department of Agriculture "at cost," to rent offices if suitable space is not available at the Department of Agriculture, and to delegate functions to employees.

Budgets: The CFTC exercises all functions with respect to preparation of budget estimates and distribution of appropriated funds according to major programs and purposes; its budget is forwarded to the Secretary of Agriculture solely for transmission with the Department of Agriculture budget request to Congress. Appropriations would be authorized, of "such sums as may be necessary for the purposes of this Act."

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Section 102 and section 103 provide for transfer to the CFTC of the powers presently vested under the Commodity Exchange Act in the Secretary of Agriculture and the present Commodity Exchange Commission (the Secretaries of Agriculture and Commerce and the Attorney General, or their designees), and also personnel, property, records, and funds employed in connection with administration of the Commodity Exchange Act.

Section 104 amends the Act to require annual reports by the CFTC to Congress, and requires review and audit of the CFTC by the Comptroller General. The latter could examine "any books, documents, papers, or records of the [CFTC]." With respect to business transactions of any person, trade secrets, and names of customers, the Comptroller General would be forbidden to include such information in his reports, but required to provide it on request by "any Committee of either House of Congress acting within the scope of its jurisdiction."

Section 105 adds a new section to the Act, providing for administrative reparation proceedings before the CFTC, against persons registered with the CFTC as futures commission merchants, floor brokers, persons associated with futures commission merchants or with agents thereof, commodity trading advisors, or commodity pool operators. A complaint could be filed by any person, based on any violation of the Act or rules, regulations, or orders thereunder. A complaint could be filed up to nine months after accrual of the cause of action alleged therein.

The CFTC is required to "forward" the complaint to the respondent who would then be required to satisfy it or answer it, if the CFTC believed that the facts alleged warranted such action.

The CFTC is required to investigate the complaint if the CFTC believes that there appears to be reasonable grounds for such investigation, and would be permitted to have the complaint served on the respondent and afford the respondent an opportunity for hearing before an Administrative Law Judge. If the complainant claimed less than \$ 2,500 damages, proof in support of the complaint and in support of respondent's answers, could be supplied by depositions or verified statements of fact.

The CFTC is required to determine whether or not the respondent had committed any violation of the Act or rules, regulations, or orders, thereunder; if it determines that he has committed such a violation, it would be required to determine the damages to which the complainant is entitled as a result of the violation, and to order the respondent to pay such damages to the complainant.

If the respondent admits liability for a portion of the damages claimed, the CFTC could order the respondent to pay the undisputed amount and subsequently determine liability for the disputed amount.

If a reparation award is not paid, the person for whose benefit it is made, would have three years to file an action in court. He would have his choice of courts: The United States district court for the district of his residence or the district where respondent has its principal place of business, or any State court having "general jurisdiction of the parties." The court action would proceed in all respects like other civil suits for damages except that the findings and orders of the CFTC would be "prima facie evidence of the facts therein stated." The petitioner

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would have certain advantages with respect to costs and attorney fees.

Paragraph (g) provides for appeal to United States district court by "either party adversely affected by entry of a reparation order." If there is an administrative hearing, the appeal is filed in the district where that hearing is held; if there is no administrative hearing, the appeal is filed in the district "in which the respondent is located."

The proceeding on appeal likewise proceeds like other civil suits for damages, except that the findings and orders of the CFTC are prima facie evidence of the facts therein stated. The appellee is not liable for costs in such court action and if he prevails he would be allowed a reasonable attorney fee, taxed and collected "as a part of his costs."

Paragraph (h) provides that unless the registrant against whom a reparation order is issued, paid the award or appealed it, he would be prohibited from trading on contract markets, and his registration would be suspended automatically until he paid the award with interest.

Under paragraph (d) complainants not residing in the United States would be required to furnish bond in double the amount claimed, for costs including a reasonable attorney's fee for the respondent if the respondent prevails, and any reparation award on a counterclaim, with provision for waiver of bond by the CFTC if the complainant resides in a country which permits filing of complaints by a resident of the United States without bond. Under paragraph (g) of the new section, persons appealing from a reparation award would also be required to file bond, in double the amount of reparation "awarded against the appellant," for payment of the court's judgment, interest, costs, and a reasonable attorney fee for the appellee if the appellee prevails.

The section would become effective one year after enactment, but claims which had arisen within nine months before the effective date could be heard by the CFTC after such one year period.

Section 106 adds a new section to the Act, requiring the CFTC to consider "the public interest to be protected by the antitrust laws" as well as the policies and purposes of the Commodity Exchange Act, in issuing any order or adopting any rule or regulation, or requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association.

TITLE II -- REGULATION OF TRADING AND EXCHANGE ACTIVITIES

Section 201: The term "commodity" in the present Commodity Exchange Act covers certain specified agricultural commodities, futures trading in which was found by the Congress to be of definite value to the nation's commercial and agricultural life. The present Commodity Exchange Act provides for futures trading in such specified agricultural commodities if conducted in accordance with the Act on boards of trade designated as contract markets by the Secretary of Agriculture. Section 201 of the bill enlarges the definition of "commodity" to include all goods and articles, except onions, and "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in" and provides for the exclusive jurisdiction of the CFTC over all futures transactions and all cash transactions

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related thereto which are executed on not only domestic boards of trade but also "on any other board of trade, exchange, or market." Section 201 contains a proviso "that nothing herein contained shall supersede or limit the jurisdiction at any time conferred on the Securities Exchange Commission or other regulatory authorities under the laws of the United States or restrict [them] from carrying out their duties and responsibilities in accordance with the laws of the United States."

Section 202 adds to section 2(a) of the Act, definitions of the terms "commodity trading advisor" and "commodity pool operator." Such persons would be regulated under other sections of the bill. The term "commodity trading advisor" means any person who, for compensation or profit, engages in the business of advising others, either directly or through publications or writings, as to the value of commodities or as to the advisability of trading in any commodity for future delivery on or subject to the rules of any contract market, or who, for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning commodities. The term would not include any of the following, provided that their furnishing of such services is "solely incidental to the conduct of their business or profession:" "(1) any bank or trust company, (2) any newspaper reporter, newspaper columnist, newspaper editor, lawyer, accountant, or teacher, (3) any floor broker or futures commission merchant, (4) the publisher of any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation including their employees, (5) any contract market." The term "commodity pool operator" would mean "any person engaged in a business which is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market." The section would empower the CFTC to specify by rule, regulation, or order, persons not within the intent of the two definitions.

Section 203 adds a new section 4j to the Act which requires the CFTC to determine, after notice and opportunity for hearing, within six months after the effective date of the Commodity Futures Trading Commission Act of 1974 ("1974 Act"), and subsequently when it determines that changes are required, "whether or not a floor broker may trade for his own account or any account in which such broker has trading discretion, and also execute a customer's order;" if the CFTC determines that such trades and executions shall be permitted, it is required to determine the terms, conditions, and circumstances under which such trades and executions shall be conducted. The new section likewise requires the CFTC to determine, after notice and opportunity for hearing, within six months after the effective date of the 1974 Act, and subsequently when it determines that changes are required, "whether or not a futures commission merchant may trade for its own account or any proprietary account;" if the CFTC determines that such trades shall be permitted it is required to determine the terms, conditions, and circumstances under which such trades shall be conducted. Any such determination with respect to either floor brokers

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or futures commission merchants, would be required "at a minimum" to take into account the effect upon the liquidity of trading of each market. The CFTC would be permitted to make separate determinations for different contract markets, and contract markets would be permitted to set terms and conditions more restrictive than those set by the CFTC.

Section 204 adds a new section to the Act which requires registration of persons who would be associated with any futures commission merchant (or with any agent of a futures commission merchant) as a partner, officer, or employee (or any person occupying a similar status or performing similar functions), in any capacity which involves "(a) the solicitation or acceptance of customer's orders (other than in a clerical capacity) or (b) the supervision of any person or persons so engaged." The CFTC is authorized to require reporting by such persons. Such registration would expire two years after the effective date thereof and the CFTC is required to renew it on application unless it is under suspension or revocation; with respect to initial registrations, however, the CFTC is required to set the effective period, not to be more than 2 years or less than 1 year from the effective date thereof. The CFTC is authorized to "specify such terms and conditions as it deems appropriate to protect the public interest, wherein exception to a written proficiency examination incident to registration shall be afforded an individual who has demonstrated, through training and experience, a required degree of proficiency and skill to protect the interests of customers." (See analysis of section 206, below.) Persons already registered as futures commission merchants or floor brokers, would not be required to register as such associates.

Section 204 amends section 6(b) of the Act to provide specifically, and would amend section 8a of the Act to provide, that such associates would be subject to administrative disciplinary proceedings provided for in those sections of the Act, which are discussed in greater detail below, in the last two paragraphs on section 205 of the Bill.

Section 205 amends the Act by adding four new sections. New section 4l would constitute a finding that the activities of commodity trading advisors and commodity pool operators are affected with a national public interest in that, among other things --

- (1) their advice, counsel, publications, writings, analyses, and reports are furnished and distributed, and their contracts, solicitations, subscriptions, agreements, and other arrangements with clients take place and are negotiated and performed by the use of the mails and other means and instrumentalities of interstate commerce;
- (2) their advice, counsel, publications, writings, analyses, and reports customarily relate to and their operations are directed toward and cause the purchase and sale of commodities for future delivery on or subject to the rules of contract markets; and
- (3) the foregoing transactions occur in such volume as substantially to affect transactions on contract markets.

New section 4m requires registration by such persons, but would not apply to any commodity trading advisor who, during the course of the preceding twelve months, has not furnished commodity trading advice to more than 15 persons and who does not hold himself out generally to the public as a commodity trading advisor.

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New section 4n authorizes the CFTC to prescribe what information, and in what form and detail, such persons would have to supply in applying for the required registration. The section specifies the minimum information to be required:

(A) the name and form of organization, including capital structure, under which the applicant engages or intends to engage in business; the name of the State under the laws of which he is organized; the location of his principal business office and branch offices if any; the names and addresses of all "parties, officers, directors, and persons performing similar functions" or, if the applicant be an individual, his name and address; and the number of employees;

(B) the education, the business affiliations for the past ten years and the present business affiliations of the applicant and of his partners, officers, directors, and persons performing similar functions and of any controlling person thereof;

(C) the nature of the business of the applicant, including the manner of giving advice and rendering of analyses or reports;

(D) the nature and scope of the authority of the applicant with respect to clients' funds and accounts;

(E) the basis upon which the applicant is compensated.

Registration would be required to become effective no more than 30 days after application, unless denied as provided elsewhere in the Act.

New section 4n provides that registrations of commodity trading advisors and commodity pool operators would expire on the 30th day of June of each year, "and shall be renewed upon application therefor subject to the same requirements as in the case of an original application."

The CFTC is authorized to prescribe record keeping and reporting requirements for such persons, who would be required to keep the prescribed books and records for at least three years or longer if the CFTC so directs. The prescribed books and records would be required to be open to inspection by any representative of the CFTC or the Department of Justice. On request of the CFTC, every registered commodity trading advisor and commodity pool operator would be required to furnish the name and address of each client, subscriber, or participant, and submit samples or copies of all reports, letters, circulars, memoranda, publications, writings, or other literature or advice distributed to clients, subscribers, or participants, or prospective clients, subscribers, or participants.

Futures market positions taken or held by individual principals of commodity trading advisors and commodity pool operators, are required to be fully and completely disclosed to subscribers, clients or participants, unless otherwise authorized by the CFTC by rule or regulation.

Statements of account would be required to be furnished "regularly" to each participant in the operations of every commodity pool operator. Such statements would be required to include complete information as to the current status of all trading accounts in which the participant has an interest. The CFTC is empowered to prescribe the form and manner of such statements.

Denial without hearing, of registration as a commodity trading advisor or commodity pool operator, is authorized for any person who

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is subject to an outstanding order of the CFTC denying him trading privileges on any contract market, or suspending or revoking his registration as a commodity trading advisor, commodity pool operator, futures commission merchant, or floor broker, or suspending or expelling him from membership on any contract market.

Denial, revocation, or suspension, after hearing, of registration of any commodity trading advisor or commodity pool operator, is authorized if the CFTC finds that such denial, revocation, or suspension is in the public interest and that --

(A) the operations of such person disrupt or tend to disrupt orderly marketing conditions, or cause or tend to cause sudden or unreasonable fluctuations or unwarranted changes in the prices of commodities; or

(B) such person (or any partner, officer, director, person performing similar function, or controlling person thereof) -- (i) has been convicted within ten years of any felony or misdemeanor involving the purchase or sale of any commodity or security, or arising out of his conduct as a commodity trading advisor or commodity pool operator; or (ii) is under court injunction from acting as a commodity trading advisor, commodity pool operator, futures commission merchant,

or floor broker, or affiliated person or employee of any of them, or from engaging in or continuing any conduct or practice in connection with such activity or in connection with the purchase or sale of commodities or securities.

(C) any partner, officer, or director of such person, or any person performing a similar function or any controlling person thereof, is subject to a CFTC denial of trading privileges on any contract market, or a CFTC suspension or revocation of registration as a commodity trading advisor, commodity pool operator, futures commission merchant, or floor broker, or a CFTC suspension or expulsion from membership on any contract market.

New section 4o forbids registrants as commodity trading advisors or as commodity pool operators, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant, or to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant. Such registrants would also be forbidden to represent or imply that they have been sponsored, recommended, or approved, or that their abilities or qualifications have been passed upon, by the United States or any agency or officer thereof, but would be permitted to state that they are registered under this Act as commodity trading advisor or commodity pool operator, if such statement is true in fact and if the effect of such registration is not misrepresented.

Section 205 also amends section 6 (b) of the Act, specifically to provide that administrative disciplinary proceedings could be instituted and administrative disciplinary orders issued, against persons registered as commodity trading advisors and commodity pool operators. Section 6(b) of the Act now provides for such proceedings and orders for manipulation or attempt to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any contract market, or for wilfully making any false or misleading statement of a material fact in any registration application

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or any report filed under the Act, or for wilfully omitting to state in any such application or report any material fact which is required to be stated therein, or for otherwise violating any of the provisions of the Act or of the rules, regulations, or orders thereunder.

Section 205 also amends section 8a of the Act to make it apply to commodity trading advisors and commodity pool operators. Section 8a of the Act now authorizes the Secretary of Agriculture to register futures commission merchants and floor brokers upon application in accordance with rules and regulations and in form and manner to be prescribed by the Secretary. Section 8a also now authorizes the Secretary to refuse to register any person --

(A) if the prior registration of such person is under suspension or revocation;

(B) if it is found, after opportunity for hearing, that the applicant is unfit to engage in the business for which the application for registration is made, (i) because such applicant, or, if the applicant is a partnership, any general partner, or, if the applicant is a corporation, any officer or holder of more than ten per centum of the stock, at any time engaged in any practice of the character prohibited by the Act or was convicted of a felony in any State or federal court or was debarred by any agency of the United States from contracting with the United States, or the applicant wilfully made any material false or misleading statement in his application or wilfully omitted to state any material fact in connection with the application, or (ii) for other good cause shown.

Section 8a further provides for suspension or revocation of the registration of any person registered under the Act if cause exists under (B) above which would warrant a refusal of registration of such person.

Section 206 adds a new section to the Act to empower the CFTC to specify by rules and regulations appropriate standards with respect to training, experience, and other qualifications which the CFTC finds necessary or desirable to ensure the fitness of futures commission merchants, floor brokers, and persons associated with them. The CFTC is empowered to prescribe the adoption of written proficiency examinations to be given to applicants for registration as futures commission merchants, floor brokers, and persons associated with them, and to establish reasonable fees to be charged to such applicants to cover the administration of such examinations. The CFTC would be empowered further to prescribe that in lieu of examinations administered by the CFTC, registered futures associations (see Title III of the Bill, discussed below herein) may adopt written proficiency examinations to be given to such applicants and charge reasonable fees to such applicants to cover the administration of such examinations.

Section 207 amends section 5 of the Act, the conditions and requirements for designation of a board of trade as a "contract market," by adding a new subsection specifically requiring a board of trade, before designation, to demon-

strate that the prices involved in transactions for future delivery in the commodity for which such designation is sought, are, or reasonably can be expected to be, generally quoted and disseminated as a basis for determining prices to producers, merchants, or consumers of such commodity or the products or by-products thereof or that such transactions are, or reasonably can be expected

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to be, utilized by producers, merchants, or consumers engaged in handling such commodity or the products or by-products thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price.

Section 208 amends section 5a of the Act, which imposes certain requirements on each contract market, to add a new subsection specifically requiring each contract market to permit the delivery of any commodity, on futures contracts, of such grade or grades, at such point or points and at such quality and locational price differentials as will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce. The new subsection would also require the CFTC, if after investigation it finds that the rules and regulations adopted by a contract market permitting delivery of any commodity on futures contracts, do not accomplish the objectives of the subsection, to notify the contract market of its finding and afford the contract market an opportunity to make appropriate changes in such rules and regulations. If the contract market within 60 days of such notification fails to make the changes which in the opinion of the CFTC are necessary to accomplish the objectives of the subsection, then the CFTC is empowered to change or supplement such rules and regulations to achieve such objectives, after granting the contract market an opportunity to be heard. Any order issued under the subsection would not apply to contracts of sale for future delivery in any months in which contracts are currently outstanding and open. The new subsection would also provide that no requirement for an additional delivery point or points shall be promulgated following hearings until the contract market affected has had notice and opportunity to file exceptions to the proposed order determining the location and number of such delivery point or points.

Section 209 also amends section 5a of the Act, by adding a new subsection. This new subsection requires each contract market to "provide a fair and equitable procedure through arbitration or otherwise for the settlement of customer's [but not futures commission merchants' or floor brokers'] claims and grievances against any member or employee thereof." The use of such procedure by a customer would be required to be voluntary. The procedure would not be applicable to any claim in excess of \$ 5,000. The procedure would not result in any compulsory payment except as agreed upon between the parties.

Section 210 also amends section 5a of the Act by adding a new subsection. This new subsection requires each contract market to submit to the CFTC for its approval all by-laws, rules, regulations, and resolutions made or issued by it, or by the governing board thereof or any committee thereof which relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relate to other trading requirements except those relating to the setting of levels of margin. The CFTC would be required to approve such by-laws, rules, regulations, and resolutions upon a determination that they are not in violation of the provisions of the Act or the regulations of the CFTC. Thereafter the CFTC is required to disapprove, after appropriate notice and opportunity for hearing, any . . . bylaw, rule, regulation, or resolution which the [CFTC]

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finds at any time is in violation of the provisions of this Act or the regulation of the [CFTC]."

Section 211 amends the Act by adding a new section, to provide for restraining orders, injunctions, writs of mandamus, or orders affording like relief, but not *ex parte*. The new section provides that whenever it shall appear to the CFTC that any contract market or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of the Act or any rule, regulation, or order thereunder, or is in a position to effectuate a "squeeze" or corner or otherwise restrain trading in any commodity for future delivery, the CFTC is permitted to notify the Attorney General, and the Attorney General is permitted to bring a court action to enjoin such act or practice, or to enjoin the continued maintenance of such a position, or to enforce compliance with the Act, or any rule, regulation or order thereunder. United States District Courts, and United States Courts of territories and other places subject to the jurisdiction of the United States, would be given jurisdiction to entertain such actions, and jurisdiction to issue writs of mandamus, or orders affording like relief, commanding any person to comply with the provisions of the Act

or any rule, regulation, or order of the CFTC thereunder, including the requirement that such person take such action as is necessary to remove the danger of violation of the Act or any such rule, regulation, or order. Any action under the section could be brought in the district wherein the defendant is found or is an inhabitant or transacts business or in the district where the act or practice occurred, is occurring, or is about to occur, or where such position is maintained, and process in such cases could be served in any district in which the defendant is an inhabitant or wherever the defendant could be found.

Section 212 amends section 6 of the Act, which provides, among other things, for administrative disciplinary proceedings for violations of the Act, or of the rules, regulations, or orders thereunder. The CFTC is authorized to assess civil penalties of not more than \$ 100,000 for each such violation. Appeals to United States Courts of Appeal, from administrative disciplinary orders, are required to be filed within 15 days after the notice of such an order is given to the offending person.

A new paragraph is added to section 6 of the Act, requiring the CFTC to consider certain facts in addition to the gravity of the violation in determining the amount of the money penalty assessed. In the case of a person whose primary business involves the use of the commodity futures market, the CFTC is required to consider the appropriateness of such penalty to "the size of the business of the person charged and the extent of such person's ability to continue in business." In the case of a person whose primary business does not involve the use of the commodity futures market, the CFTC would be required to consider the appropriateness of the penalty to "the net worth of the person charged." If a civil penalty is not paid, the CFTC is required to refer the matter to the Attorney General, who would be required to recover the penalty by court action.

Section 212 also amends section 6b of the Act, which now provides for orders to contract markets, directors, officers, agents, and employees thereof to cease and desist from violations of the Act, the rules, regulations, and order thereunder. Civil penalties of not more

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than \$ 100,000 for each violation, are provided for. Such penalties would be collected by the Attorney General by court action, upon referral by the CFTC. In determining the amount of such a money penalty assessed under section 6b, the CFTC is required to consider the appropriateness of the penalty to "the net worth of the offending person and the gravity of the offense," and in the case of a contract market, the CFTC would be required further to consider whether the amount of the penalty "will materially impair the contract market's ability to carry on its operations and duties."

Section 212 also amends section 6(c) of the Act, which provides for orders to "any person (other than a contract market)" to cease and desist from violating the Act, regulations, or orders thereunder. The fine for violating such a cease and desist order would be changed from "not less than \$ 500 nor more than \$ 10,000" to "not more than \$ 100,000." Section 212 also amends section 9 of the Act by changing from \$ 10,000 to \$ 100,000 the maximum fine for the criminal offenses provided in the three subsections of section 9.

Section 213 adds a new subsection to section 8a of the Act to give the CFTC specific authority to alter or supplement the rules of a contract market insofar as necessary or appropriate by rule or regulation or by order. Before taking such action, the CFTC is required first to make an appropriate request in writing to the contract market that it effect on its own behalf specified changes in its rules and practices. The CFTC could then so alter or supplement such rules if after appropriate notice and opportunity for hearing the CFTC determined that the contract market had not made the changes so required and that such changes were necessary or appropriate for the protection of persons producing, handling, processing, or consuming any commodity traded for future delivery on the contract market, or the product or by-product thereof, or for the protection of traders or to ensure fair dealing in commodities traded for future delivery on the contract market. The CFTC could so alter or supplement such rules with respect to such matters as: contract terms and conditions; the form and manner of execution of contracts; other trading requirements except levels of margin; safeguards with respect to the financial responsibility of members; the manner, method and place of soliciting business, including the content of such solicitations; and the form and manner of handling, recording, and accounting for customers' orders, transactions, and accounts.

Section 214 also adds a new subsection to section 8a of the Act to authorize the CFTC to make and promulgate such rules and regulations with respect to those registrants under the Act who are not members of a contract market, "as in the judgment of the [CFTC] are reasonably necessary to protect the public interest and promote just and equitable

principles of trade, including but not limited to the manner, method and place of soliciting business, including the content of such solicitation."

Section 215 also adds a new subsection to section 8a of the Act (which is 7 *U.S.C. 12a*) to give specific authority to the CFTC to direct any contract market, "whenever [the CFTC] has reason to believe that the amount of deliverable supplies, the number of open contracts, the relative size of individual traders' positions, the amount and direction of price movements in cash and futures markets, the impact of government

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edicts and regulations, the existence of a market emergency, or any other such market factor creates a condition which threatens orderly trading in, or liquidation of, any futures contract, to take such action as in the [judgment of the CFTC] is necessary to maintain or restore orderly trading in, or liquidation of, any futures contract." Examples of such actions are: limiting trading to liquidation only; extending the expiration date of futures contracts; extending the time for making deliveries in fulfillment of futures contracts; ordering liquidation of futures contracts under such terms as the CFTC deems necessary; suspending trading; ordering the fixing of settlement prices for the liquidation of futures contracts; and "any other action necessary to prevent significant intervention or manipulation by a foreign, government." It is further provided that the term "market emergency" shall be defined to mean significant intervention of foreign governments in the futures market, war, or other national emergency, price controls, export embargoes, or any other significant disruption of normal commercial processes which can reasonably be deemed to affect futures transactions. It is further provided in section 215 of the bill that nothing therein shall be deemed to limit the meaning or interpretation given by a contract market to the terms "market emergency", "emergency" or equivalent language in its own by-laws, rules, regulations, or resolutions.

TITLE III -- ENABLING AUTHORITY FOR CREATION OF NATIONAL FUTURES ASSOCIATIONS

This title adds a new section to the Act to provide that the CFTC may register any association of persons as a registered futures association when it meets certain specified requirements and conditions. Persons eligible for membership in such an association could be comprised of registrants under the Act, contract markets and any other persons found eligible by the CFTC. Each applicant association would be required to file with the CFTC for review and approval a registration statement, in such form as the CFTC would prescribe, together with specified documentary materials. No applicant association would be eligible for registration as a futures association unless the CFTC finds, among other things, that such association is in the public interest and meets certain fitness standards and that its rules meet specified terms and conditions relating to such matters as membership, suspension and expulsion of members, conduct of members and arbitration procedures. The rules of the applicant association must, among other things, be designed to promote just and equitable principles of trade and "provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules." The CFTC would be authorized to take such actions as: to revoke or suspend the registration of any futures association for failure to maintain its rules in conformity with the Act or other violation thereof; to set aside disciplinary action taken by a registered futures association against a member; to abrogate, alter, or suspend the rules of any registered futures association; to suspend or expel from a registered futures association any member or bar any person from being associated

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with a member if the CFTC finds that such member or person violated the Act.

There would be two stated inducements for belonging to a registered futures association: Each registrant not a member of such an association would (1) be required to pay such fees and charges as the CFTC would establish, "to defray the costs of additional regulatory duties required to be performed by the [CFTC] because such person is not a member of a registered futures association," and (2) be subject not only to the obligations and requirements of the Act imposed on other persons but such other requirements and obligations as the CFTC found necessary "to protect the public interest and promote just and equitable principles of trade."

TITLE IV -- MISCELLANEOUS PROVISIONS

Section 401 adds new subsections to section 9 of the Act to make it a felony punishable by a fine of not more than \$ 10,000 or imprisonment for not more than five years, or both, for any Commissioner of the CFTC or any employee or

agent thereof, to participate, directly or indirectly, in any commodity futures or option transaction or in any transaction in an actual commodity except that the prohibition against any transaction in an actual commodity would not apply to a transaction in which the person sells an agricultural commodity which he has produced in connection with his own farming or ranching operations nor to any transaction in which he sells livestock which he has owned at least three months. With respect to such excepted transactions, however, it is provided that the CFTC shall require the person who participates therein to notify the CFTC of such transactions in accordance with such regulations as the CFTC shall prescribe and that the CFTC shall make such information available to the public. It would also be a felony punishable by a fine of not more than \$ 10,000 or imprisonment for not more than five years, or both, for any Commissioner of the CFTC or any employee or agent thereof who, by virtue of his employment or position, acquires information which may affect or tend to affect the price of any commodity futures or actual commodity and which information has not been made public, to impart such information with intent to assist another person, directly or indirectly, to participate in any commodity futures or option transaction or in any transaction in an actual commodity.

Section 402 amends section 4c of the Act to continue the ban now contained in section 4c of the Act on trading in options (privileges, indemnities, bids, offers, puts, calls, advanced guaranties, and decline guaranties) in the now-regulated commodities, but would permit trading in options in all other commodities if not done "contrary to any rule, regulation, or order of the [CFTC] prohibiting any such transaction or allowing any such transaction under such terms and conditions as the [CFTC] may prescribe." It further provides that the CFTC could promulgate such an order, rule or regulation, "only after notice and opportunity for hearing" and that the CFTC "may set different terms and conditions for different markets."

Section 403 amends section 4a(1) of the Act to authorize the CFTC, in fixing trading and position limits, to exempt "arbitrage" transactions, and defines the word "arbitrage" as meaning the same as a "spread" or "straddle".

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Section 404 amends section 4a(3) and (4) of the Act to delete the definition of "bona fide hedging transactions" now contained in the Act and allow the CFTC to define that term "by order consistent with the purposes of this Act." It would be further provided that until the CFTC issues regulations defining what constitutes bona fide hedging transactions and positions under the Act and such regulations are in full force and effect, such terms would continue to be defined as set forth in the Act prior to its amendment by the 1974 Act.

Section 405 amends section 4b of the Act by deleting the word "cotton" where it appears in the last full paragraph of that section and inserting in place thereof the word "commodity". In pertinent part, section 4b of the Act now provides that nothing in the Act "shall be construed to prevent a futures commission merchant or floor broker who shall in hand, simultaneously, buying and selling orders at the market for different principals for a like quantity of cotton for future delivery in the same month, from executing such buying and selling orders at the market price" if such execution takes place on the floor of the exchange by open outcry and is duly reported, recorded, and cleared in the same manner as other orders executed on the exchange. Section 450 of the bill further amends section 4b of the Act to provide with respect to such transactions that they "shall be made in accordance with such rules and regulations as the [CFTC] may promulgate regarding the manner of the execution of such transactions."

Section 406 amends section 5a(6) of the Act by deleting the semicolon at the end thereof and adding the words "and adopted by the Commission." Section 5a(6) now provides that each contract market shall require that the futures contracts made thereon provide for the delivery of commodities conforming to United States standards if such standards have been officially promulgated. Under the amendment proposed by section 406 of the bill, the delivery of commodities conforming to official United States standards would be required if such standards were adopted by the CFTC.

Section 407 amends section 5a(8) of the Act by deleting the words "not been disapproved by the Secretary of Agriculture pursuant to paragraph (7) of section 8a", and inserting in place thereof the words "been approved by the Commission pursuant to paragraph (12) of section 5a", and by deleting the word "so" and inserting the words "by the Commission" immediately before the semicolon at the end of such section. Section 5a(8) of the Act now requires each contract market to enforce all bylaws, rules, regulations, and resolutions, made or issued by it or by the governing board thereof or any committee, which relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relate to other trading requirements and which have not been disapproved by the Secretary of Agriculture pursuant to section 8a(7) of the Act and to revoke and not enforce any such bylaw, rule, regulation, or resolution, made, issued, or proposed by it or by the governing board thereof or any committee, which has been so disapproved. Under section 407 of the bill each contract market is required to enforce all such bylaws, rules, regula-

tions and resolutions which have been approved by the CFTC and to revoke and not enforce any such bylaw, rule, regulation, or resolution, which has been disapproved by the CFTC.

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Section 408 amends section 6(b) of the Act by striking the word "referee" wherever it appears therein and inserting in place thereof the words "Administrative Law Judge".

Section 409 references new provisions of the bill in section 9(c) of the Act establishing criminal penalties. Under section 409 of the bill criminal sanctions are applicable to failure to register commodity trading advisors, commodity pool operators and persons associated with futures commission merchants or with any agents thereof, and to acts of fraud or deceit by commodity trading advisors and commodity pool operators.

Section 410 authorizes the CFTC to "place an additional twenty positions in GS-16, GS-17, and GS-18 for purposes of carrying out its functions."

Section 411 provides that all operations of the Commodity Exchange Commission and of the Secretary of Agriculture under the Commodity Exchange Act, including all pending administrative proceedings, shall be transferred to the CFTC as of the effective date of the 1974 Act and continue to completion, and that all rules, regulations, and orders previously issued by the Commodity Exchange Commission and by the Secretary of Agriculture under the Act to the extent not inconsistent with the provisions, of the 1974 Act shall continue in full force and effect unless and until terminated, modified, or suspended by the CFTC.

Section 412 provides that pending proceedings under existing law shall not be abated by reason of any provision of the 1974 Act but shall be disposed of pursuant to the applicable provisions of the Act, as amended, in effect prior to the effective date of the 1974 Act.

Section 413 is a "saving clause" and provides that if any provision of the 1974 Act or the application thereof is held invalid, the validity of the remainder of the 1974 Act and the application of such provision to other persons or circumstances shall not be affected thereby and that the provisions of the section, if any, of the Commodity Exchange Act, as amended, which is amended by provision of the 1974 Act shall apply to such person or circumstances.

Section 414 provides that the 1974 Act shall become effective 180 days after enactment, that activities necessary to implement the change effected by that Act may be carried out after the date of enactment and before as well as after the effective date, and that such activities may include, but not be limited to, appointment of the members of the CFTC, designation of boards of trade as contract markets, registration of futures commission merchants, floor brokers, and other persons required to be registered, and approval or modification of bylaws, rules, regulations, and resolutions of contract markets.

COMMITTEE INTENT

Commission Structure (Sections 101,102 and 103)

1. The Committee intends that other agencies of the Federal Government give maximum cooperation to the proposed Commodity Futures Trading Commission in its organizational stages, as well as in its subsequent activities.

2. Of particular importance is the Commission's relationship with the Civil Service Commission. The Committee intends that in providing

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adequate staffing levels and grades, the Commission give appropriate cognizance to the complex nature of the industry being regulated, and past criticisms of the ability of the Commodity Exchange Authority to attract and retain adequate personnel to perform its functions under law.

3. Section 101 (b) of H.R. 11955 provided as follows:

"(b) The Commission shall appoint an Executive Director at executive level V and a Commission Secretary at GS-16, an Associate Executive Director and a General Counsel at GS-18."

Certain parts of this language were subsequently deleted or amended in H.R. 13113 at the request of the Chairman of the Post Office Committee and in an attempt to insure that the language would adequately reflect the relationship between the principal appointees of the Commodity Futures Trading Commission and the Commission structure. It was brought to the Committee's attention by the Chairman of the Post Office and Civil Service Commission that fixing grades, as provided in the quoted subparagraph, could have the effect of precluding the consideration of desired personnel by the Commission under the so-called "Whitten rule" because of a lower grade level of the individual under consideration. The Committee intends that notice be given to what the Committee feels are appropriate levels for the position of General Counsel and Commission Secretary, and that such changes were made for the purposes described here. The Committee also assumes that the position of Executive Director will be provided at the level of GS-18, subject to the considerations mentioned here.

4. The Committee views the relationship of the Commodity Futures Trading Commission as one of complete independence from the Department of Agriculture with regard to policy, budget, staffing (including legal) and enforcement activities. The Committee reiterates that the Commission budget is not to be subjected to any substantive change or administrative delay by the Department of Agriculture in performance of the ministerial duty of forwarding such budget request together with that of the Department of Agriculture. The Committee is sure that the Department will cooperate freely with the Commission to carry out its mandate and assist the Commission freely upon Commission request.

5. The Committee intends that the vital interests of farmers and producers of agricultural commodities not be ignored by the Commission in the regulatory process.

6. The Committee believes that the President should consider all qualified persons in selecting Commissioners for nomination that come to his attention including farmers and producers of agricultural commodities.

7. To the extent practicable, the Committee feels that organization of the Commodities Futures Trading Commission should be implemented in accordance with the following suggested timetable and organizational chart:

I. Within sixty days after the bill is signed by the President:

Four public members should have been appointed, confirmed, and authorized to perform such functions as selecting key personnel, establishing organizational structure and any other actions needed to insure an orderly transfer of functions and responsibilities from the CEA to the CFTC.

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II. Within ninety days after the bill is signed by the President, the Commission should:

1. Appoint Executive Director, Associate Executive Director and General Counsel.
2. Appoint Secretary to the Commission and such stenographic and clerical help as needed by the Commissioners.
3. Approve a basic organizational structure for the Commission (headquarters and regional offices).
4. Develop request for supplemental appropriations to implement new legislation.
5. Begin recruiting and training the additional people needed to administer the new law. It is particularly crucial to hire sufficient experts in the new commodities and futures contracts with which CEA has no prior experience.
6. Obtain any additional office space and equipment.
7. Begin developing rules and regulations regarding new categories of registrants.

III. Within 120-180 days, the Commission should:

1. Begin accepting and processing new applications for --
 - (a) Designation as a contract market
 - (b) Registration as futures commission merchants
 - (c) Registration as floor brokers
 - (d) Registration as registered commodity representatives (RCR's)
 - (e) Registration of commodity advisors and commodity pool operators

2. Help contract markets make preparations for issuing the daily release on volume of trading and open interest in accordance with CFTC standards on the day the new commodities come under regulation.

3. Establish reporting levels for all new commodity futures contracts.

4. Prepare forms for reports on new commodity futures contracts.

5. Assign a numbering system to cover the new commodity futures contracts.

6. Be prepared to perform audits of firms applying for status as FCM's to determine whether they meet the minimum financial requirements.

7. Begin educational program for new registrants on recordkeeping requirements, segregated bank accounts, time-stamping of orders and other requirements relative to trading and compliance with the Act, rules and regulations.

8. Educate traders of new commodities on reporting requirements.

9. Develop any needed computer programs.

10. Begin developing rules and regulations regarding new authorities other than registrations.

The Committee's goal in providing authority to begin necessary preliminary work before the new law takes complete effect is to have the commodity futures trading commission organized and fully manned with new employees, and registrants and exchanges informed and trained of their responsibilities so the new commodities and responsibilities

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can be effectively regulated the day the law becomes fully effective, 180 days after enactment. The following chart represents the Committee's concept of the organizational structure of the new Commission.

Proposed Organizational Chart

for

New Commodity Futures Trading Commission

Reparation Procedure (Section 105)

This section establishes a formal complaint procedure before the Commission for the adjudication of grievances which result from violations of the Act. It is primarily intended as a forum for aggrieved customers of persons registered under the Act under Sections 4d, 4e, 4k, or 4m. Contract markets are not intended to be included since they are not "persons registered under the Act". The procedure is also intended as a separate remedy designed to supplement the informal "settlement procedures" contemplated of the contract markets and registered futures associations which are required under other sections of the legislation (H.R. 13113, Sections 209 and 301). The Committee expects the Commission to publish regulations, commensurate with these related provisions of the Act, to implement and coordinate these three types of grievance proceedings and their utilization and availability for resolution of disputes. It is the intent of the Committee that those complaints which can be resolved informally and settled without a formal proceeding through the mechanism contemplated of the contract market or a registered futures association should be encouraged to be resolved in such manner.

The Committee delayed the effective date of this section for one year after enactment to permit the Commission to become fully organized and operational before being required to adjudicate claims. However, all complaints arising from violations which occur within nine months prior to its implementation will be subject to filing after the one year period and be adjudicated by the Commission.

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Counterclaims will be recognized in the proceedings but on such terms and under such circumstances as the Commission may prescribe by regulation. It is the intent of the Committee that the Commission will promulgate appropriate regulations to implement this section.

Commission Considerations (Section 106)

Section 106 of H.R. 11955 provided a new subsection 1(a) of the Act as follows:

"(a) Notwithstanding any other provision of law, a contract market, registered futures association established pursuant to section 15 of the Act, or person registered under the provisions of this Act who is acting pursuant to and in accordance with any order, rule, or regulation of the Commission or any bylaw, rule, or regulation of a contract market which has been required or specifically approved by the Commission as provided in this Act, shall be exempt from the antitrust laws of the United States as defined in *section 12 of title 15 of the United States Code*, and amendments and Acts supplementary thereto."

Subsequently, the Justice Department objected to this provision in a letter addressed to the Chairman, as follows:

DEPARTMENT OF JUSTICE,
Washington, D.C., January 30, 1974.

Hon. W. R. POAGE,
Chairman, Committee on Agriculture, House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: I would like to take this opportunity to comment on certain aspects of H.R. 11955, a bill to "amend the Commodity Exchange Act to strengthen the regulation of futures trading, to bring all agriculture and other commodities traded on exchanges under regulation, and for other purposes."

1. The Proposed Antitrust Exemption

Section 106 of H.R. 11955 would provide an exemption from the antitrust laws in the following terms:

(a) Notwithstanding any other provision of law, a contract market, registered futures association established pursuant to section 15 of this Act, or person registered under the provisions of this Act who is acting pursuant to and in accordance with any order, rule, or regulation of the Commission or any bylaw, rule, or regulation of a contract market which has been required or specifically approved by the Commission as provided in this Act, shall be exempt from the antitrust laws of the United States as defined in *section 12 of title 15 of the United States Code*, and amendments and Acts supplementary thereto.

(b) The Commission shall take into consideration the public interest to be protected by the antitrust laws as well as the policies and purposes of this Act in issuing any order or adopting any rule or regulation, or in requiring or approving any bylaw, rule or regulation of a contract market or registered futures association established pursuant to section 15 of this Act.

We think this exemption is unwise from the standpoint of public policy and unnecessary because present law provides an adequate antitrust

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exemption for those activities of contract markets necessary to achieve valid objectives of the Commodity Exchange Act.

Under existing law, the conduct of exchanges or their members which is *mandated* by the Commodity Exchange Commission would be exempt from the antitrust laws. The antitrust laws have long recognized a distinction between voluntary business conduct, and conduct mandated by affirmative action of a regulatory agency. The latter is not private volitional action which would subject, an exchange or its members to antitrust liability. See, e.g., *Olson v. Smith*, 195 U.S. 332 (1904); *United States v. Rock Royal Co-op*, 307 U.S. 533 (1939); *Parker v. Brown*, 317 U.S. 341 (1943). The only manner in which the validity of agency mandated conduct can be challenged is by seeking judicial review of the *agency's* action. Thus, there is no need for a legislative antitrust exemption for exchange rules or conduct mandated by the Commodity Exchange Commission.

Under existing law, activities of regulated exchanges approved, as distinguished from mandated, by a regulatory agency, are also exempt from the antitrust laws if they are "necessary to make the . . . [regulatory act] work" and no more restrictive than necessary. *Silver v. New York Stock Exchange*, 373 U.S. 341, 357 (1963). Thus existing law assures the exchanges that, where there is a conflict between the antitrust laws and the Commodity Exchange Act, the latter is paramount, but, where there is no conflict, the antitrust laws are fully applicable. Section 106 of H.R. 11955,

however, would permit exchanges to violate the antitrust laws, by establishing anticompetitive rules and regulations which are not necessary to fulfill any purpose of the Commodity Exchange Act, but which have nevertheless been approved by the Commission under Section 210 of the proposed bill simply because they do not violate the Commodity Exchange Act. We think such a result would be contrary to the public interest and therefore strongly urge that Section 106 be deleted from the bill.

The rationale for refusing to grant blanket antitrust immunity to exchanges in *Silver* was explained by the Supreme Court as follows (373 U.S. at 359-60):

Since the antitrust laws serve, among other things, to protect competitive freedom, i.e., the freedom of individual business units to compete unhindered by the group action of others, it follows that the antitrust laws are peculiarly appropriate as a check upon anticompetitive acts of exchanges which conflict with their duty to keep their operations and those of their members honest and viable. Applicability of the antitrust laws, therefore, rests on the need for vindication of their positive aim of insuring competitive freedom. Denial of their applicability would defeat the congressional policy reflected in the antitrust laws without serving the policy of the [regulatory] Act.

The "necessity" test of *Silver* applies where the regulatory agency reviews the rules of a self-regulatory organization, *Thill Securities v. NYSE*, 433 F.2d 264, (7th Cir. 1970) *cert. den.* 401 U.S. 994 (1971); *Harwell v. Growth Programs, Inc.*, 451 F.2d 240, 247 (6th Cir. 1971) *rehearing den.*, 459 F.2d 461 (1972), *cert. den.* 409 U.S. 876 (1972); and it also applies to commodity as well as securities exchanges. *Ricci v. Chicago Mercantile Exchange*, 409 U.S. 289 (1973); *Chicago*

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Mercantile Exchange v. Deaktor, _____ U.S. _____ 42 U.W.L.W. 3390 (December 3, 1973).

We think the standards formulated in the above cases represent a sound resolution of the possible conflicts between the antitrust laws and a regulatory statute such as the Commodity Exchange Act. Blanket antitrust immunity for all Commission approved rules of a commodity exchange regardless of whether they are necessary to achieve a regulatory objective, the approach taken in H.R. 11955, would serve to defeat antitrust policy without furthering the objectives of the Commodity Exchange Act. It is far preferable for any exemption to be limited to those activities truly necessary to achieve a goal of the Commodity Exchange Act; and such an exemption is already afforded under the *Silver* rule.

Of course, it is our position that an agency can only mandate or approve private conduct which would violate the antitrust laws if the mandated or approved conduct is necessary to achieve a goal of regulatory statute. This follows from the rationale of *Silver*. We note that Section 106 (b) of H.R. 11955 would require the Commodity Exchange Commission only to "take into consideration" the public interest to be protected by the antitrust laws in approving or requiring any exchange rule. Such a requirement has already been imposed by the Courts on regulatory agencies, see, e.g., *FMC v. Aktiebolaget Svenska Amerika Linien*, 390 U.S. 233 (1968); *Northern Natural Gas v. FPC*, 399 F.2d 953 (D.C. Cir. 1968), and thus Section 106 (b) would not appear to add anything to existing law. Moreover, a requirement merely to "take into consideration" antitrust policy might result in agency imposition or approval of an anticompetitive rule which was not necessary to achieve a valid regulatory objective. For example, the Commission might conclude that a rule was *appropriate* under the regulatory statute even considering antitrust policy, even if the rule was not the least restrictive means *necessary* to effectuate a regulatory objective. In such a case, the Commission's rule could impose an unreasonable restriction on exchange members and unnecessarily deprive the public of the benefits of competition. See *United States v. Third National Bank in Nashville*, 390 U.S. 171, 189 (1968). For this reason, we submit that the existing rule of law is clearly superior to the standard which would be adopted under section 106(b).

Our position with respect to broadening the antitrust exemption for commodities exchanges is identical to the position we have publicly stated with respect to antitrust exemptions for securities exchanges. In many respects, the functions of the two types of self-regulatory bodies are similar, although they operate under different statutes. Subcommittees of both the House and Senate have recently made extensive studies of whether there is a need for additional antitrust exemption for securities exchanges and have concluded that no change in the judicially created immunity is warranted. *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce*, pp. XVII, 160-161 (1972); *Securities Industry Study, Report of the Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs*, 93rd Cong., 1st Sess., pp. 19-21, 219-240 (1973). We believe that the rationale of these reports is fully applicable to the commodities industry and that no change in the existing antitrust exemption for commodities exchanges would be appropriate.

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Of course, in any antitrust challenge to an exchange rule approved by the Commission, the Commission could be called upon to provide its expert views to the antitrust District Court on the possible effects of eliminating the rule. Indeed, in our pending antitrust action against the Chicago Board of Trade for fixing minimum rates of brokerage commissions,ⁿ¹ we recommended that the Administrator of the Commodity Exchange Authority report to the Court on the probable effects of competitive commission rates on commodity exchanges and urged that his report be accorded substantial weight. The Administrator accepted the District Court's invitation, solicited views from interested parties, and filed a comprehensive report concluding that competitive commission rates would benefit commodity traders without adversely affecting the markets. Similar procedures could be employed in all cases involving substantial issues of reconciling the Commodity Exchange Act and the antitrust laws. Indeed, in situations where the challenged activity is alleged to violate the Commodity Exchange Act as well as the antitrust laws, the Supreme Court has required initial resort to the regulatory agency for its views, with final authority to decide the antitrust issues remaining in the District Court. *Ricci v. Chicago Mercantile Exchange*, 409 U.S. 289 (1973); *Chicago Mercantile Exchange v. Deaktor*, -- U.S. --, 42 U.S.L.W. 3330 (December 3, 1973). In this manner, the District Courts, which are the "repository of antitrust expertise,"ⁿ² decide the antitrust case assisted by the expert advice of the administrative agency on the regulatory issues. Such a procedure is most likely to result in sound accommodations between the antitrust laws and the Commodity Exchange Act in the future and we see no compelling reason for its alteration.

ⁿ¹ *United States v. Board of Trade of the City of Chicago*, No. 71 C 2875 (N.D. Ill.).

ⁿ² *Thill Securities v. NYSE*, *supra*.

2. The Standards for Approving Exchange Rules

Since the standards for approving exchange rules are intimately related to the antitrust exemption, we would also like to comment on the different standards for reviewing exchange rules set out in Sections 210 and 213 of H.R. 11955. Section 210, which requires submission of certain exchange rules to the Commission, requires the Commission to approve any rule which is "not in violation of the provisions of this Act or the regulations of the Commission." Section 213, on the other hand, spells out the criteria to be used by the Commission where it seeks to alter or supplement exchange rules. The Commission may change exchange rules, after notice and hearing, if the Commission finds that changes in the rules are "necessary or appropriate for the protection of persons producing, handling, processing, or consuming any commodity traded for future delivery on such contract market, or the product or byproduct thereof, or for the protection of traders or to insure fair dealing in commodities traded for future delivery on such contract market." This standard, which appears to be based on similar language in Section 19 (b) of the Securities Exchange Act³

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creates specific public interest criteria to guide the Commission, and, in our opinion, is preferable to Section 210. By specifically stating the Congressional policy goals underlying the Commodity Exchange Act, language such as that used in Section 213 will better assist both the Commission and the courts in their efforts to determine whether particular rules actually involve a conflict between the Commodity Exchange Act and the antitrust laws.

ⁿ³ *15 U.S.C. § 78s*. The cumbersome procedures of this section have been severely criticized by the Securities and Exchange Commission and a Congressional subcommittee. *House Securities Industry Report*, *supra*, p. 108-110. Recent bills in both Houses would substantially revise Section 19(b). See H.R. 5050, S. 2519, 93rd Cong., 1st Sess. In view of this, we question whether it is wise to adopt the procedures of § 19(b).

We also note that the types of exchange rules over which the Commission has approval authority under Section 210 are different from the types of rules which it can alter or supplement under Section 213. The Commission's authority should be made uniform with respect to the type of exchange rule over which it has plenary authority.

The Commission is specifically prohibited from exercising any authority over margin requirement fixed by exchange rule. Sections 210 and 213. While the fixing of minimum margin requirements by an exchange may be reasonable as a matter of antitrust law if done for appropriate reasons, it would appear to be potentially too powerful an economic weapon to be left solely to concerted exchange member discretion without some regulatory oversight. We

realize that proposals to provide agency control over margin requirements has evoked considerable opposition from commodity exchanges in the past, but we seriously question whether a regulatory agency can adequately police undue speculative activity without some input into the margin equation. Careful consideration should be given to this issue.

The Office of Management and Budget has advised that there is no objection to the submission of this report from the standpoint of the Administration's program.

We would appreciate any consideration you are able to give to these comments. Should you desire further amplification of these views, we would be happy to testify at some time in the future.

Sincerely,

MALCOLM D. HAWK,
Acting Assistant Attorney General.

In its later decision to delete the proposed section 17(a) language, the Committee placed great reliance on the following statement by the Justice Department:

". . . We think this exemption is . . . unnecessary because present law provides an adequate antitrust exemption for those activities of contract markets necessary to achieve valid objectives of the Commodity Exchange Act.

"Under existing law, the conduct of exchanges or their members which is *mandated* by the Commodity Exchange Commission would be exempt from the antitrust laws. The antitrust laws have long recognized a distinction between voluntary business conduct and conduct mandated by affirmative action of a regulatory agency. The latter is not private volitional action which would subject an exchange or its members to antitrust liability. See, e.g., *Olson v. Smith*, 195 U.S. 332 (1904); *United States v. Rock Royal Co-op*, 307 U.S. 533 (1939); *Parker v. Brown*, 317 U.S. 341 (1943). The only manner in which the

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validity of agency mandated conduct can be challenged is by seeking judicial review of the *agency's* action. Thus, there is no need for a legislative antitrust exemption for exchange rules or conduct mandated by the Commodity Exchange Commission.

"Under existing law, activities of regulated exchanges approved, as distinguished from mandated, by regulatory agency, are also exempt from the antitrust laws if they are 'necessary to make the . . . (regulatory act) work' and no more restrictive than necessary, *Silver v. New York Stock Exchange*, 373 U.S. 341, 357 (1963)."

In light of this authoritative description of antitrust considerations of regulation, and the possible limiting effect of an amended stated exemption then being considered by the Committee, the Committee deleted the proposed new section 17 (a).

In retaining 17 (b) (now section 106 of the bill) the Committee intends that the new Commission consider antitrust policy when considering the issuance of any order, or adopting any Commission rule or regulation, or reviewing, approving (or disapproving), or requiring rules, regulations and bylaws. Section 106 will assure that the public interest reflected in the antitrust laws will be weighed against the public interest protected through regulation of the futures trading industry.

The present Commodity Exchange Act contains no such express mandate. As the Supreme Court recently noted:

"(T)he area of administrative authority (under the present Commodity Exchange Act) does not appear to be particularly focused on competitive consideration; there is no express provision in the Act directing administrative officials to consider the policies of the antitrust laws in carrying out their duties . . ." (*Ricci v. Chicago Merchantile Exchange*, 409 U.S. 289, 303, at n. 13 (1973); see also 409 U.S. at 317-18.)

Regulated Commodities (Section 201)

Although the expanded definition of "commodity" contained in Section 201(B) may include rights and interests which are securities as defined in the federal securities laws, except in the area of transactions involving a contract market, the jurisdiction of the Commodity Futures Trading Commission ("CFTC") over any such rights and interest is

intended to exist concurrently with the jurisdiction vested in the Securities and Exchange Commission. Accordingly, the first proviso of the Section 201(B) indicates that the CFTC's jurisdiction shall be exclusive with respect to transactions involving contracts of sale of a commodity for future delivery which are traded or executed on a contract market that has been designated pursuant to Section 5 of the Commodity Exchange Act (the "CEA") (7 U.S.C. 7) and which, in accordance with Section 4h of the CEA (7 U.S.C. 6), may not lawfully be executed or consummated otherwise than through a member of a contract market, and the second proviso of Section 201 (B) indicates that, except as to transactions covered by the first proviso, the expanded definition of commodity is not intended to derogate from the jurisdiction of the Securities and Exchange Commission (the "SEC").

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To the extent that the language of Section 201 (B) subjects rights and interests or transactions involving rights and interests to the concurrent jurisdiction of the CFTC and the SEC, the Committee intends that the two commissions will consult and cooperate in determining what approaches to the exercise of their respective jurisdictions will best serve the public interest.

Defining Commodity Pool Operators and Commodity Advisors (Section 202)

The Committee intends that the discretionary power vested in the Commission to exclude by rule, regulation, or order "(6) such other persons not within the intent of this definition as the Commission may specify . . ." be exercised to exempt from registration those persons who would otherwise meet the criteria for registration under this section if, in the opinion of the Commission, there is no substantial public interest served by such registration.

Economic Purpose (Section 207)

The Committee intends that the Commission require each board of trade designated as a contract market and each board of trade seeking such designation to demonstrate economic justification by showing that the contract or proposed contract is one which facilitates, or in the case of a new contract, reasonably can be expected to meet the criteria set forth in Section 207. To meet these criteria something more than occasional use of the contract for hedging or price basing must be established.

This section requires boards of trade to demonstrate that contracts traded in, or sought to be traded in, are in the public interest. It would, thus, permit the Commission to deny designation to a board of trade if the contract or proposed contract is, or can be expected to be, used entirely or almost entirely for speculation or if the manner in which the board of trade operates or permits trading to be conducted in the contract is or reasonably can be expected to be contrary to the public interest.

However, the Committee points out that economic justification is not solely dependent on the "importance" of the contract or proposed contract or the commodity. The Committee intends that useful and beneficial new contracts be encouraged, rather than discouraged. Thus, to reconcile doubt as to economic justification of a given proposed new contract the Commission should look to the marketplace as an economic justification of the contract or proposed contract in question.

Multiple Delivery Points (Section 108)

Although provision is made for market participation in the process of designating a delivery point or points, as provided in this section, the Committee intends that final authority for such designation lies with the Commission. The Commission exercises its authority over the designation of delivery points through the procedure described in section 207.

The Committee also intends that the words "after granting a contract market an opportunity to be heard . . ." not be read as empowering the Commission to preclude consideration of comments on the

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proposed change or changes from other interested parties, prior to entering an order changing or supplementing the rules of the contract market, as provided in section 207.

Injunctive Authority (Section 211)

While the Committee feels strongly that authority to the CFTC to seek injunctions through the Department of Justice is a vital adjunct to effective regulation, it is concerned that the authority provided not be abused by the Commission. Accordingly, the Committee intends that the authority provided by this section be viewed by the Commission as a power to be exercised with caution, and with an eye as to any disruptive effect beyond the scope of the interests to be protected through the seeking of such an injunction or order. The Committee assumes that there will be an informal determination by the Commission that other remedies provided by this or other Acts are inadequate or not realistic to the fact situation then being addressed by the Commission before seeking an injunction.

Emergency Powers (Section 215)

The Committee does not intend that section 215 be used to prescribe a remedy more severe than the malady sought to be cured. The effective use of section 215 (as with other regulatory functions of the Commission) requires the exercise of expert and strictly impartial judgment by the Commission, and the Committee intends a cautious exercise of the authority provided in section 215 to the CFTC.

The Committee is aware of disputes that may touch on the issue that some or all the authority provided in section 215 is within the parameters of the present Commodity Exchange Act. As to the existence or nonexistence of such authority, the Committee makes no determination, inasmuch as this is now a matter under adjudication and can best be resolved in forums more appropriate to such resolution than the legislative process.

Enabling Authority for Futures Association (Title III)

The Committee reiterates that the authority provided for the recognition of an association as provided in this title is a grant of discretion for registration to the Commission, to be exercised by the Commission under the terms and conditions provided in this title, and orders and regulations adopted by the Commission to implement the statutory language. However, an association once registered with the Commission may be suspended under the terms and conditions provided in Title III.

Criminal Conduct (Section 401)

The primary purpose of this overall legislation cannot be achieved without provisions to deter those who will obtain inside information in the course of their public service from utilizing such information or their position to enrich themselves by participating in transactions in futures or actual commodities themselves or to benefit others by imparting such information for that purpose. Section 401 adds two new felonies to section 9 of the statute to achieve these objectives. The intent of new sections 9(d) and (e) with respect to acts of self enrichment

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is to make punishable an abuse of public office by erecting objective standards of conduct. The only exception from the prohibition against futures market or actual commodity trading by Commissioners or employees in section 9(d) is the recognition that a Commissioner or employee may legitimately sell commodities produced or owned in connection with his own farming or ranching operation. As an additional safeguard, however, these transactions will be monitored by a reporting requirement to the Commission and made public to avoid any appearance of impropriety or abuse of position. Participating in futures or actual commodity transactions indirectly, through family members or any other beneficial arrangement, would be punishable under section 9(d). There is, of course, no intention to supplant any conflict of interest or other provision of Federal law that may also be applicable. With respect to disclosures for the benefit of others, only those disclosures made by Commissioners or employees with the intent to assist other persons in commodity transactions are covered. While careless disclosures of inside information would be reprehensible, that matter is properly left to be prevented administratively.

The crimes described in this section are made severely punishable, the maximum fine being set at \$ 10,000 and/or a maximum of 5 years imprisonment, in view of the financial gains that might potentially be realized through a violation.

Options Trading (Section 402)

The discretionary authority granted the CFTC to regulate or ban trading in options in commodities not specifically named in section 2(a)(1) of present law (the Commodity Exchange Act, as amended) is not to be exercised by the Commission to approve any transaction of the character of, or commonly known as an "option", "privilege", "indemni-

ty", "advance guaranty", or "decline guaranty", if the option or transaction named does not guarantee the purchase of the futures contract in fulfillment of the option, should the purchaser seek to exercise the option. The Committee intends the Commission act as expeditiously as possible to prohibit such transactions.

Hedging (Section 404)

Section 404 of the bill deletes language in the present Act relative to determining the elements of a bona fide hedge for purposes of exceeding the speculative limits provided by the Commission order in section 4a(1) and replaces it with discretionary provisions for the Commission to determine the elements of a valid hedge for purposes of this section. The proviso of section 404 indicates the Committee's intent that the present definition of amounts to be included for purposes of hedging (provided in the deleted language of section 4a(3) of the present Act) not be abandoned without positive alternatives and clear consideration by the Commission of the effects of such abandonment and determination that such action would be consistent with the purposes of the current Act as amended by H.R. 13113.

The Committee recognizes that many of the hedging practices allowed under the language deleted by section 404 of the bill constitute a "bona fide hedging transaction" within the purposes of the Act. The

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goal of the Committee in replacing the so-called "mechanical test" of hedging in section 4a (3) of the present Act was to free the Commission to define hedging in a manner more consistent with the times and practices of the industry. It is not the intent of the Committee that it be used to overtly restrict industry use of the futures market for hedging.

In four respects the Committee's attention has been directed toward possible deficiencies of the present law where the Committee feels the Commission should depart from present trade practices to consider revisions of the present test: (1) to allow offsetting of a cash risk in new commodity contracts, such as international commodities and metals not now covered under the Act; (2) as a derivative of a study the Commission may wish to undertake regarding the problem of "double hedging"; (3) as a result of study by the Commission of the limitations of the section 4a(3) test in present law with regard to anticipatory hedging; and (4) as a result of a study made by the Commission of the desirability of allowing seed companies and others similarly situated to hedge on "contract" bushels, as opposed to actual physical bushels.

With regard to (1) supra, section 502 of H.R. 11955 provided amendments to present law regarding amounts of commodities that were to be included in hedging transactions for purposes of exceeding the speculative limits, as follows:

"(A) the amount of such commodity such person is raising, mining, refining, or otherwise producing, or in good faith intends to raise, mine, refine, or otherwise produce within the next twelve months (or within such greater period of time as the Commission may prescribe), on land or in facilities which such person owns, leases, or otherwise utilizes;

"(B) an amount of such commodity the sale of which for future delivery would be a reasonable hedge for such commodity or the products or byproducts of such commodity owned or purchased by such person, or the purchase of which for future delivery would be a reasonable hedge against the sale of such commodity or of any product or byproduct of such commodity by such person."

These amounts also represent legitimate hedges under section 404 of H.R. 13113, in the view of the Committee, subject to the limits of the so-called "mechanical test" of present law.

Further, with regard to (3), it has been called to the Committee's attention that bakers and other processors are limited as to their hedging transactions in that they take a product for example, (flour) derived from a commodity on which a contract is provided (wheat) but are unable under present law to anticipatorily hedge their product against a wheat contract for purposes of exceeding the speculative limits set by the Commission. The Committee feels that the Commission should study anticipatory hedging problems in the interest of assuring logical access by bakers and other processors similarly situated in their respective retail chains, for purposes of allowing this group of processors to provide a price to consumers which reflects, as much as possible, an elimination of any higher consumer prices which are the product of inability of the processor to offset an existing cash risk in excess of the existing speculative limits.

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NEED FOR H.R. 13113

I. BACKGROUND

Futures trading is a basic adjunct of the marketing of agricultural and other commodities, and a source of sophisticated speculative activities by a growing number of American investors. Its economic purpose, its peculiar needs and effect upon the cash pricing system of those commodities which are traded as futures is often misunderstood by those both within and without industry. Often equally misunderstood is the role of governmental regulation of the industry.

The commodities exchanges are old institutions. The present day exchanges, where futures are traded, trace their lineage to medieval trade fairs that sprang into existence in the Twelfth Century on the Continent. At these fairs, trading was first formalized into the practices of preannounced markets at fixed time and places, with subsequent specialization. Early trading fairs had immediate delivery of the commodity traded, but gradually the practice of contracting for merchandise for subsequent delivery with standards of quality established by samples, gained favor. The practices of such trading were subsequently codified into the Law Merchant.

Following the example of the Continent, producers and merchants in America formed the first centralized commodity markets in the late 1700's, for trade in eggs, butter, vegetables and grain. By and large, the commodity exchanges in the United States were largely cash markets for "spot" delivery.

As farmers brought grain and livestock to regional markets at essentially the same time each year, they often found that the supply of meats and grain far exceeded the immediate, short-term needs of packers and millers. These processors in turn, seeing more than adequate supplies at particular times, would bid at the lowest possible price. Often, the short-term demand could not absorb the glut of commodities at any price, and goods were dumped in the street for lack of buyers. The problem was often aggravated by lack of adequate storage facilities and road and water transportation. Through much of the year, snow and rain made the dirt roads from country farmlands to the city impassable, and once the commodities reached the exchange area, there was a continual problem of inadequate storage. Standards of quality and weight were often nonexistent and complicated a marketing system that also was victim of inadequate and underdeveloped harbor facilities.

Yet several months after the fall harvest and marketing of grain and livestock, prices would soar and people often went hungry. Businesses faced bankruptcy through lack of raw materials and inability to meet financing of their businesses. The rural population was unable to pay for needed manufactured products from the city -- tools, building materials and textiles.

This situation led to the emergence in the United States of *forward contracting*, following its development in England. Forward contracting solved the basic problems of availability and demand, but did nothing to control the financial risk of loss that could occur with rapidly changing prices resulting from crop failures, losses of ships, inadequate storage and transportation, and the recurring economic

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panics of 19th Century America. There was an obvious need to establish price as well as quality in "to arrive" contracts. This led to the development in the early 1860's of *futures contracts*.ⁿ¹

ⁿ¹ Amplification of the development and internal workings of the industry complex are provided in the Appendix.

II. FEDERAL REGULATION OF FUTURES TRADING

Today a great part of the enormous volume of futures trading is done by tens of thousands of speculators buying or selling as dictated by their opinions on whether prices will advance or decline. Inevitably this basically speculative feature of the markets, on occasions, leads to attempts -- sometimes successful -- to manipulate prices. Such manipulative activities destroy the usefulness of the market to hedgers. The markets also provide a backdrop against which confidence games have been operated, and they have been the scene of economic struggles by powerful opposing groups.

The conditions under which trading is conducted in order to facilitate speedy execution of orders make possible the cheating of customers and other sharp practices not easily discoverable by the victims. Brokerage firms hold large sums of money representing customers' margins and equities. The use of such funds to finance the firms own operations or the operations of favored customers could result in financial losses by other customers. The public interest,

therefore, requires that these markets operate under close scrutiny so that they serve their legitimate marketing functions.

From the outset commodities trading was subject to a variety of price distortions, including manipulation, fraud, and the outright cornering of a particular market. Soon after the Civil War, state governments became aware of such problems and passed the first laws attempting to regulate commodities trading. Such laws typically prohibited "bucketing" of orders and other obvious categories of malfeasance.

In 1883, the federal government began considering legislative action to regulate futures trading. The first tangible result of Congressional debate was the Hatch bill, passed by both Houses but never finally enacted. This bill essentially imposed a regulatory tax on certain commodities, and was relatively narrow in scope. Futures trading continued to attract Congressional attention, however, and by 1922 over 200 bills had been introduced that were designed to somehow affect domestic commodities markets.

In 1921 the Futures Trading Act began its short life. This law foreshadowed the basic logic and language of the 1922 Grain Futures Act, and, therefore, of the 1936 Commodity Exchange Act as well, but it was placed under the aegis of the Federal taxing power. For this reason the 1921 law was declared unconstitutional as "regulation, not taxation" on May 15, 1922. The Grain Futures Act was essentially a rewriting of the Futures Trading Act, but instead it was placed under the newly expanded commerce power. This new version of the old law was judicially sanctioned by the Supreme Court in 1923.

This act conferred limited authority with respect to futures trading in wheat, corn, oats, barley, rye, flaxseed, and grain, sorghums. By amendment on June 15, 1936, it was renamed the Commodity Exchange

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Act and its regulatory provisions strengthened and extended to include cotton, mill feeds, butter, eggs, potatoes, and rice. By the amendment of April 7, 1938, wool tops were added to the commodities subject to the act, and fats and oils, cottonseed, cottonseed meal, peanuts, soybeans, and soybean meal were added October 9, 1940. Wool (as distinguished from wool tops) was added on August 28, 1954, and the act was made applicable to onions on July 26, 1955. Public Law 85-839, approved August 28, 1958, prohibited futures trading in onions, effective September 27, 1958, but did not remove onions from the list of commodities covered by the Commodity Exchange Act. Effective June 18, 1968, the act was amended to include livestock and livestock products and its regulatory provisions were further strengthened. Public Law 90-418, approved July 23, 1968, extended coverage of the act to frozen concentrated orange juice.

The present Commodity Exchange Act is predicated upon findings and conclusions of the Congress that (1) transactions in commodity futures are carried on in large volume by the public, as well as by persons engaged in the business of buying and selling agricultural commodities in interstate commerce, and (2) such transactions and prices are susceptible to speculation, manipulation and control, and sudden and unreasonable price fluctuations, and such fluctuations are a burden upon interstate commerce and make regulation essential in the public interest. A fundamental purpose of the Commodity Exchange Act is to insure fair practice and honest dealing on the commodity exchanges and to provide a measure of control over those forms of speculative activity which too often demoralize the markets to the injury of producers and consumers and the exchanges themselves.

Futures trading involves purchases and sales of contracts for delivery at some future date certain quantities of specified commodities at fixed prices. In effect, the Commodity Exchange Act has required that futures trading in regulated commodities be conducted at a commodity exchange designated as a "contract market" by the Secretary of Agriculture. Future trades (transactions) are made by or through a member of such a commodity exchange. A separate futures market is established for each regulated commodity trade on a contract market. The contract markets have the authority, with certain limitations, to admit members and select officers; discipline offenders and expel members; determine delivery months and contract terms; fix price fluctuation limits (the amount of permissible price change during a trading day); and establish margin requirements, brokerage fees, and commissions.

In order to qualify for designation as a contract market by the Secretary of Agriculture a commodity exchange must meet certain conditions and requirements including those covering the (1) maintenance of certain records and the preparation of reports on futures transactions, (2) prevention of dissemination of false, misleading, or inaccurate commodity information, (3) prevention of manipulation and other abusive trading practices, and (4) allow inspection of records by the Department of Agriculture and the Department of Justice.

A futures commission merchant (FCM) is the agent for futures transactions in commodities regulated under the Commodity Exchange Act. The Commodity Exchange Act defines futures commission merchant as including individuals, associations, partnerships, corporations,

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and trusts engaged in soliciting, or in accepting, orders for the purchase or sale of any commodity for future delivery on, or subject to the rules of, any contract market and provides that, in connection with such solicitation or acceptance of orders, the futures commission merchant accept any money, securities, or property (or extend credit instead) as a margin to guarantee, or to secure, him from loss on any trades or contracts. The order solicited or accepted by the futures commission merchant is filled by a broker, on the trading floor of the exchange. The future commission merchant charges a fee or commission for his services. In many respects the futures commission merchant's role is similar to that of a stockbroker in the securities market.

A floor broker is any person who, in or surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged, shall engage in executing for others any order for the purchase or sale of any commodity for future delivery, on or subject to the rules of any contract market, who for such services receives or accepts any commission or other compensation. A floor broker may be employed on a salary basis by a futures commission merchant, may execute trades on a commission basis for more than one futures commission merchant, or may be compensated as a member or partner of a future commission merchant.

The Secretary of Agriculture established the Commodity Exchange Authority (CEA) as an agency in the Department of Agriculture to administer the Commodity Exchange Act. The Secretary delegated to CEA his authority under the Commodity Exchange Act except his authority to designate contract markets, promulgate regulations, and issue complaints. A designee of the Secretary serves as chairman of the Commodity Exchange Commission. The commission establishes trading and position limits, suspends or revokes contract market designations, and issues cease and desist orders.

The major objectives of CEA in the enforcement of the Commodity Exchange Act, are to protect the price and hedging services of the commodity futures markets. These services are widely used by farmers, merchandisers, and processors. To carry out its enforcement objectives, CEA works to maintain fair trading practices and competitive pricing on commodity exchanges; and to prevent price manipulation, cheating, fraud, and abusive acts and practices in commodity transactions.

III. INADEQUACY OF EXISTING LAW

GENERAL CONSIDERATIONS

Through the 1960's the existing pattern of weak federal oversight of some (but not all) commodity futures trading, coupled with self regulation by the exchanges, and varying state laws, proved generally adequate to handle the public interest of regulation of market forces and market practices of the trading of futures. Beginning in 1971, however, the necessity for change in the federal role began to emerge, as a result of governmental investigation, concern by responsible leaders within the industry, attention of the investigating public, and concern from traditional hedgers that the future markets were not as useful as previously for hedging their cash risk in a shortage situation.

Thus, in introducing H.R. 11955 on December 13, 1972, the Chairman

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described the following general considerations relating to the necessity for significant change in the federal government's traditional role relating to future trading:

For sixty years or more, futures markets operated in a posture that encouraged no government interference or supervision of their activities. However, beginning in 1922, the federal government injected itself in a minor supervisory role over grain futures when the Congress enacted a limited "Grain Futures Trading Act". In 1936, the Act was amended, and broadened, and became the present "Commodity Exchange Act" which envisioned a mixture of limited federal supervision, and "strong" self-regulation of the markets by their members. It has been amended many times, in reaction to specific major and minor problems that required the attention of the Congress.

Again today, Congress has taken notice of the situation in the futures markets. Unlike past years, however, and past approaches of the Congress, the Committee seeks not only to assist the futures industry in dealing with immediate problems that beset it -- problems that have brought about a crisis by the lack of public confidence in the present regulatory scheme -- but also to look ahead and deal with the problems that are clearly on the horizon.

First, as to immediate problems, the strains of a shortage situation in the past year in many of the cash crops that are the subjects of futures contracts were reflected dramatically in the futures markets which had become accustomed to trading futures in periods of surplus. Also, the present regulatory activities of the Commodity Exchange Authority in the Department of Agriculture are totally inadequate to police the industry under the limited authority given them by the present law.

During the past year, these and many other problems have been compounded in the public eye, with failures of futures commission merchants who have been trafficking exclusively in futures that are not regulated by the present Act. As an example of how disastrous such an occurrence can be, a California firm's failure reportedly took 71 million dollars of commodity customers' money with it. In Texas, another firm dealing in non-regulated commodities collapsed, also causing great loss to customers. These firms were vending a form of "puts and calls" or "options" as they are sometimes called. Under the theory of options trading, which is prohibited under present law for the handful of commodities covered under the present Act, the customer does not buy or sell a contract for future delivery of a commodity as most hedgers or speculators in regulated commodities undertake. Instead, he or she purchases the "right" to purchase or sell a contract in the future, paying a premium for someone else to actually guarantee to provide the actual contract at a specified price. Because there are no margin calls, and the degree

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of exposure is fixed, it initially appears more attractive to the small investor.

However, because some individuals will seek opportunities to exploit any given system, the high cost of "hedging" the options, as must be done to protect both the customer and options merchant, has proved forbidding to many merchants seeking option customers, so they write so-called "naked options", which are not hedged or covered in any way. The good faith and solvency of the broker is all that is securing the transaction.

It has been documented that, in some of these firms, customers who desired the proceeds of their transaction in these options were actually paid in many instances from other customer's accounts, and eventually the pyramid structure created, where one customer's account is robbed to pay another, collapses. Because there is no requirement on the options merchant to segregate customer's funds, as the law now requires for the trading of futures in regulated commodities, the investments of the customers are usually lost.

Nor are "regulated" futures commission merchants so tremendously more secure. Regulated firms also go under as well and because there had been insufficient attention given by a regulatory body to the bookkeeping practices of one which recently collapsed it was found too late that customer's accounts had not been segregated as required by law with a resultant loss of the funds supposedly belonging to the customers.

On the floors of the exchanges where commodity futures are bought and sold there is little or no real security for the customer, despite the inherent honesty of most brokers. Brokers, like many futures commission merchants, number among themselves the most honorable of men. Yet, there are also those who have been attracted to futures markets for their volatile environment and the hoped for ability to reap great profits in a hectic atmosphere . . . often times taking advantage of that atmosphere at the customer's expense. Again, because not all commodities are covered under the present Act, many attempts at self-regulation in those exchanges have been and continue to fail. Attempted investigations in regulated exchanges are often characterized by the unwillingness of the investigating committees composed of exchange members to inquire too closely into the possible excesses of their own brethren. In one or more unregulated exchanges it is continually charged that the owners of the exchange manipulate and evade the traditional rules for their own personal gain. Brokers, customers, and, eventually, the American economy suffers in this atmosphere of so-called "self-regulation" where tradition and self interest has been allowed to displace the public interest.

Mr. Speaker, today I will not attempt to chronicle all that has been learned through the investigations of the Committee

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on Agriculture, in our October hearings on possible amendments to the present Act, the earlier hearings of the Subcommittee on Small Business Problems, and the excellent job that has been done by the news media on the subject, despite a few excesses.

I would like to turn now, however, to a problem that is becoming increasingly severe and which mandates sure changes in the philosophy of self-regulation as it is now practiced.

Many of these immediate problems facing the industry can be easily cured by simple changes in the language of the law. However, from witnesses, customers, the news media, the exchanges themselves and separate staff investigations of the two House Committees, it has become increasingly clear that there are great problems in the entire structure of federal authority over futures trading which demand the attention of the Congress, inasmuch as they are problems that are a function of the system of self-regulation by the exchanges under a limited federal "umbrella" of authority

SPECIFIC PROBLEM AREAS

Several specific situations mandate a comprehensive rewrite of futures trading regulation. During the drafting and consideration of H.R. 11955, and subsequent hearings and markup that led to H.R. 13113, the following among others commended themselves to the attention of the Committee:

a. Significantly Increasing Volume of Futures Trading

In recent years public interest in commodities trading and speculation has mushroomed. Five major exchanges reported record volume in 1972 and 73 and there is every indication that the trend will continue. In the first quarter of 1973, overall volume was 6.8 million contracts, as compared with 4.1 million during the same 1972 quarter, and 6.4 million for the entire year of 1964.

New investments in commodity futures are coming from the securities markets, attracted by price leverage, low margin requirements, volatile price action. Less supervised commodity markets sometimes offer attractive speculative opportunities to the securities investor. The number of U.S. stockholders began declining by 800,000 early in 1973, the first drop since recordkeeping began in 1952. For the purposes of inter-market comparisons on a volume basis, 1973 dollar volume in commodities trading far exceeded that of securities dealing. Whereas a recent price for a seat on the NYSE was \$ 95,000, a recent price for a seat on the Chicago Merchantile Exchange, the second largest domestic futures market, was \$ 112,500. This new volume (as demonstrated by the following chart) puts an even greater burden on an already overworked regulatory system:

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COMMODITY FUTURES

VOLUME OF TRADING

(NUMBER OF TOTAL TRADES)

1957 THRU 1973

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b. Diversification of Futures Trading

Under the present Act, only certain commodity futures are regulated, as listed in Section 2 of the Commodity Exchange Act:

Barley

Butter

Corn

Cotton

Cottonseed

Cottonseed meal

Eggs

Fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, coconut oil and all other fats and oils)

Flaxseed
 Frozen concentrated orange juice
 Grain sorghums
 Irish potatoes
 Livestock
 Livestock products
 Mill feeds
 Oats
 Onions (Futures trading prohibited under PL 85-839)
 Peanuts
 Rice
 Rye
 Soybeans
 Soybean meal
 Wheat
 Wool
 Wool tops

The following are some major non-regulated commodity futures:

Aluminum
 Apples
 Cocoa
 Coffee
 Copper
 Fishmeal
 Foreign currency
 Iced broilers
 Lead
 Lumber
 Mercury
 Nickel
 Palladium
 Platinum
 Plywood
 Propane gas
 Silver
 Sugar
 Tin
 Tomato paste
 gold

While trading in regulated commodity futures has nearly doubled (9,345 contracts in 1969 to 18,285 contracts in 1973) since the Committee last considered amendments to the Commodity Exchange Act, trading in non-regulated contracts has approached four times its 1969 figure (1,861,494 to 7,541,370) for the same period.

Thus, traders find themselves at one moment trading a regulated contract on a regulated market. The next, a non-regulated contract at the same exchange or a non-regulated contract on an unregulated exchange. Options trading in regulated contracts are essentially prohibited under present federal law. Yet another agricultural contract, such as cocoa or sugar, will legally support option trading. Failure of a firm handling only regulated contracts will have differing consequences for the customer from failure of a firm handling only non-regulated contracts. In the first, the customer's funds will have been required to be segregated by law. In the latter, not.

Current figures indicate the following: There are 10 active regulated exchanges and six non-regulated. There are 19 active regulated commodity contracts and 15 non-regulated. There are 1,417 registered floor brokers and approximately 170, non-regulated. There are 224 individuals, corporations or partnerships registered as futures commission merchants under the Commodity Exchange Act and perhaps 100 not registered. There are 240,000 traders in regulated

commodities and approximately 80,000 who are not. Finally, in fiscal year 1973, there were 17.8 million contracts traded in regulated commodities and 5.7 million in non-regulated.

The above is further heightened by discussions of new contracts in items ranging from mortgages to petroleum allocations -- none of which would be regulated under present law. It is abundantly clear

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that all futures trading must be brought under a single regulatory umbrella.

c. Inadequacies of the Commodity Exchange Authority-Commodity Exchange Commission Regulatory Structure

Part of the CEA problem is purely geriatric in nature. The agency in one form or the other is essentially 52 years old and during that time its legislative mandate of maintaining a status of limited federal regulation and self-regulation with the exchanges has remained unchanged. While the Committee bill does not envision an end to self-regulatory activities by the exchanges, it does replace the present limited federal authority with a more comprehensive grant of federal authority to make the overall regulatory pattern of the industry more appropriate to the times and the needs of the American public and the international economy.

The volume of commodities futures trading has soared in dramatic contrast to the level of the Commodity Exchange Authority/Commission ability to cope with the attendant magnitude of regulatory needs.

Trading in 1969 was twenty percent higher than 1968 : 1970 trading was up twenty-two percent; 1971 -- seven percent; 1972 -- twenty-six percent. In 1973, the volume of trading increased again nearly forty-one percent. In 1969 the total of all contracts traded was 11,206,685. By the end of fiscal year 1973 it had more than doubled (25,826,747). The trend seems to be continuing.

COMMODITY EXCHANGE AUTHORITY: APPROPRIATION, EMPLOYMENT, NUMBER OF CONTRACTS TRADED, FISCAL YEAR 1965 THROUGH FISCAL YEAR 1974

Yet the principal regulatory agency for futures trading, the CEA, during the same period declined in total number of employees during four years of that period (1970 to 1973). Moreover, it was during this same period (1971) that CEA experienced major personnel problems and the Inspector General of the Department of Agriculture could say of the agency:

CEA has unique regulatory responsibilities requiring highly qualified specialists in professional positions to be assured of competent productivity. It has had difficulty in securing personnel who possess futures backgrounds and the required professional skills. As a result, personnel of lesser skills have been hired. While much training was given, it was not the type relating to the needs of these professional employees

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to be assured that competent replacements were available for personnel who resign, retire, or transfer. *As a result, severe gaps existed in the expertise of the various professionals who have been with CEA for some time and the competency of the regulatory work they perform is questionable.* (Emphasis supplied)

and again, in the same report at page 108:

. . . CEA has been unable to hire personnel with sufficient prior experience and training to effectively perform the required compliance activities. This lack of experience caused the deferment of some investigations . . .

The problems of the Commodity Exchange Authority go beyond its inability to obtain the kind of administrative support for increased budget and staffing levels necessary for effective regulation of futures trading. There are problems of internal workings of the agency that mandate in the opinion of the Committee, significant changes in the regulatory body.

Actual operation of the activities of the Commodity Exchange Authority are hampered by structural problems, such as the following: The Administrator of the CEA (at present a GS-17) is subject to direction from two sources: he acts directly under the Commodity Exchange Commission for some purposes of the Act, but in most other instances is subject to two tiers of control (Assistant Secretary for Agriculture -- Secretary of Agriculture).

CEA has no independent legal staff, therefore, it must draw on the pool of departmental lawyers subject to the distraction of answering the legal needs of other agencies within the Department as determined by the General Counsel of the Department, and the Secretary. The Administrator has only the most limited authority to impose penalties for violations of the Act, and an issuance of a cease and desist order, or a suspension of a trader from trading for violation of the Act can involve as many as five levels of review within the Department -- allowing in one case, a delay of seven years in obtaining a suspension order for violation of the present law.

In a memorandum submitted to the ad hoc subcommittee considering the desirability of creating a new structure for the regulation of futures trading the following considerations relative to CEA were mentioned:

The problems in making CEA operate effectively within its present structure are real. The history of the agency shows that it not only has had to absorb the same budget cuts as have other agencies within the Department, it has had little increase in its budget during the past several years. This year the Appropriations Committee granted it money for ten or twenty new employees.

Witnesses who appeared before the full Committee (during the October hearings) were almost unanimous in recommending -- at a minimum -- some strengthening in the present CEA operation. Nearly half of the witnesses who appeared and delivered an opinion on the subject testified in favor of a semi-independent

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or completely independent agency. Additional staff conversations with users of the market (chiefly grain trades) indicate that this group of witnesses were virtually unanimous in calling for an important independent role for commodities regulation.

. . . While it would be possible to strengthen the CEA within the Department, there are some real technical problems with the drafting of separate legal staff, adequate employee levels, and other internal matters in a statute that can only be amended through Act of Congressn1

n1 Legal memorandum to Members of Ad Hoc Subcommittee. November 5, 1973, from Committee attorneys, John O'Neal and John Rainbolt.

Additional reasons for creating an independent Commodity Futures Trading Commission (CFTC) envisioned by H.R. 13113 abound. n2 While as many as 90 percent of all futures contracts traded are agricultural in origin (including timber, plywood, and other nonregulated contracts) the necessity to bring all futures, from whatever source, into the regulatory fold should make adequate allowance for independent input outside of the Department. In fact, the composition of the Commodity Exchange Commission reflects such an input at present. Important new regulatory powers are desperately needed (injunctive authority, administrative penalties, designation of delivery points, and others) but the possibility of the powers provided in H.R. 13113 being wielded solely by any Administration subject, perhaps too much, to the political winds that sweep Washington, cause anxiety to both the regulated and the public whom regulation is also designed to protect. The Committee feels creation of the Commodity Futures Trading Commission with new powers as envisioned in the bill will provide adequate protection to the vital interests represented in the regulation of this volatile industry.

n2 See, for example, the testimony of Acting Inspector General, Department of Agriculture, before Subcommittee on Special Small Business Problems, Select Committee on Small Business. Hearings: "Small Business Problems Involved in the Marketing of Grain and Other Commodities" (1973) where he listed the following deficiencies of the CEA found in a 1971 investigation: (1) Reliance on self-regulation by commodity exchanges; (2) Trade practice investigations; (3) Tracking techniques; (4) Followup on trade abuses; (5) Trader reporting requirements; and (6) Economic analysis of the maturing futures. These and other problems of the CEA are analyzed in depth in the Inspector General's Report (1971).

d. Exchange Self-Regulation and the Public Interest

Since the early part of this century, the Federal Government has been moving in the direction of greater regulation of the industry. Always, the Committee on Agriculture has been faced with the question of what degree of regulation of exchanges and the industry complex is adequate to protect the public interest and still allow freedom to the industry

to reflect vital supply and demand considerations that are the core of its existence. Of necessity, the Committee, in determining what powers should be lodged in the federal regulatory agency overseeing futures trading, was drawn into an examination of the concept of "self-regulation", which has been followed by the exchanges since their inception, and continually encouraged by the Congress. The evolution of the self-regulatory concept was best described by the Chairman during introductory remarks on the bill, H.R. 11955:

To deal for a moment with basics, the origin of self-regulation by the stock and commodity exchanges is apparently obscure.

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However, certain theories have been advanced to explain why the futures exchanges, standing almost alone in the American industrial society, elected to develop an extensive system of self-regulation.

The evolution of self-regulation by the stock and commodity exchanges was probably the result of two principal factors. First, the centralized nature of the market brought most industry participants into close proximity, thereby making it feasible to construct more elaborate institution functions. Second, the unusual sensitivity of the industry, led almost naturally to a code of conduct and honesty.

The founders of most exchanges were men of acknowledged leadership in their communities. They recognized that it was simply "good business" to discourage sharp practices which could undermine the vital public confidence in the exchanges. Therefore, as long as 100 years before the first Federal legislation in the area, the exchanges, which then dealt only with cash commodities, had some sort of a self-regulatory system complete with codes of conduct, surveillance procedures, and disciplinary powers.

In the late 19th century and the first quarter of the 20th century, exchange self-regulation was viewed by the exchanges as establishing codes of conduct which were goals or objectives rather than minimum standards. Exchanges promulgated many bylaws and rules descriptive of "ideal industry practice," and encouraged their members to strive toward that ideal. Very little thought was probably given to whether the failure to meet those ideals would expose the exchanges to legal liability, since the courts looked upon exchange self-regulation as a desirable objective for better practices rather than a guarantee of member's performance at compliance.

Beginning roughly 50 years ago, the legal posture of exchange self-regulation began to change. Perhaps the adoption of federal regulatory legislation spurred this total reorientation of the relationship between the exchanges and the public. Slowly, the courts began to look upon exchange self-regulation as a guarantee to the public that its members would not violate its code of conduct. As noted earlier, the exchanges' codes were perhaps not developed for that purpose, and frequently contained broad pronouncements which clearly could not easily be enforced in all instances. For example, nearly all exchanges have nebulous rules prohibiting "inequitable conduct" or "unbusinesslike dealings".

As the importance of futures trading grew, federal requirements on exchanges also increased in the years that followed the enactment of the Grain Futures Act. New regulated commodities and new duties were placed on exchanges, their brokers, and futures commission merchants. As exchange practices adjusted to changing technology, the exchanges themselves sought to cope with a series of ever-increasing demands on the self-regulatory activities of the boards of directors. Various Administrations sought new federal powers to enforce the

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Commodity Exchange Act. n1 Authority was given to disapprove contract market rules relating to trading requirements.

In the 1968 amendments to the Commodity Exchange Act (P.L. 90-258), a legislative mandate was promulgated which required contract markets to enforce their own rules in these key respects:

[to] (8) enforce all bylaws, rules, regulations, and resolutions, made or issued by it or by the governing board thereof or any committee, which relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relate to other trading requirements, and which have not been disapproved by the Secretary of Agriculture pursuant to paragraph (7) of section 8a of this Act; and revoke and not enforce any such bylaw, rule, regulation, or resolution, made, issued, or proposed by it or by the governing board thereof or any committee, which has been so disapproved; and

(9) enforce all bylaws, rules, regulations, and resolutions made or issued by it or by the governing board thereof or by any committee, which provide minimum financial standards and related reporting requirements for futures commission merchants who are members of such contract market, and which have been approved by the Secretary of Agriculture. (7 U.S.C. 7a)

In the few years this provision has been in the present Commodity Exchange Act, there is growing evidence to indicate that, as opposed to strengthening the self-regulatory concept in present law, such a provision, coupled with only limited federal authority to require the exchanges to make and issue rules appropriate to enforcement of the Act -- may actually have worked to weaken it. With inadequate enforcement personnel the Committee was informed that attorneys to several boards of trade have been advising the boards to *reduce* -- not expand exchange regulations designed to insure fair trading, since there is a growing body of opinion that failure to enforce the exchange rules is a violation of the Act which will support suits by private litigants.

Moreover, there is continuing evidence that in some exchanges, at least, there do occur practices which are violations of the present Act. Of such situations, the 1971 Inspector General's report stated (at page 6) the following:

CEA relied on exchanges to enforce their rules and to insure that all trades were executed competitively. Insufficient effort was made to determine whether trading rules were enforced even though the regulations require that trading is to be done openly and competitively in the pit. Our examination of exchange records disclosed several instances of apparent abusive trading practices. We found evidence of direct and indirect bucketing of customer orders, accommodation trading, excessive trading between brokers executing customer and

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house account orders for the same firm, and matching customer orders. There were a significant number of trades between partners or members of the same firm. Although exchange rules do not prohibit this, there is no assurance that the trades were competitive and that the trades were not wash trading used to manipulate prices and deceive other traders. We noted a case where one spreading transaction between affiliated members exceeded 20 percent of the total volume of all transactions in the two futures. It did not appear that the transaction was executed competitively.

It was CEA policy not to review clearing house records for violations of day trading speculative limits. We found that the total trading on these reports exceeded the total trades reported to CEA for three traders.

And again (page 9):

We also found other suspected violations of trading rules which we believe indicate a lack of control, detection, and enforcement of rules governing the execution of customer orders. We found transactions involving trades where the same broker was on both sides of a trade and where trading between combinations of brokers appeared to be intentional. Also, a number of trades were made where associated members, acting as floor brokers executing customer orders for other clearing members, traded between themselves to an extent great enough to indicate that such trading was prearranged. Further, floor brokers executing orders for other clearing members successfully manipulated the orders and prices by executing similar orders for their own personal accounts which had a price movement effect and then executed clearing member orders.

Another example of the difficulty of reliance on self-regulation occurred following the 1972 sale of grain to Russia. As cited in the testimony to the Committee by Congressman Neal Smith of Iowa, the following sequence of events occurred:

1. On July 28, 1972, Mr. Caldwell (Administrator of CEA) received a complaint alleging manipulation of the Kansas City September wheat future.

2. On the same day, Caldwell referred it to the CEA regional office in Kansas City with a directive to start an investigation and give it "the highest priority".

3. On August 15, 1972, the CEA regional office communicated with the Kansas City Board of Trade and asked them to make an investigation of the matter.

4. On September 27, 1972, the CEA regional office *was advised by the Kansas City Exchange that their investigation showed that the market had functioned properly and there were no indications of price manipulation.* (Emphasis supplied)

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5. On April 30, 1973, the CEA finally completed its own investigation and *found that the market had been manipulated on the close for several days resulting in the payment of millions of dollars more in export subsidies.* (Emphasis supplied)

6. On May 23, 1973, the matter was referred to the Justice Department.

The Committee does not cite this example as a determination of the truth or falsehood of the facts in question, but rather as an indication that total reliance on exchange self-policing efforts, can hold the possibility of damage to the public.

The Committee bill does not propose that self-regulatory activities of the exchanges be abolished in favor of continued and direct federal regulation of all aspects of futures trading. However, self-regulation cannot be viewed in this and later decades as an argument against greater Federal regulation. Self-regulation is a commendable and noble concept and useful in such a complex atmosphere as that which surrounds futures trading. It cannot continue to function without a strong Federal regulatory umbrella over self-regulatory activities of the industry. Self-regulation cannot be permitted to be a barrier against public policy and the interests of the American public. Yet, with proper Federal supervisory authority, needed self-regulatory efforts of the exchanges can live a useful life into the 21st Century and, hopefully, beyond.

e. Additional Considerations

Additional considerations leading the Committee to propose major changes in the existing law fall into certain groups, represented by the following items brought to the Committee's attention during the seven months it worked on formulating the bill:

(1) Widespread complaints by hedgers and producers that lack of more effective control over futures trading by the exchanges, or by government, at times distorted the traditional relationships between cash and futures prices, and increased the cost of hedging -- since borrowed money is often used to make up margin brought about, some witnesses indicated, through manipulative activities which heightened price swings brought about through leaner supplies.

(2) Growing difficulties facing exchanges engaged in self-regulatory actions as a result of private plaintiffs seeking damages against self-regulatory activities of the markets. As examples, exchanges are sued for actions taken in emergency situations even when the action has been taken at the request (or order) of CEA.

(3) A growing list of proposed and actual state regulations and laws, moving into areas (such as commodity options in non-regulated commodities) where the Federal law, to date, has not entered.

(4) Confusion in court decisions, both as to traditional definitions of commodities and securities, and with regard to antitrust consequences of self-regulatory activities of exchanges.

(5) Heavily publicized failures of firms vending commodity options written "naked", i.e. where the contract supposedly secured by the option premium was never purchased or margined for future purchase. In one instance the collapse of such a firm was responsible for the loss of over \$ 71 million in customer funds.

(6) Existence of schemes of systematic solicitations and bilking of

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unsophisticated potential customers attracted to certain nonregulated futures contracts investments by misleading advertising.

(7) Complaints by consumers that excessive speculation and manipulative practices in futures trading were partly responsible for increased food costs.

(8) User complaints that "mechanical" definitions of hedging transactions in present law were inadequate and governmental concern that the same definitions were being abused.

(9) General agreement among the industry that the present law, as written, was simply inadequate to cope with the needs of the present or the foreseeable future, with new problems and new contracts facing the industry.

Thus, when the Committee, during its first formal hearings on futures trading in October 1973, solicited the comments of the Administrator of the Commodity Exchange Authority on the proposals presented by the Committee as potential areas for amendment of present law, his testimony (on his own behalf) recommended the following:

. . . 2. I favor amending the Act to authorize the agency to require, after appropriate notice and hearing, a contract market to effect specified changes in its rules and practices as determined necessary for the protection of persons producing, handling, processing or consuming any commodity or by-product of a commodity traded for future delivery. If we had this authority, we would use it to help correct a number of problems facing futures markets. For example, we could require contract markets to permit delivery at multiple delivery points or effect other changes in contract terms that would make the futures contract less susceptible to market congestion or price manipulation.

3. I favor giving the CEA the authority to regulate the content of advertising of a firm soliciting customers for the futures markets. For some time we have been concerned with the type of promotional literature being used by some brokerage firms and commodity advisory services which entice unsophisticated investors into commodities futures markets. Some of this advertising literature or promotional activity involves deception which must be stopped. False advertising not only unfairly misleads investors, but also does great harm to public confidence in futures trading and its role in the marketing system.

4. I favor the concept of computerizing floor trading on contract markets. However, I see no reason to legislate trading in this manner at any time in the near future. Computerized trading may well be the wave of the future, but many questions of both technological and economic feasibility must be answered before it can or should be implemented.

5. I favor creating a government sponsored insurance or trust-fund to provide protection for commodity investors from the possibility of loss of funds in the event of financial failure of a contract market or a futures commission merchant. Such a plan should be administered by a federal insurance corporation similar to the Federal Deposit Insurance

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Corporation and financed by the industry. The insurance should cover all firms and contract markets registered under the Commodity Exchange Act. This would be particularly relevant in conjunction with your subject number 7 which would bring all futures trading under federal regulation. The corporation should provide protection for commodity futures customers whenever their brokerage firm becomes insolvent and unable to pay the amount due customers. The purpose of the corporation would be similar to that of the Securities Investor Protection Corporation authorized by the 91st Congress to protect securities customers of insolvent brokerage firms

. . . 7. I strongly favor bringing all futures trading under federal regulation. The concern over prices of unregulated commodities and the integrity of their futures markets, plus losses incurred by persons induced to trade in unregulated commodity options, make federal action timely and effective. Unregulated futures markets are growing rapidly and becoming increasingly important to the economy. The markets for lumber, plywood, sugar, silver, copper, cocoa, coffee and iced broilers, for example, directly affect consumers, producers and merchandisers. Manipulations of futures prices and price distortions caused by excessive speculation have serious repercussions on these markets, yet no federal agency is responsible for preventing price manipulation or curbing excessive speculation in them. In addition, traders have no federal protection against fraud or embezzlement in the handling of their futures trades and funds. Extending regulation to all futures trading will require all brokerage firms to meet minimum financial requirements and employ and be managed by persons found to be fit to handle funds and trades. Today such unfit persons and financially weak firms may freely handle customers' accounts in unregulated commodities.

8. I favor an amendment which would relieve CEA of the responsibility for investigating and prosecuting cash market price manipulations (except those related to operations in a commodities futures market). Such an amendment would enable us to concentrate our antimanipulation efforts in the area of regulating futures rather than defusing them over the broad spectrum of marketing which has no connection with futures trading.

9. I favor prohibiting trading by floor brokers for their own account and for customers, except under certain limited situations when the Secretary of Agriculture finds that such a prohibition would unduly restrict the liquidity of trading or hinder the execution of customers' orders. A contract market should be required to adopt written rules which would adequately protect the interest of customers in these limited situations. Such rules should be submitted to and approved by the Secretary before going into effect. Prohibiting floor brokers from trading for their own accounts or for accounts in which they have an interest when they also are executing

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trades for customers would eliminate the possible conflict of interest now present when they are permitted to trade for customers and for their personal accounts.

10. I also favor limiting trading by futures commission merchants for their own account and for customers under the same conditions and for the same general reasons as set forth in the paragraph above pertaining to floor brokers.

11. I favor granting to CEA injunctive authority to stop any person from violating the Act or regulations promulgated thereunder, and to stop any trader from maintaining sufficient control over a commodity futures contract to effectively restrain trading in such contract. This would enable CEA to move rapidly and more effectively to protect the public against fraud, cheating, mishandling of funds and against a trader who has sufficient control over a futures market to effectively restrain trading or is in a position to create market congestion or affect prices. For example, CEA could quickly get a court order prohibiting an insolvent brokerage firm from using customers' funds or accepting customers' orders. It now takes months, and sometimes years, to stop such practices through administrative complaints or criminal charges. Most regulatory agencies, including the Securities and Exchange Commission, currently have broad injunctive authority.

12. I favor requiring boards of trade to demonstrate that contracts for the commodities for which they are designated or seek designation serve an economic purpose. The Commodity Exchange Act now authorizes and directs the Secretary to designate a board of trade as a contract market if it meets stated minimum requirements. The stated minimums do not now include any reference to serving a useful economic purpose. Sec. 3 of the Act, which details the basis for regulating commodity exchanges, emphasizes the economic role of trading in commodity futures contracts. This proposed amendment would provide a basis for (a) refusing to designate a new contract market that serves no useful economic purpose and (b) revoking the designation of a contract market that no longer serves any economic purpose.

13. I favor giving the Secretary and the Commodity Exchange Commission authority to impose money penalties in administrative proceedings. This would enable Administrative Law Judges, acting for the Secretary, to levy a sanction that better fits the violation. Under current law the only sanctions available are (a) a cease and desist order or (b) suspending or revoking the right to continue in business or to continue using the futures markets. With civil money penalties as an additional sanction, Administrative Law Judges can impose (a) a sanction on persons whose business involves using futures markets that is more stringent than a cease and desist order but less stringent than putting the violator out of business and (b) a heavier sanction on persons who would be penalized seriously by a suspension of their right to trade or

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do business. Similar authority should be granted to the Commodity Exchange Commission.

14. I favor expanding registration and fitness check authority to include all individuals handling commodity customers' accounts and giving the Secretary authority to deny, suspend or revoke such registration. The Secretary of Agriculture now has authority to deny registration to a futures commission merchant or floor broker if he is found to be unfit to engage in this type of business, but this authority should be expanded. There is a need to keep all unfit persons from handling customers' accounts and this can best be done through a registration and fitness program. It has been the CEA's experience that dishonest individuals go from one brokerage firm to another. Often they are hired without the brokerage firm having any knowledge of their unsavory background. If the CEA is to give real protection to traders in the markets, it should have this authority.

15. I favor giving the Secretary authority to require, in emergency situations, that contract markets take such actions as the Secretary may direct to facilitate the orderly trading in or liquidation of any futures contract.

In four instances this year the CEA resolved emergency situations by requesting the exchange involved to take actions to keep trading orderly and permit the orderly liquidation of contracts (soybeans and soybean meal, frozen concentrated orange juice, frozen pork bellies and cotton). In each case the exchange acted favorably on the CEA request, but there is no assurance that in other emergencies exchanges would act in response to a request.

16. I favor giving the Secretary authority to require contract markets to permit delivery at multiple delivery points if he finds that this will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of

such commodity in interstate commerce. This amendment would help correct a major problem facing futures markets -- the failure of some markets to provide adequate delivery provisions. In some cases delivery is permitted at a single delivery point which is no longer a center for trading in the cash commodity deliverable on the futures contract, creating a situation much more susceptible to price manipulation. This provision would require proper deliverable grades and delivery at points where sufficient amounts of the commodity would be available and where there are adequate storage facilities. In addition, the provision would require proper freight and quality differentials.

17. I favor requiring each contract market to establish a procedure for settlement of customers' claims. This could be accomplished by requiring each contract market to provide a fair and equitable procedure for the settlement of such claims against any member or employee thereof arising from conduct inconsistent with the rules of such contract market or inconsistent with just and equitable principles of trade. Such a contract market rule would help carry out the congressional

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intent that exchanges provide an effective system of self policing and it would be an effective way to protect the industry and the general public.

18. I also favor providing for an appeal to a regulatory authority from decisions made by contract markets on customers' claims. There should be some public body to which a commodity customer could appeal from the decision of a contract market, and the federal regulatory agency is the logical one. This would be a natural and necessary function for the regulatory agency to have whenever it requires a contract market to establish a procedure for settling customers' claims.

19. I favor giving the Comptroller General access to the books and records of the regulatory agency. As the Commodity Exchange Act is now written, the Comptroller General does not have specific authority to examine the books and records of CEA. A memorandum from the Department of Justice in 1964 concluded that the General Accounting Office does not have the authority to examine the CEA's files. This year we received a memorandum from the Department of Justice authorizing us to permit the General Accounting Office to examine CEA's records under certain specified conditions. We feel this matter can best be resolved on a permanent basis by putting the General Accounting Office in the same status which respect to accessibility to CEA records as governmental agencies in the executive department

COMMITTEE CONSIDERATION

During the August recess of 1973, the Committee staff began a review of the existing act, studies of problems of the regulation of the industry and their possible solution. On the return of the Congress, the Chairman and several members of the Committee met informally with small separate groups of Commodity Exchange Authority officials, heads of regulated boards of trade, and users of the futures market. Without exception, these groups indicated dissatisfaction with the present law regulating futures trading.

After orientation meetings for members of the full Committee, hearings were set on a series of concepts taking the form of amendments to the present Act. No actual language was before the witnesses or the Committee in order to provide an atmosphere of completely free discussion. The hearings were held in connection with the following Committee announcement:

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

ANNOUNCEMENT OF COMMODITY EXCHANGE AUTHORITY ACT HEARINGS BEFORE THE HOUSE COMMITTEE ON AGRICULTURE, OCTOBER 16, 17, AND 18, 1973

The House Committee on Agriculture expects to review the Commodity Exchange Act with a view toward strengthening and revising

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the existing law. A preliminary review has revealed a number of areas of possible revision.

The primary purpose of the hearings announced today is to receive comments on the following list of areas of Committee interest. The Committee has not endorsed any of these concepts but rather is seeking to compile a record of evidence and promote a dialogue and an exchange of information between all interested witnesses and Committee members which would later provide a sound basis for meaningful reform and a strengthening of existing Commodity Exchange Act authority.

This list should not be construed to be all inclusive. To the contrary, all views pertinent to the subject of the Commodity Exchange Act, presently pending bills, along with any other suggestions by witnesses for revision are solicited. Because of the complexity of this subject, oral testimony will necessarily be limited in presentation but should not be limited in scope. More comprehensive views on any or all subjects should be submitted in writing and addressed to the subjects listed below in the order presented --

1. Creating an independent Commodity Exchange Commission modeled after the Securities and Exchange Commission and transfer to it the authority now exercised by the existing Commodity Exchange Commission and Commodity Exchange Authority;

2. Authorizing the Commission to require, after appropriate notice and hearing, a contract market to effect specified changes in its rules and practices as determined necessary for the protection of persons producing, handling, processing or consuming any commodity or by-product of a commodity traded for future delivery;

3. Giving the Commission authority to regulate the content of advertising of a firm soliciting customers for the futures market;

4. Providing for the computerization of floor trading on the floor of a contract market;

5. Creating a government sponsored insurance or trust fund to provide protection for commodity investors from the possibility of loss of funds in the event of financial failure of a contract market or commission merchant;

6. Allowing the commission to set margin requirements;

7. Bringing all futures trading under federal regulation;

8. Relieving CEA of the responsibility for investigating and prosecuting cash market price manipulations (except those related to operations in a commodities futures market);

9. Limiting trading by floor brokers for their own account and for customers;

10. Limiting trading by futures commission merchants for own account and customers;

11. Providing for injunction authority to stop any person from violating the Act or regulations and to stop any trader from maintaining sufficient control over a commodity futures contract to effectively restrain trading in such contract;

12. Requiring boards of trade to demonstrate that the contracts for the commodities for which they are designated or seek designation serve an economic purpose;

13. Giving the Secretary and the Commodity Exchange Commission

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authority to impose money penalties in administrative proceedings;

14. Expanding registration and fitness check authority to include all individuals handling commodity customers' accounts. At present such authority is limited to future commission merchants and floor brokers;

15. Giving the Secretary authority to require, in emergency situations, that contract markets take such actions as the Secretary may direct to facilitate the orderly trading in or liquidation of any futures contract;

16. Giving the Secretary authority to require contract markets to permit delivery at multiple delivery points if he finds that this will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce;

17. Requiring each contract market to establish a procedure for settlement of customers' claims;

18. Providing for an appeal to the Commission from decisions on customers' claims;

19. Giving the Comptroller General access to books and records of the Commission;
20. Requiring the Commission to make annual reports to Congress, and prompt reports of unusual transactions;
21. Providing a civil remedy (treble damages) in cases where a trader obtained and profited from inside information concerning proposed government action;
22. Making it unlawful for a government employee to disclose confidential government crop or other confidential information to persons not specifically authorized to receive it;
23. Establishing an office within the Commodity Exchange Authority to monitor markets, study market conditions, and disseminate such information to the public as will prevent undue speculation and provide for informed trading;
24. Banning speculation or hedging in commodity futures by foreign governments or their agencies in contract markets; and
25. Requiring the CEA to restrict excessive speculation in commodity markets when speculative transactions exceed 50 percent of the market in a particular commodity.

In addition, the Committee is interested in hearing any other suggestions defining the appropriate federal role in the regulation, if any, or protection of the integrity of the practice of forward contracting of agricultural commodities.

These hearings continued into a following week with testimony from a broad spectrum of witnesses. As a result of these hearings, the Committee directed that a special ad hoc subcommittee be formed, to formulate actual legislation. In a series of informal sessions over a period of several weeks, the subcommittee, chaired by the gentleman from Kentucky, Mr. Stubblefield, formulated and refined legislation. During the same period, the members of the subcommittee officially traveled to Chicago to view the floor operations on the Chicago Board of Trade and the Mercantile Exchange, and met also with Department and CEA officials.

H.R. 11955, introduced on December 13 by the Chairman on behalf of all members of the ad hoc subcommittee, was the product of those efforts.

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H.R. 11955 had five titles, amending the Commodity Exchange Act as follows: Title I created a new Commodity Futures Trading Commission to regulate the trading of futures. Title II made certain major and minor changes in activities allowed under the present Act, and moved to generally strengthen the authority for regulation of the exchanges and persons registered under the Act. Title IIIⁿ¹ created a new Federal Commodity Account Insurance Corporation to provide protection to smaller investors against the financial failure of the brokerage house servicing their commodity account. Title IV contained enabling authority for the creation of National Futures Association(s), and title V contained several sections implementing programs contained in earlier titles, and providing necessary changes in the act to provide for the new authority to regulate futures not covered under the present Act. A more complete summary of the provisions of that bill follows:

ⁿ¹ Subsequently, the Committee deleted Title III in order that it could be considered on its merits as separate legislation.

SUMMARY OF THE MAJOR PROVISIONS OF H.R. 11955, A BILL TO AMEND THE COMMODITY EXCHANGE ACT, DECEMBER 13, 1973

The bill is drafted in the form of amendments to the Commodity Exchange Act (*7 U.S.C. 1 et seq.*) and contains five titles.

TITLE I creates a new five man regulatory commission within the structure of the Department of Agriculture to be called the "COMMODITY FUTURES TRADING COMMISSION". The Secretary of Agriculture will be the permanent Chairman of the Commission. The remaining four members of the Commission will be appointed by the President from the general public and confirmed by the Senate. No more than two of the public members shall be of the same political party. The public members will be appointed for staggered five-year terms and will be compensated at Executive Level IV on a per diem basis for the time they spend in the performance of their official activities. They could, therefore, serve part-time or full time depending upon the workload of the new Commission. The bill requires

that the public members be knowledgeable in the commodity trading business and prohibits them from participating directly or indirectly in any market operations or transactions subject to regulation by the Commission. The Commission will be allowed to utilize the facilities and services of the Department of Agriculture, without cost, including office space. The Commission will be required to meet as often as necessary but not less than one regular meeting per month. Additional meetings may be called by the Chairman or any two members of the Commission.

All existing authority under the Commodity Exchange Act presently delegated to the Secretary of Agriculture and the old Commodity Exchange Commission will be transferred to the new Commission. All existing personnel of the CEA will be transferred to and be employees of the Commission. Provision is made for a Secretary to the Commission, who will be responsible directly to the Commission members. Line responsibilities will be delegated to an Executive Director who will perform the day to day functions of the operation of the Commission

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under the direction of the members of the Commission. In addition, the Commission will have its own General Counsel and legal staff as well as independent budgeting capability and its own Administrative Law Judges. Commission budgets will be forwarded to the Secretary of Agriculture for transmittal purposes in the Department of Agriculture's budget requests.

A customer reparation proceeding before the Commission will be authorized for handling customer complaints which arise from violations of the Act, particularly those which result in monetary damages to the customer. The Commission will have original jurisdiction to consider all such complaints which have not been resolved through the informal settlement procedure required of the contract markets and registered futures associations under the bill. Formal hearings will be held in those cases involving amounts in controversy which exceed \$ 2,500 and will be in accordance with the Administrative Procedure Act. Initially, complaints would be considered by an Administrative Law Judge and then reviewed by the Commission before a final order is entered. A special judicial review of Commission decisions will be established for these proceedings which will allow either party adversely affected to appeal to the U.S. District Court.

The Commission will be directed to take into consideration the public interest designed to be protected by the anti-trust laws of the United States before issuing any order, rule or regulation under the Act and before requiring or approving any bylaw, rule, regulation or resolution of a contract market or registered futures association. Accordingly, a contract market, registered futures association, or person registered under the Act, who is acting pursuant to and in accordance with a Commission order, rule or regulation or a required or approved contract market bylaw, rule, regulation or resolution will not be deemed to be in violation of the antitrust laws by such action. The scope of such action under approved contract market bylaws, rules, regulations and resolutions will be limited to those relating solely to futures contract specifications and other trading requirements.

TITLE II provides broad new authority to the new Commission over futures trading in a number of areas. All commodities trading in futures will be brought within federal regulation under the aegis of the new Commission, however, provision is made for preservation of Securities Exchange Commission jurisdiction in those areas traditionally regulated by it. "Commodity Trading Advisors" and "Commodity Pool Operators" will be brought within the purview of the Act and will be required to register with the Commission annually. Trading by floor brokers and futures commission merchants for their own accounts and at the same time trading for their customers will be restricted and allowed only under such circumstances as prescribed by the Commission. The existing registration and examination for fitness requirement will be expanded to include all individuals handling customer accounts. Contract markets will be required to demonstrate that the futures contracts for the commodities for which they are designated or seek designation serve an economic purpose. The Commission will be given authority to require contract markets, after hearing and comments procedure, to permit delivery of the commodity at additional geographical locations if it finds that this will tend to diminish price

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manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce. Contract markets will be required to establish their own customer claims settlement procedures complementing the Commission's procedures for the handling of customer complaints. Contract markets will be required to submit their bylaws, rules, regulations or resolutions which relate to the terms and conditions of futures contracts or other trading requirements to

the Commission for its approval. The Commission will be given authority through the Attorney General to seek injunctions to stop any person from violating the Act or regulations thereunder and to stop any trader from controlling a commodity futures contract to the extent that he is effectively restraining trading in such contract. The Commission will have authority to impose monetary penalties up to \$ 100,000 in both administrative and criminal proceedings for violations of the Act. The Commission will be authorized to require a contract market, after notice and hearing, to effectuate changes in its rules and practices which the Commission determines to be necessary for the protection of the public interest. The Commission will have authority to promulgate special rules and regulations for persons registered under the Act but who are not members of a contract market which may reasonably be required to protect the public interest. The Commission will have special emergency authority to direct contract markets to take such actions as it may deem necessary in "market emergency" situations, such as war, price controls, export embargoes, or significant intervention of a foreign government in the futures market, in order to facilitate the orderly trading in or liquidation of any futures contract.

TITLE III creates a commodity investor protection corporation, to insure individual customer accounts up to \$ 50,000 against futures commission merchants' insolvency or bankruptcy. The corporation will be a wholly owned government corporation and be named "The Federal Commodity Account Insurance Corporation". It initially will be funded by a 10 million dollar loan authority from the Treasury but will ultimately be self-funding. It will be governed by a ten member Board of Governors which will be made up from members of the Commodity Futures Trading Commission and from the public appointed by the Commission.

TITLE IV provides enabling authority for persons registered under the Act and in the commodity trading business to establish a voluntary futures association or associations which would have authority to regulate the practices of its members in the public interest. Such an association would register with the Commission and establish a uniform code of professional conduct for those in the commodities business and have disciplinary authority over its members. It would also be required to establish a procedure for the settlement of claims and complaints against its members similar to that required of contract markets. Association rules and actions would be subject to review by the new Commission. Association activity would serve solely as a complement rather than a displacement to the authority of the new Commission.

TITLE V contains miscellaneous provisions most of which are conforming amendments. In addition, the Commission will be authorized, if it deems such necessary, to make exceptions from speculative limits for arbitrage transactions. The definition of hedging under existing

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law will be expanded for purposes exceeding the speculative limits in order to make allowances for additional types of commodities proposed for coverage under the Act. "Crossing of Trades" authority will be expanded to include all commodities. There will be a requirement that "U.S. standards" for commodities be specifically adopted by the Commission. The criminal penalties will be expanded under the Act to include certain acts made unlawful under the provisions of the bill. All operations of the Commodity Exchange Commission pending upon enactment, including all administrative proceedings, will be transferred to the new Commission and will continue to completion without abatement.

Time was again set aside for hearings before the Full Committee on January 23, 24, 29, 30 and 31. During the course of the hearings governmental and public witnesses again appeared before the Committee, this time directing their comments to specific bills before the Committee, principal of which was H.R. 11955.

Several communications were solicited and received from other Committees and government agencies during hearings and in later markup sessions. Among those presented were the following comments from the General Accounting Office:

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., February 13, 1974.

B-146770.
Hon. W. R. POAGE,
*Chairman, Committee on Agriculture,
House of Representatives.*

DEAR MR. CHAIRMAN: By letter dated February 7, 1974, you requested our views on H.R. 11955, 93d Congress, which, if enacted, would be cited as the "Commodity Futures Trading Commission Act of 1974."

The purpose of H.R. 11955 is to amend the Commodity Exchange Act (7 U.S.C. 1) to strengthen the regulation of futures trading, to bring all agricultural and other commodities traded on exchanges under regulation, and for other purposes.

On February 6, 1974, representatives of this Office briefed your Committee staff on the status of our review of the Commodity Exchange Authority (CEA) and discussed our preliminary observations on several major questions now confronting your Committee in its effort to enact new CEA legislation. We believe that H.R. 11955 will, in large measure, correct some of the major deficiencies noted during our survey of the operations of the CEA. In accordance with your request, we offer the following observations on selected major provisions of the bill.

ESTABLISHMENT OF A COMMODITY FUTURES TRADING COMMISSION WITHIN THE DEPARTMENT OF AGRICULTURE

Section 101 of the bill would amend the Commodity Exchange Act (CE Act) to create a new five member regulatory commission within the structure of the Department of Agriculture to be called the Commodity

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Futures Trading Commission. The Secretary of Agriculture would be the permanent Chairman of the Commission, and all existing CEA employees, property, records and funds would be transferred to the new Commission. Commission budgets would be prepared by the Commission and forwarded to the Secretary of Agriculture for transmittal with the Department's budget requests.

These provisions apparently are intended to combine the advantages of independence in budgeting and staffing while continuing to retain the Department's experience and support for both technical and administrative purposes. The structure of the proposed futures trading authority would appear to be a distinct improvement over that of the present CEA. We believe, however, that an independent agency might be a more appropriate solution.

Our principal reasons for advocating an independent agency follow:

1. A potential conflict of duties and responsibilities might exist if the Commission were located within the Department of Agriculture, and chaired, on a permanent basis, by the Secretary of Agriculture, who is charged by law to influence and maintain the prices of many of the commodities traded in the futures markets. In the past Congress has established independent commissions, such as the Securities and Exchange Commission, Interstate Commerce Commission, and Federal Communications Commission, to perform functions that are primarily regulatory in nature. Presently, the Congress is considering legislation to separate the regulatory function from the research and development activities of the Atomic Energy Commission primarily in order to minimize potential conflicts of duties and responsibilities. With respect to the Commodity Futures Trading Commission, the removal of any appearance of conflict of duties and responsibilities is necessary to instill the fullest public confidence.

2. The extension of Federal regulation to all futures trading would encompass many commodities other than agricultural, such as metals (copper, silver and lead), forestry products (lumber and plywood) and foreign currencies. It is also expected that, in the near future, noncommodities such as ocean freight, residential mortgages and others will be traded in the futures markets. Because the Department of Agriculture has little or no expertise regarding many of these items, it is at least questionable whether the Commission should be placed within the Department.

Because the futures markets play a significant role in the economic well-being of our country, and in order to instill the fullest public confidence, we believe they should be regulated by a strong and prestigious agency that is as free from, outside influence as possible. The Securities and Exchange Commission enjoys the reputation of being such an agency and we believe that the futures market is as vital and important as the securities market. In order to achieve a similar reputation and to obtain and retain the high quality personnel necessary, we suggest that the committee consider making the Commissioners full-time employees of an independent agency.

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PROVISION FOR REVIEWS AND AUDITS BY THE COMPTROLLER GENERAL

We strongly support the provisions of section 104 of the bill, which amends section 8 of the Commodity Exchange Act, as amended, to grant the Comptroller General access to Commission records for purposes of review and audit. To assure the Comptroller General's access to all records necessary for an effective evaluation of the operations of the Commission, we suggest his authority be expanded to include access to the records of the boards of trade, commodity trading advisors, and commodity pool operators. Currently the bill provides for Commission investigations regarding the "operations of boards of trade and other persons subject to any of the provisions of this Act" (lines 2 and 3, page 8) and access, along with the Department of Justice, to the books and records of commodity trading advisors and commodity pool operators (lines 9 to 23, page 25), but limits the Comptroller General's access to the books, documents, papers or records of the Commission. In addition the Federal Commodity Account Insurance Corporation has access to the books and records and to certain reports of insured futures commission merchants (line 13 *et seq.*, page 47 and line 18 *et seq.*, page 52). We believe the Comptroller General should also have access to the books and records and reports of the insured futures commission merchants in order to carry out his audit responsibilities of the Corporation. This suggestion could be accomplished by placing the phrase ", boards of trade, commodity pool operators, commodity trading advisors, insured futures commission merchants and other persons subject to any of the provisions of this Act," at the end of line 13, page 8.

This amendment of section 8 of the CE Act also provides that "in his reports to the public the Comptroller General shall not include data and information which would separately disclose the business transactions of any person and trade secrets or names of customers, * * *." We might point out that the Comptroller General's reports are not made directly to the public. Rather, they are generally directed either to the Congress, or a committee thereof, or to the head of the department or agency involved. We recommend that lines 14 and 15 of page 8 be amended to read: "except that the Comptroller General shall not sepa-"

The last clause of this section states that the data and information discussed in the above paragraph "shall be provided to the Congress upon request." This language appears to require the data and information be made available only to the Congress and only upon request of the Congress apparently by concurrent resolution. The committee may wish to clarify the language and indicate specifically who may make such a request. One alternative would be to revise line 18, page 8, to read substantially as follows: "be provided upon request by any committee of either House of Congress acting within the scope of its jurisdiction; and."

EXTENSION OF FEDERAL REGULATION TO ALL FUTURES TRADING

Section 201 of the bill would amend the CE Act to extend Federal regulation to all futures trading by expanding the definition of "commodity"

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to include all other goods and articles and all services, rights, and interests, in which contracts for future delivery are presently or in the future will be dealt in. We believe that the implementation of this provision would significantly increase public confidence in the futures market by providing the same protection to the unregulated commodity customers that is now afforded the regulated commodity customers.

Magnitude of unregulated futures trading

The need for Federal regulation of such nonregulated commodities as silver, copper, sugar, and cocoa was accentuated by the over 90 percent increase in the number of nonregulated contracts traded in fiscal year 1973 over the prior year. The estimated dollar value of the 5.8 million nonregulated contracts traded in fiscal year 1973 was \$ 131 billion as compared with the 17.8 million contracts of regulated commodities valued at \$ 268 billion that were traded during the same year.

Both the exchanges and CEA officials have estimated that the futures markets will continue to increase in value and volume in the coming years. Exchange and other knowledgeable officials stated that new contract markets were planned to be established in the near future in such areas as ocean freight rates, mortgages, and possibly petroleum products.

With the number of nonregulated futures contracts traded being a significant percentage of the total futures market, and with the planned establishment of additional futures markets, we believe that it is vital that these commodities and services be regulated in order to protect the public and to instill confidence in the market.

Views of other concerned parties

CEA, the two largest commodity exchanges, and the National Grain and Feed Association, have expressed support for Federal regulation of all futures trading. Among the reasons given were that it would (1) provide consistency in exchange operations and handling of customer amounts, (2) eliminate the sale of commodity options in unregulated commodities because such options are prohibited by the CE Act, and (3) provide the authority to investigate unusual price behavior in all futures contracts, not just those under the CE Act.

The only significant opposition to regulation of all futures trading was voiced by the exchanges which trade in world commodities such as coffee, cocoa, sugar, silver and copper. The principal arguments posed were that (1) because world commodities are produced almost entirely abroad, it is unnecessary and inappropriate for the Government to attempt regulation, and (2) the self-regulatory program of the exchanges has been tested over many years and has proved successful without superimposing additional governmental regulation. The exchanges expressed the view that Federal regulations would impair the orderly workings of the U.S. exchanges and entail substantial costs of compliance and that, as a consequence, foreign exchanges would become more attractive to traders and cause many of them to divert their business from U.S. exchanges to foreign exchanges.

We believe that Federal regulation of trading in commodities that are produced primarily in foreign countries is necessary and appropriate if such commodities are traded on U.S. exchanges. Processors

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and other users of the futures markets in these commodities are entitled to the same protection as those who use regulated commodities. We believe also that any loss of business caused by Federal regulation might be offset by new traders who would enter these world markets because of the increased public confidence brought about by Federal regulation.

Regulated commodity customers provided greater protection

Traders in regulated commodities are provided greater protection than those who deal in nonregulated commodities because (1) the funds of regulated customers are required to be segregated, (2) there is a regulatory agency to investigate customer complaints of unfair trading practices or unusual price fluctuations, and (3) individuals who commit serious violations of the CE Act or who have a history of fraudulent actions may be suspended or prohibited from trading.

The CE Act requires that a regulated commodity customer's funds be segregated from the funds of futures commission merchants (FCM), however, nonregulated customer funds may be commingled with the FCM's funds. In the event of financial failure by an FCM, the nonregulated customer is more likely to sustain a loss. For example, one FCM, which petitioned for bankruptcy in 1970, had claims of about \$ 740,000 filed against it. The attorney for the FCM said that about 90 percent of these claims were filed by nonregulated commodity customers. Only 10 percent of the amount of the claims was paid with an additional undetermined amount to be paid from one of the FCM's outstanding accounts receivable.

Traders in regulated commodities may call upon CEA to investigate complaints but traders in nonregulated commodities have no such recourse. We noted several instances at each of the three CEA regional offices where nonregulated commodity customers complained to CEA but CEA could not do anything about their complaints. For example, a customer trading in sugar contracts alleged that his broker initiated trades without proper authorization. He first complained directly to his broker but received no response. Then, in order, he wrote the Chicago Merchantile Exchange (with a courtesy copy of letter to the brokerage house involved), the New York Coffee and Sugar Exchange, the Better Business Bureau of Chicago, and the Chicago Tribune, which referred the problem to the Securities Exchange Commission (SEC) and the CEA. Both exchanges, CEA, and SEC denied jurisdiction in the case. The complainant, therefore, had exhausted all possible sources of assistance except legal action without gaining any satisfaction.

Another detrimental effect of failing to federally regulate all commodities is that individuals who have been suspended from trading in regulated commodities because of serious violations of the CE Act can continue to trade in unregulated commodities. Thus, the public is not protected from dealing with individuals of questionable character. For example, two individuals who were trading in regulated commodities on a Chicago exchange were prohibited from trading on all regulated contract markets for 2 years because they failed to meet minimum financial requirements prescribed by CEA and made false reports to CEA regarding such financial requirements. Before these individuals

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were suspended, they became large traders in nonregulated commodities in another city, and they are presently under severe criticism because of questionable trading practices.

REGULATION OF TRADING BY FLOOR BROKERS AND FUTURES COMMISSION MERCHANTS

Section 203 of the bill would amend the CE Act to provide that trading by floor brokers and futures commission merchants for their own accounts while at the same time trading for their customers' accounts will be restricted and allowed only under such terms and conditions as established by the Commission. The regulations are to avoid undue restrictions on trading liquidity, and different terms and conditions may be established for different contract markets. We support this provision of the bill.

In 1965 we reported to the Congress (B-146770, July 16, 1965) that members of a commodity exchange who trade for their own accounts enjoy special privileges and advantages over the trading public. In our review of selected futures trading transactions at one exchange we found 47 instances where questionable trading practices had occurred during a 3-month period. In 19 instances, the records indicated that the floor brokers (all of whom were officials of one futures commission merchant) had filled customers' orders noncompetitively by taking the opposite side of the transaction either for their own account or for the account of the futures commission merchant.

CEA subsequently investigated the questionable trading practices we identified and issued a complaint against the futures commission merchant and two of its officials. The Department suspended the two officials and the futures commission brokerage firm.

Because of the inherent conflict of interest wherein a broker may in one instance be trading for a customer's account and in the next instance trading for his personal account, we believe that such practices should be closely regulated. We note that the Securities and Exchange Commission regulations do not permit a member of a national securities exchange to initiate, while on the exchange floor, any transaction in any security trading on the exchange for any account which he has discretion over or in which he has an interest.

The exchanges, brokers, and futures commission merchants contended that prohibiting the brokers or futures commission merchants from trading for their own account would materially reduce the liquidity of the market to the extent that the normal function of the market would be adversely affected. They contended also that reduced liquidity would seriously affect the operations of the smaller exchanges. The bill provides that the regulations promulgated by the Commission shall avoid undue restriction on liquidity and would not prohibit the Commission from setting different trading standards for different contract markets.

We believe that such a provision would, if properly implemented, refute the argument of reduced liquidity and its adverse effects on the smaller exchanges and provide the necessary conditions to safeguard customers' interest.

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EXPANSION OF REGISTRATION REQUIREMENT TO INCLUDE ALL PERSONS INVOLVED WITH SOLICITATION OR ACCEPTANCE OF CUSTOMER ORDERS

Section 204 would amend the CE Act to extend the requirement for registration to any person associated with a futures commission merchant or with any agent of a futures commission merchant in any capacity which involves (1) the solicitation or acceptance of customers' orders or (2) the supervision of persons so engaged. The CE Act now requires only floor brokers and certain employees of futures commission merchants such as officers or partners to register, however, most individuals involved in handling customer accounts are not covered. Registration is accompanied by a fitness check to assure that reputable persons handle customer orders.

We support this provision of the bill because it will provide greater assurance that commodity customers are dealing with reputable brokerage representatives of good character.

Some exchanges currently require registration and fitness checks for certain employees of its member firms while other exchanges have no such requirements. The two largest commodity exchanges -- the Chicago Board of Trade and the Chicago Mercantile Exchange -- require employees of member futures commission merchants to be registered before they are permitted to solicit or handle customer orders. Officials of the two exchanges told us that each of their exchanges had in excess of 20,000 registered commodity futures representatives. Also, both exchanges subject appli-

cants to fitness checks which normally include a review of court and credit records. In contrast, CEA fitness checks may include reviews of investigation records maintained by the Department of Agriculture, the Securities and Exchange Commission, and the Federal Bureau of Investigation which are not available to private investigative organizations.

Other exchanges have only limited requirements or none at all. For example, the Mid-America Commodity Exchange requires only clearing members' representatives to be registered and does not subject them to fitness checks. The Minneapolis Grain Exchange, the New York Mercantile Exchange and the New York Cotton Exchange have no registration programs for commodity futures representatives. Thus, it is evident that a person of undesirable character could be employed as a futures representative by a member of an exchange that does not require registration and/or fitness checks.

Although this expanded requirement would significantly increase CEA's registration workload, particularly if all futures trading comes under Federal regulation, we believe it is necessary to assure adequate protection of individuals trading in futures contracts.

AUTHORITY TO DESIGNATE DELIVERY POINTS AND GRADES OF COMMODITIES

Section 208 would amend the CE Act to require the contract markets to permit the delivery of commodities in fulfillment of a futures contract at such points as designated by the Commission. The Commission would also have authority to designate the grade and quality of the deliverable commodities and the locational price differentials. We believe that a need exists for the Commission to have authority over the

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establishing of additional delivery points and that such additional delivery points will help in preventing or diminishing price manipulation, market congestion, or the abnormal movement of commodities in interstate commerce.

During recent years the volume of certain commodities such as soybeans and corn, has increased significantly as has the volume of futures trading. Despite these increases the number of delivery points at which delivery of certain commodities on futures contracts is permitted has not kept pace.

In August 1973 two associate professors at Iowa State University submitted a proposal to CEA and the Chicago Board of Trade that additional delivery points for corn and soybeans contracts be established to facilitate deliveries. At that time, Chicago, was and continues to be the only approved delivery point for corn and soybeans. The proposal pointed out some of the reasons for the need to establish multiple delivery points and cited the following recent example of the effect that the inability to deliver had on the cash-futures price relationship.

On July 30, 1973, the closing Chicago futures price for July corn contracts was \$ 1.13-1/4 per bushel above the closing Chicago cash price for No. 2 yellow corn. If delivery had been possible, it is clear that a strong incentive would have existed to buy cash corn, sell futures contracts and deliver on the futures contract. Several Iowa grain elevators verified that it had been difficult if not impossible to deliver corn and soybeans futures contracts in recent months because of full warehouses in Chicago, heavy Chicago export movement, and congestion in the railroad system.

In August 1972, a CEA official testified before the Subcommittee on Domestic Marketing and Consumer Relations House Committee on Agriculture that price distortion, manipulation, and control, which are detrimental to the public interest and the national economy, are easier, and in some cases encouraged, when the provisions of a futures contract call for delivery at a single point which is no longer a center for trading in the cash commodity deliverable on that contract. He stated that too few delivery points or improper delivery points, with restricted storage or holding capacity, could result in market congestion or arbitrary supply conditions which, in turn, could create erratic price fluctuations. More recently, in October 1973, the CEA Administrator testified before a House Committee that the failure of some exchanges to provide adequate delivery provisions is a major problem in the commodity futures industry.

We believe that the contract markets should continue to be primarily responsible for establishing delivery points because of the many economic factors which must be considered but that the Commission should have the authority to require, and if necessary to establish, additional delivery points.

AUTHORITY TO ESTABLISH MARGIN LEVELS SPECIFICALLY EXCLUDED

Section 210 would amend the CE Act to specifically preclude the Commission from approving margin levels established by the contract markets. Thus, the exchanges would determine their margin needs.

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In 1973 the commodity futures markets experienced an unprecedented volume of trading at record prices and CEA estimates that the volume of trading will continue to grow. During 1973 the exchanges repeatedly had to adjust the level of margin required to insure performance and to protect the integrity of the futures commission merchants and the commodity markets. These frequent changes resulted in charges of discriminatory practices and the initiation of legal actions by affected parties. Conversely, the exchanges were also criticized for not raising the margin level high enough or soon enough to prevent what was thought to be excessive speculation and the rise in commodity and food prices.

If those factors which are considered and evaluated by exchange officials in establishing and adjusting margin requirements are identifiable, a formula or table might be developed for margin levels. Testimony by the National Grain and Feed Association before your Committee on October 17, 1973, pointed out that a careful study would reveal safe margin levels to be a function of current price and trading conditions. The Association stated that a margin formula or table for each commodity would put all traders on notice of any automatic margin changes that would go into effect under given circumstances and would alleviate charges against the exchanges of discriminatory changes in margins.

The Committee may wish to consider requiring that the Commission, in conjunction with the commodity industry, study the feasibility of developing a margin formula or margin table.

The Federal Government does not have the capability at the present time to establish and monitor commodity margin requirements on a day-to-day basis without the expenditure of a significant amount of manpower and funds. A Department of Agriculture sponsored study in 1967 concluded that CEA would need better reporting and analyses to successfully perform such a function.

The Committee may wish, however to consider providing the Commission with authority to set margins under certain emergency market conditions as described in Section 215 of the bill. This section would provide the Commission with special emergency authority in market emergency situations such as war, price controls, export embargoes, or significant intervention of a foreign government in the futures market in order to facilitate orderly trading in or liquidation of any futures market.

AUTHORITY FOR INJUNCTIONS AND CIVIL PENALTIES

Section 211 would amend the CE Act to provide the Commission the authority through the Attorney General to seek injunctions to stop any person from violating the act or its regulations and to stop any person from controlling a commodity futures contract so as to effectively restrain its trading. Section 212 would amend the CE Act to authorize the imposition of monetary penalties up to \$ 100,000 in both administrative and criminal proceedings.

The basic function of commodity regulation is to preserve the price-basing and hedging services of the commodity futures markets. To preserve these services, CEA is dependent upon its ability to identify

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and deter violations of the act. Under current law when violations occur CEA may issue a cease and desist order or suspend or revoke the violator's right to continue in business or to use the futures markets. We believe that additional enforcement powers such as injunctions and civil penalties (fines) would be desirable to provide an effective means of preventing market price disruptions and protecting the market user.

Injunctive authority would provide a method of stopping violations from continuing after being detected or limiting their impact on the price-setting mechanism or on losses to the public of funds. Injunctive relief may often be obtained more expeditiously than the CEA can currently exercise its enforcement powers. For example, the Commission could obtain a court order prohibiting a brokerage firm that is insolvent or that fails to meet minimum financial requirements from accepting orders and funds from new customers until the requirements are met.

Injunctive authority could also be used to stop a trader from maintaining a position in the market that is causing the market to be disrupted or causing an abnormal price movement. For example, in June 1972, CEA became concerned about the large percent of the outstanding futures contract held by a trader in the July 1972 oat future. Without injunctive authority CEA could only advise the trader that it was concerned and would investigate his trading if there was any indication of price manipulation or price artificiality. The trader persisted in maintaining his dominant position in the

futures contract and upon the completion of its investigation CEA issued a complaint alleging price manipulation. With injunctive authority, CEA may have been able to stop the trader from maintaining his dominant position.

Civil money penalties would provide an additional sanction that could be imposed and one that could be adjusted to the seriousness of the violation. Current administrative actions range from suspension or revocation of trading privileges -- tantamount to putting some firms out of business -- to cease and desist orders which, in effect, may have little impact. For example, suspension for a period of several days to a firm could result in extensive losses and expenses and could put the firm out of business, whereas suspension of a trader for 2 to 3 weeks may not have a substantial effect.

We believe a definite need exists to provide additional enforcement authority for the regulation of the commodity futures market. The use of civil money penalties and the granting of injunctive powers are two powers that, in our opinion, would allow greater flexibility in enforcing the rules and regulations. In order to expedite the handling of cases, the committee might consider authorizing the Commission to seek injunctions in the United States District Courts rather than requiring that it be represented by the Attorney General. The Securities and Exchange Commission has been given similar authority.

CREATION OF A FEDERAL COMMODITY ACCOUNT INSURANCE CORPORATION

Title III of the bill provides for the creation of a Federal Commodity Account Insurance Corporation for the purpose of insuring customer accounts and customer related liabilities of futures commission

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merchants. Section 302 of the bill makes the Corporation subject to the provisions of the Government Corporation Control Act.

Sections 105 and 106 of the Government Corporation Control Act require the Comptroller General to make annual audits of financial transactions of Government corporations and to report the findings resulting from each such audit to the Congress within six and one-half months following the end of the fiscal year covered by the audit. We believe that our Office should be allowed flexibility in scheduling the use to be made of its available manpower resources. Accordingly, we recommend that the Committee revise Title III by adding the following provision at the end of such Title:

"Notwithstanding the provisions of sections 105 and 106 of the Government Corporation Control Act, the financial transactions of the Federal Commodity Account Insurance Corporation shall be audited by the Comptroller General not less than once during each three-year period and reports of the results of each such audit made to the Congress within six and one-half months following the end of the fiscal year covered by the audit."

As noted in our comments to section 104, we believe it would be useful for us in carrying out our audit responsibilities if the Comptroller General were to be given access to the records of futures commission merchants.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

While the Committee was appreciative of the contribution made by the General Accounting Office staff to the Committee's deliberations, the recommendation for creation of a separate Commission without representation of the agricultural interests represented by 80-90 percent of all commodity futures, ignored historical reality. The Committee was fearful that such a Commission could, in all likelihood, advocate a regulatory pattern controlled by speculative interests, at cost to legitimate hedging interests, with resultant harsh effects on the marketing system of agricultural commodities. The Committee preferred to rely on the proven experience of successive Secretaries in regulating futures trading, and in the absence of abuse of such regulation being called to the Committee's attention through improper influence by the Department of Agriculture on futures trading in order to affect cash prices of commodities regulated under the price support program, the Committee could see no reason for change from the CFTC composition provided in H.R. 11955, with the significant exception of deleting the Secretary's automatic designation as Chairman, and substituting instead a provision that allowed any Commissioner to be nominated to serve as Chairman, subject to confirmation by the Senate in such position.

In arriving at the concept of the 5 man independent Commodity Futures Trading Commission, the Committee similarly considered and rejected proposals to first leave the regulatory power completely with the Secretary and the Department of Agriculture, as at present, and proposals to merge futures and securities regulation.

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The Structure of the Commodity Futures Trading Commission (CFTC)

At the outset there were several suggestions before the Committee as to the structure of the regulatory body that should have oversight over futures trading.

First, there were suggestions to keep the present regulatory body as it was in, and completely under, the jurisdiction of the Department of Agriculture, run by the Secretary of Agriculture and the Commodity Exchange Commission.

The strength of such a proposal was that it found support among the exchanges; it recognized that approximately 90 percent of futures contracts traded on exchanges were agricultural products; that the Department had historical expertise in dealing with commodities futures and the personnel and an existing structure oriented toward regulation. Also, proponents pointed out that the Department itself was showing an increasing willingness to strengthen the CEA within its structure.

The other side of the proposal was the historical weakness of the Commodity Exchange Authority, often finding itself being treated as a stepchild by the Department, the Office of Management and Budget and with little respect as a regulatory body within the industry itself -- despite the sincere and well-meaning efforts of its officials. The CEA has failed to move with the times. The number of contracts traded has more than doubled, while the level of employment at the Commodity Exchange Authority had, at the time H.R. 13113 was being conceived, actually declined from its 1971 level. Additionally, the level of employees within the GS systems is inadequate to attract and retain the necessary expertise to supervise such a complicated market structure.

Additionally, under the present Act, there is a great confusion of authority as a result of the division of powers between the largely inactive Commodity Exchange Commission and the Secretary. For example, the CEA Administrator is actually subject to direction from two sources -- directly under the CEC and under two tiers of control within the Department itself. Legal staff and Administrative Law Judges are borrowed from the Department.

A second concept presented to the Committee was the creation of a new independent Commission. In addition to the practical difficulties of putting such a concept into effect without tremendous associated costs, and the creation of yet another giant bureaucracy with its demands for increasing space, costly new buildings, and associated demands for an entirely new separate support structure, was the practical difficulty of creating an effective organization de novo. Neither the public nor the industry can afford such a gap in the regulation of this volatile economic force.

Yet, there were significant strengths associated with the Commission concept: independence of budgetary authority, separate legal staff, and the input of public members who could do much to temper the thrust of an agency completely subject to the political winds which fan every Administration.

There was also a proposal advanced briefly to place the regulation of futures trading within the present SEC. The advantage was the

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existence of the SEC as an independent regulatory structure. The disadvantages were legend.

Often erroneously viewed as twins, there is little correlation in theory or in fact between the regulation of futures trading and the regulation of securities transactions. Futures trading regulation is essentially a regulation of a marketing device, that is, a contract right which is terminable at a time certain, for mainly agricultural commodities while the SEC regulates the handling of certificates of tangible ownership which are permanent in nature.

Futures, and their handling require highly specialized skills which are normally obtained expensively in the marketplace. Few universities teach the ins and outs of commodities trading, and those that do usually present it as an adjunct to coursework in agricultural economics. While securities markets attract the small speculator, with a limited exposure to loss, futures speculation is normally limited to the more venturesome and solvent speculator. In fact, many commission merchants discourage small investors, since according to a major board of trade, three out of four first-time inves-

tors in commodities suffer a net loss. Additionally, the concepts of margin -- which is a guarantee of performance in the futures market as contrasted with an extension of credit by the broker in the securities industry -- the actual delivery of commodities in certain limited situations -- approximately 3 percent -- of all contracts, and the handling of devices such as options are, and should remain, entirely different within the respective spheres of regulation.

The existence of another, more volatile regulatory function within the SEC could create difficulties that could probably never be overcome. No SEC Commissioner is appointed because of expertise in futures trading, and a merger of the staffs of the CEA within the respective organizations would do little more than precipitate a continuing conflict as to the priorities of the Commission with its jurisdiction so confused. The possibility seemed to terrify experts on futures trading who appeared before the full Committee, and who met with the Committee staff on numerous occasions. Neither is it a welcome prospect at the SEC.

In adopting the concept of the Commodities Futures Trading Commission, the bill seeks to build a bridge between the philosophy of regulatory independence and the reality of maintaining the expertise of the Department of Agriculture. The CFTC combines the two concepts -- drawing upon the strengths of the existing structure and leaving behind the weaknesses. In doing so, H.R. 13113 gives the CFTC independence in policy budgetary authority, staff, including legal staff, Administrative Law Judges and the additional guarantees provided by the bipartisan composition of the public members. Personnel and policy are the strengths of the independent Commission concept. From the existing regulatory body the CFTC will be able to retain experience, cohesiveness of purpose, and limited administrative support for both technical and administrative purposes. Additionally, with an administration official as a member of the Commission, the Commission will be continually connected to the policies of the Government, which so strongly affect the reactions of the market. For example, if an emergency embargo on all commodity exports were

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decided by the administration to be necessary, the Commission would have a headstart in promulgating emergency policies to meet any crisis created through such an action, hopefully, even before the markets had reacted. Additionally, because of the committee's decision to keep the Commission responsible for cash market manipulations, it will have closer ties to the Department most responsible for those cash transactions regulated.

Open markup sessions were held on H.R. 13113 during the month of February, on the 6th, 7th, 13th, 14th, 15th and 27th, with final consideration of the bill by the Committee on March 6, 1974. The Committee voted to instruct the Chairman to introduce a bill incorporating the more than 50 amendments to H.R. 11955 adopted by the Committee during markup. This bill, H.R. 13113, was introduced on February 27, referred to the Committee, and subsequently reported by a record vote of 24 ayes to 8 voting no. A quorum was present and voting.

DEPARTMENTAL POSITION

The Department of Agriculture appeared before the Committee on January 23, 1974, generally in support of the legislation. Assistant Secretary Yeutter presented the Department's views. His statement, taken from the Committee transcript, follows:

STATEMENT OF DR. CLAYTON YEUTTER, ASSISTANT SECRETARY OF AGRICULTURE, ACCOMPANIED BY ALEX CALDWELL, ADMINISTRATOR, CEA AND HAROLD CARTER, OFFICE OF GENERAL COUNSEL

Dr. YEUTTER. Thank you, Mr. Chairman. I appreciate those remarks.

I want to join in those accolades, because our staff has enjoyed the relationship it has had, both with the Subcommittee and Mr. Stubblefield and the members of that Subcommittee and with John O'Neal and John Rainbolt. It seems to me, Mr. Chairman, that this group of people has done the finest job of legislative draftsmanship on a very complicated subject that any of us has seen in the agriculture area in a long time. They are really to be complimented. As you know, this is one of the most complex subject matter areas that any one of us can deal with. It is not easy to draft legislation in this area. Yet it is extremely important. I suppose few people recognize how truly important this legislation is.

Mr. Chairman, you are to be complimented on your leadership, too, because this might well be one of the most important pieces of legislation that has come out of the Committee on Agriculture in a long, long time. So it does merit everyone's attention.

Now, turning to the statement, I would like to add preliminarily that like Mr. Smith, there will be some critical comments in this testimony, but this should not detract from our general impressions of this legislation, because as I said, we are very pleased with the substance of this legislation, and though that may not be indicated by the fact that I am concentrating the testimony on what we feel to be some of the shortcomings, I would like to emphasize that we feel that basically, this is a very fine piece of legislation.

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Mr. Chairman, I appreciate the opportunity of appearing before this Committee to present the Administration's views with respect to H.R. 11955, a bill which would provide a comprehensive revision of the recognition of futures markets. The Administration recommends that it be adopted with certain modifications. Specific changes for your consideration are included in an addendum attached hereto. I would like to add also that we have not dealt with each of the subject issues which we have raised here and we would be happy to work with the Committee and with the staff for additional modifications if you would like us to do so.

In the past year the futures markets have attracted more attention than at any other time in history. They have been praised by some and criticized by others. For perhaps the first time, it has become clear to the general public that futures markets touch the lives of all of us. With the value of contracts traded in fiscal 1973 reaching almost \$ 400 billion, and I will add parenthetically that the increase in the calendar year 1973 which we just announced yesterday is simply phenomenal, it is an appropriate time for the Congress to consider and adopt legislation which will recognize the growing importance of futures markets in the national economy; protect all market users; protect the general public including producers and consumers indirectly affected by futures markets; dispel what the Chairman referred to as a "crisis of confidence" in the institutions and practices of the commodity futures industry; and provide a climate in which futures markets can continue to grow and operate in the public interest.

In general, this bill is a considered approach to the problems that beset futures markets. While our present authority is adequate in most cases with respect to the commodities currently covered by the Act, we believe the bill in many respects an improvement and I must say a significant improvement over the present Act.

H.R. 11955 will replace the present Commodity Exchange Commission, composed of the Secretaries of Agriculture and Commerce and the Attorney General, and transfer all duties of that Commission and the Secretary of Agriculture under the Commodity Exchange Act to a new five-member regulatory Commission, known as the Commodity Futures Trading Commission, which will supervise futures trading. The Commission will be composed of the Secretary of Agriculture or his designee as permanent chairman and four members with staggered terms appointed by the President from the general public with the advice and consent of the Senate. The President may select the public members from any sector, the only statutory requirement being that all must be knowledgeable in the commodity trading business. Such commissioners cannot participate, either directly or indirectly, in any contract market operations or transactions subject to regulation by the Commission.

Some persons feel that regulation of the futures markets should remain solely within the jurisdiction of the Secretary of Agriculture, since the Department has over 50 years' experience in supervising these futures markets now under regulation and approximately 90 percent of futures trading is in agricultural commodities. Others feel that since regulation is being extended to cover futures markets in non-agricultural commodities and services, a completely independent regulatory

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Commission is advisable. As you all recognize, this is the system favored by Congressman Smith in his testimony.

This bill combines features of each of these proposals. By the appointment of the Secretary as permanent chairman and the transfer to the Commission of personnel of the present Commodity Exchange Authority of the Department of Agriculture, the Commission will be able to retain the futures market expertise which has been developed within the Department of Agriculture. It will also be able to continue the close day to day, door to door, liaison which has been developed with a number of other USDA agencies. This will be invaluable as the Commission's regulatory activities become more extensive, and thus more dependent on the basic data and market intelligence of these other agencies. At the same time, the broad based Commission will be able to make independent judgments with respect to the regulation of the futures markets in both agricultural and non-agricultural commodities.

I should add parenthetically here that we feel rather strongly on this structure of the Commission, be it the type enunciated or described in this bill or whether it be a separate and independent commission as described by Congressman Smith. I will not elaborate on that point now, but, Mr. Chairman, I will be happy to do so in questions and comments later, if you wish.

While we support the Commission concept, we believe it should be an agency within the Department of Agriculture. We are opposed to provisions of the bill allowing the Commission to use selected facilities and services of the Department without cost, and providing that the Commission shall have its own General Counsel and legal staff, its own Administrative Law Judges, and independent budgeting capacity. Beginning July 1 of this year all Federal departments must reimburse the General Services Administration for the space they use. To allow the Commission free use of facilities and services of the Department runs counter to this policy established by the Congress in 1972 and places an undue burden on the other resident agencies.

Likewise, the Commission's budget should be included in and considered as part of the Department's budget. If the Department is to provide administrative support to the Commission in budget preparation, surveillance, et cetera, we see no reason for the submission of separate budgets. It would be more efficient and economical to have an integrated budget for all agencies within or associated with the Department, including the Commission.

There is no need for an additional General Counsel and a separate legal staff to furnish legal services in connection with the Act. The existing office of the General Counsel of the Department can readily provide whatever legal services might be needed. It has the legal expertise, background, and facilities to do so. The experience of the Department of Agriculture has clearly demonstrated that in order to have independent and objective legal advice and services it is essential that the legal staff not be subject to the supervision or control of those who are engaged in the actual administration of a statute. With the Secretary as permanent chairman of the Commission and with the Commission's associations with the Department, we strongly feel that the legal services for the Commission should remain in the Office of the General Counsel. Further, any other arrangement in

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such a situation could result in conflicting legal advice to the Secretary of Agriculture on the same subject. That there is no need for an additional General Counsel and a separate legal staff is illustrated by the Commodity Credit Corporation which operates very efficiently using the services of the Department's legal office. There is likewise no need for Administrative Law Judges separate from the Department since such judges are independent in any event.

A major objective of H.R. 11955 is the increased visibility and autonomy of the proposed Commission. This is achieved through statutory creation of the Commission and the direct grant of regulatory powers to it. Thus, the Secretary of Agriculture cannot abolish the Commission or diminish its powers by Secretarial action. The Secretary is only one of five commissioners and the four public members are not subject to his control. Therefore, we believe the independence of the Commission is achieved through these provisions and performance of the administrative functions for the Commission within the Department of Agriculture will not detract from the objectives of the bill but will be far more economical and efficient.

We are also concerned with whether the new Commission can effectively carry out its functions under this bill as presently written. This is not a substantive issue, Mr. Chairman; it is a question really of draftsmanship. H.R. 11955 provides that the Commission is to meet at least once a month or at the call of the chairman or two members. Such additional meetings cannot be called on less than three days' notice. There is no provision for delegation of duties, and in fact the bill specifically requires that all administrative and executive functions be carried out solely by the Commission. There is no authority for less than the full Commission to act. In view of the magnitude of the duties of the Commission, we see no way in which it can effectively carry out its responsibilities without more flexibility in its decision-making and operating procedures. This would seem particularly true in the case of emergency situations. We would recommend that careful consideration be given to these aspects of the bill. Provision should be made for the delegation of authority by the Commission to the chairman in order to provide for action in instances in which such action must be taken before the full Commission can be convened. Also, consideration should be given to the delegation of the adjudicatory and other functions of the Commission. As I said, Mr. Chairman, these are all matters that can easily be handled by draftsmanship and I am sure it was not the intent of the Committee to cause any difficulty in terms of delegation of authority which obviously is essential to make the Commission function properly.

Section 106 of the bill provides exemption from the antitrust laws for actions of a contract market, registered futures association, or registrant under the Act taken pursuant to any order, rule, or regulation of the Commission or any bylaw, rule, or regulation of a contract market which has been approved by the Commission. We believe broad exemption from the antitrust laws is unwise from a policy standpoint, and we understand that the Department of Justice feels that the present case law provides an adequate antitrust exemption for activities of contract markets. I will not embellish on that point, Mr. Chairman. I am aware of the concerns that the Antitrust Division of the Justice

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Department has with the existing language and I will simply say at this point that we defer to the Department of Justice for any further Comment that might be in order.

The bill would bring within the purview of the Act, in addition to the commodities now covered, all commodities, goods, articles, services, rights, and interests which are or may be the subject of futures contracts. In other words, the intent of this provision would be to cover all futures trading that might now exist or might develop in the future. I would add again parenthetically that we consider this to be one of the most critical points in this bill and one of its strongest points.

This has long been needed. There is no reason why a person trading in one of the currently unregulated futures markets should not receive the same protection afforded to those trading in the currently regulated markets. Each commodity or service has certain individual characteristics. However, all futures markets operate in substantially the same manner. It was once thought that protection was needed only for producers of a commodity. It is now recognized, however, that all persons along the merchandising chain and consumers are entitled to the full protection of the law. Whether a commodity in the United States is grown or mined or whether it is produced in the United States or outside makes little difference to those in this country who buy, sell, and process the commodity or to U.S. consumers whose prices are affected by the futures market in the commodity. Persons trading in the unregulated markets and persons affected by those markets are not receiving the same protection as those who trade in or are affected by the regulated markets. This bill will put all exchanges and all persons in the industry under the same set of rules and regulations for the protection of all concerned.

Under this bill, contract markets must demonstrate that the futures contracts for which they are designated or seek designation serve an "economic purpose." To do so they must show that the contract is used or can be expected to be used for hedging or price basing purposes by the industry. We do not believe that this sets forth an adequate guideline. Trading in almost any futures contract may serve a price basing purpose but may still be designed primarily for gambling purposes and have no real economic value other than to the individual participants. We believe this provision should be clarified. And, Mr. Chairman, we will be happy to try to work with the Committee on this point, too. Again, this is a question of draftsmanship. It is very difficult to draft a provision that will effectively cover this point, but I believe that jointly, we ought to attempt to do so.

At the present time, the Act proscribes the manipulation of the market price in cash transactions of those commodities covered by the Act. It should be noted that the expansion of the definition of commodities to include all commodities, goods, articles, services, rights, and interests subject to futures trading will result in a corresponding expansion of such manipulation provisions relating to cash transactions. As simply an observation on our part, we are simply pointing out to the Committee that this is a substantial additional regulatory burden that automatically presents itself as one expands coverage of the futures area.

Included in the bill are a number of strengthening provisions. I will comment only upon some of the more important of these. Although

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there is adequate legal authority to do several of the things contemplated by the bill, clarification is certainly welcome and should be helpful.

One of the major problems in maintaining orderly markets has been the single delivery point provided for some contracts. That issue has been raised by Congressman Smith and by many others over the last years and months. For many years, the Department has been urging the exchanges to provide an adequate number of delivery points in the production areas and along the routes by which the various commodities move from the producer to the consumer. The

need for such points is readily apparent. On July 20, 1973, the last trading day for July corn on the Chicago Board of Trade, the futures price rose \$ 1.20 per bushel. In large part this rise was the result of the provision in the contract which allows delivery only at Chicago. In July there was a limited amount of corn available for delivery in Chicago. Transportation problems made it difficult to move corn into the Chicago area and warehouses in that area were either filled or reluctant to accept corn coming in for delivery on the futures contract. The result was that many who would have made delivery had there been provision for delivery at other points where supplies are ordinarily available, were unable to do so. They were thus forced to buy futures contracts at an escalating price largely caused, not by an overall change in the supply or demand for corn, but an artificial shortage of deliverable supply resulting from the inadequacy of the exchange delivery rule.

This bill will give the Commission the specific authority to require exchanges to permit delivery of commodities at such a point or points as the Commission finds necessary to diminish price manipulation, market congestion or the abnormal movement of commodities in interstate commerce. Under the bill this can be done only after opportunity for a hearing and comments from interested parties, and a Commission order requiring additional delivery points can be issued only after the exchange involved has had opportunity to file exceptions. Multiple delivery points will help eliminate undue price fluctuations in maturing futures and thus protect market users and the public. I would like to add on this point that the establishment of multiple delivery points or additional delivery points in any commodity is likewise a complex matter. It requires very intricate economic analysis and it is an analysis that ought to be made by the exchanges in the first instance. We have no desire, insofar as a regulatory agency is concerned, to do this job for the exchanges. In fact, we feel very strongly that they ought to do the job. Our concern here is simply making sure that if they do not do the job properly, adequate authority is present for the regulatory agency to take action should such be desirable. If that were done, it would obviously be in accordance with the legal procedures that are enunciated here.

The present Commodity Exchange Act contains no specific authority to secure injunctions. Under this bill, the Commission will be given specific authority through the Attorney General to seek injunctions to stop any person from violating the Act or regulations thereunder and to stop any trader from controlling a commodity futures contract to the extent that he is effectively restraining trade. This would facilitate enforcement of the Act.

Many persons have questioned the procedure on commodity exchanges

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in which floor brokers and futures commission merchants trade for their own accounts and for their customers. You had a rather lengthy colloquy with Congressman Smith on this point just a few minutes ago. The possible conflict of interest is self-evident in a situation of this type. However, a flat prohibition against such trading would discourage the formation of new exchanges and would work to the serious disadvantage of the more established exchanges which have a comparatively small volume of trading. This bill will give the Commission specific authority to consider the problem separately for each exchange and take whatever action is required to protect the public. The bill provides that trading by floor brokers and futures commission merchants for their own accounts and for customers will be restricted and allowed only under such circumstances as may be prescribed by the Commission. We feel that this is the proper way to handle this very delicate and sensitive issue.

Congressman Smith earlier indicated that he was concerned about the delay that might take place in the development of regulations in this area. My only follow-up comment on that is that we consider this a high priority area just as he does and we certainly would not delay regulations any longer than would absolutely be required in the administrative process.

The existing registration requirements are applicable only to floor brokers and futures commission merchants. The present fitness requirements relate only to registrants and applicants for registration, their partners, officers and stockholders of more than 10 percent interest. Under this bill, the registration and fitness requirements will be specifically extended to all individuals handling customers' accounts. Operation under the present fitness provision has clearly demonstrated the need for this extension. Individual customers' men who have been involved in the mishandling of customers' accounts at one brokerage firm frequently transfer their operation to another firm, quite often without the second firm having any knowledge of the earlier difficulties. This bill will specifically enable the Commission to maintain an accurate record of persons handling customers' accounts and bar from this occupation those persons who by their past actions have demonstrated that they cannot be entrusted with customers' trades and funds.

Contract markets will be required under the new bill to submit their bylaws, rules, regulations, or resolutions which relate to the terms and conditions of futures contracts and other trading requirements to the Commission for its approval and the Commission will be authorized to require a contract market to change its rules and practices when the Commission finds, after opportunity for hearing, that such changes are necessary for the protection of the public. While we have similar authority now by means of broad rulemaking authority and disapproval of contract market bylaws, rules, regulations, and resolutions, the changes made by the bill would extend to the commission even broader authority in this respect to make certain that in every instance the rules fully protect all traders and the public and provide for orderly trading in futures contracts. Further, we recommend that the bill be amended to specifically authorize the Commission to revoke any rule previously approved.

From time to time emergency situations arise when it is clear that some drastic action is necessary to protect futures markets and market

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users. The provisions of the bill giving the Commission specific authority to direct exchanges to take action in emergency situations would, in our view, facilitate the carrying out of their responsibilities under the Act.

Self-regulation by exchanges has come under fire in recent months and some critics have even claimed that there is no place for self-regulation in federally supervised futures markets. While we continue to feel that the concept of self-regulation retains validity under certain circumstances, and in fact ought to be expanded in most contract markets in this country, we do not believe it should be expanded as set forth in the bill. Therefore, we oppose the authority to be granted by the bill under which persons in the commodity trading business can establish a voluntary futures association or associations to regulate the practices of members. The creation of such associations would be an abdication of the regulatory role to be carried out by the Commission. Such associations would create an unnecessary layer of regulation, would tend to become pressure organizations forcing all in the commodity industry to join, and could make effective regulation by the Commission more difficult. With the new authority given to the Commission by this bill, particularly the customers' reparation procedure under which it will handle customers' complaints of financial loss arising from violations of the Act, there seems no need for such futures associations. We recognize that there is a comparable association system in the securities industry and that such could ultimately work in a functional and effective manner in the commodities industry. But for the present, at least, we certainly feel that there are enough challenges in establishing all the additional regulatory framework that is enunciated in this bill without going one step further and attempting to establish a system of self-regulation here that at least in the immediate future, we do not feel would be either necessary or desirable.

One of the ways in which unsophisticated traders have lost substantial amounts of money is through commodity advisors and commodity pool operators. This bill will provide for the registration of all such persons, establish procedures under which they will be permitted to operate and specifically eliminate certain undesirable practices which have enticed unsuspecting traders into the markets with, far too often, substantial loss of funds. While at the present time the Act does give a measure of authority over such persons, such as the prohibition on cheating and defrauding, we feel that this provision of the bill will facilitate the effective regulation of such persons.

As presently drafted, the bill would create a Federal Commodity Account Insurance Corporation which would insure individual customers' accounts. While the Administration supports insuring these accounts, we favor locating such financial protection within the existing framework of the Securities Investors Protection Corporation. The SIPC, established by Congress in 1970, already provides the kinds of protection envisioned in Title III. We believe this approach would provide better service to the customers because in many cases brokerage firms deal in both securities and commodities. In the event of a firm's insolvency or bankruptcy, the customer would need to deal with only one liquidator and one insurer rather than two. Furthermore, a unified insurance approach under SIPC could also be carried out much more

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efficiently and without unnecessary duplication. A parenthetical comment here, Mr. Chairman, would simply be that it seems to me some significant questions have been raised with regard to the structure of this kind of insurance entity. They were raised both by Congressman Smith earlier this morning and we likewise raised comparable questions in our testimony, and I believe that additional study ought to be given to this particular matter. No one disagrees with the

concept. I believe that all of us feel that an insurance system would contribute to protection of the participants in the markets. The only question is how this can best be done.

Mr. Chairman, the bill provides for an effective date 180 days after enactment. The setting up of the new Commission, the designation of new contract markets, the registration of new futures commission merchants and floor brokers and several other matters should be completed prior to that date. We recommend that the bill provide authority under which the commissioners can be appointed and the organizational work started soon after the legislation is signed by the President. This will enable the Commission to begin full operation on the effective date of the legislation.

This concludes my statement Mr. Chairman. I apologize for taking so much time, but it is a very comprehensive piece of legislation. I will now be pleased to answer any questions that you or any member of the Committee might have.

[The above referred to attachment follows:]

ADDENDUM

AMENDMENTS TO H.R. 11955 SUGGESTED BY USDA

On page 2, line 7, insert the phrase "within the Department of Agriculture" after the word "established."

On page 4, line 16, insert a comma after the phrase "level V" and delete the word "and"; on line 17, insert "and" after the comma and delete the phrase "and a General Counsel"; and on lines 19 and 20, delete the phrase "attorneys, special experts, administrative law judges, clerks, and".

On page 5, delete lines 12 through 17. On page 5, line 18, insert a comma after the word "executive", delete the word "and" and insert after the word "administrative" the phrase ", and regulatory", and in line 24, delete the word "solely" and insert after the word "Commission" the following:

unless delegated by the Commission to the Chairman or other official or employee of the Commission or the Department of Agriculture.

On page 5, delete line 25, and delete lines 1 through 6 on page 6.

On page 7, line 13, delete the word "All" and substitute the word "Such", and in line 17, insert after the word "Act" the phrase "as the Secretary of Agriculture may determine".

Delete Section 106 of the bill (page 15, lines 15 through 25, and page 16, lines [TEXT ILLEGIBLE] through 10).

On page 13, line 4, insert the following immediately before the period:

and thereafter the Commission shall disapprove, after appropriate notice and opportunity for hearing, any such by-law, rule, regulation or resolution which the Commission finds at any time is in violation of the provisions of this Act or the regulations of the Commission.

Delete Title IV of the bill (page 60, line 9, through page 75, line 19).

On page 77, line 6, insert the following immediately before the period:

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and by deleting the word "so" and inserting the words "by the Commission" immediately before the semi-colon at the end of such section.

On page 78, lines 25 and 26, amend Section 512 to read as follows:

Sec. 512. This Act shall become effective one hundred and eighty days after enactment. Activities necessary to implement the changes effected by this Act may be carried out after the date of enactment and before as well as after the effective date. Such activities may include, but are not limited to, appointment of the members of the Commodity Futures Trading Commission, designation of boards of trade as contract markets, registration of futures commission merchants, floor brokers and other persons required to be registered under the Act, and approval or modification of bylaws, rules, regulations, and resolutions of contract markets.

Appropriate amendments to Title III of the bill will be provided at a later date.

Then on February 8, 1974, the Department furnished the Committee with the following written report:

DEPARTMENT OF AGRICULTURE,
OFFICE OF THE SECRETARY,
Washington, D.C., February 8, 1974.

Hon. W. R. POAGE,
*Chairman, Committee on Agriculture,
House of Representatives*

DEAR MR. CHAIRMAN: This is in response to your request for a report on H.R. 11955, a bill to amend the Commodity Exchange Act to strengthen the regulation of futures trading, to bring all agricultural and other commodities traded on exchanges under regulation, and for other purposes.

We recommend that H.R. 11955 be enacted if modified as discussed below.

In the past year the futures markets have attracted more attention than at any other time in history. For perhaps the first time, it has become clear to the general public that futures markets touch the lives of all of us. The Commodity Exchange Act provides for the regulation of 19 commodities in which there were active futures markets in 1973. There were, however, 7 other agricultural or forest commodities and 9 nonagricultural commodities with active futures markets which were completely unregulated by the Federal Government. With the value of contracts traded in fiscal 1973 reaching almost \$ 40.0 billion, it is an appropriate time for the Congress to consider and adopt legislation which will recognize the growing importance of futures markets in the national economy, protect all market users, protect the general public, including producers and consumers indirectly affected by futures markets, and provide a climate in which futures markets can continue to grow and operate in the public interest.

The proposed bill would bring under regulation the futures markets in such important agricultural and nonagricultural commodities as coffee, sugar, cocoa, plywood, lumber, silver and copper. This has long been needed. There is no reason why a person trading in one of the currently unregulated futures markets should not receive the same protection

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afforded to those trading in the regulated markets. It was once thought that protection was needed only for producers of a commodity. It is now recognized, however, that all persons along the merchandising chain and consumers are entitled to the full protection of the law. Whether a commodity is grown or mined, or whether it is produced in the United States or outside, makes little difference to those in this country who buy, sell, and process the commodity or to U.S. consumers whose prices are affected by the futures market in that commodity. This bill will put all exchanges and all persons in the industry under the same set of rules and regulations for the protection of all concerned.

This proposed bill includes a number of strengthening amendments to the Commodity Exchange Act. Although there is adequate legal authority to do several of the things contemplated by the bill, clarification is welcome and should be helpful. The Department supports most of these proposed amendments, particularly those that would:

- (1) give the Commission the specific authority to require exchanges to permit delivery of commodities at such a point or points as the Commission finds necessary to diminish price manipulation, market congestion or the abnormal movement of commodities in interstate commerce;
- (2) give the Commission specific authority through the Attorney General to seek injunctions to stop any person from violating the Act or regulations thereunder and to stop any trader from controlling a commodity futures contract to the extent that he is effectively restraining trade;
- (3) provide that trading by floor brokers and futures commission merchants for their own accounts and for customers will be restricted and allowed only under such conditions as may be prescribed by the Commission;
- (4) extend the registration and fitness requirements to cover all individuals handling customers' accounts;
- (5) require contract markets to demonstrate that the futures contracts for which they are designated or seek designation serve an economic purpose. However, we do not believe this provision sets forth an adequate guideline and, therefore, it should be clarified;

(6) require contract markets to submit their bylaws, rules, regulations or resolutions which relate to the terms and conditions of the futures contracts and other trading requirements to the Commission for approval. However, we recommend that the Commission be given specific authority to revoke any rule previously approved;

(7) authorize the Commission to require a contract market to change its rules and practices when the Commission finds, after opportunity for hearing, that such changes are necessary for the protection of the public;

(8) give the Commission the specific authority to direct contract markets to take action in emergency situations in order to facilitate the orderly trading in or liquidation of any futures contracts;

(9) provide for the registration of commodity advisors and

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commodity pool operators, establish procedures under which they will be permitted to operate, and eliminate practices which have enticed unsuspecting traders into the markets with, far too often, substantial loss of funds; and

(10) provide for a customers' reparation procedure under which it will handle customers' complaints arising from violations of the Act, particularly those which result in financial loss to the customers. The Commission will consider all such complaints which have not been resolved through the settlement procedures required of exchanges. The provision for this review and settlement of customers' complaints should make possible full and equal justice for those who feel that they have been in some way damaged in the handling of their commodity accounts.

This bill will replace the present Commodity Exchange Commission and transfer all duties of that Commission and the Secretary of Agriculture under the Commodity Exchange Act to a new five-member regulatory Commission which will supervise futures trading. The Commission will be composed of the Secretary of Agriculture or his designee as permanent chairman and four members with staggered terms appointed by the President from the general public with the advice and consent of the Senate. While we support the Commission concept, we believe it should be an agency within the Department of Agriculture. We are opposed to provisions of the bill allowing the Commission to use selected facilities and services of the Department without cost, and providing that the Commission shall have its own general counsel and legal staff, its own administrative law judges, and independent budgeting capacity. We believe the independence of the Commission is achieved through statutory creation of the Commission and the direct grant of regulatory powers to it and the performance of the administrative functions for the Commission within the Department of Agriculture will not detract from the objectives of the bill, but will be far more economical and efficient.

Section 106 of the bill provides exemption from the antitrust laws for actions of a contract market, registered futures association or registrant under the Act taken pursuant to any order, rule, or regulation of the Commission or any bylaw, rule, or regulation of a contract market which has been approved by the Commission. We believe broad exemption from the antitrust laws is unwise from a policy standpoint, and we understand that the Department of Justice feels that the present case law provides an adequate antitrust exemption for activities of contract markets. We defer to the Department of Justice for further comment on this point.

We oppose the authority to be granted by this bill under which persons in the commodity trading business can establish a voluntary futures association (s) to regulate the practices of members. We feel the functions authorized to be carried out by national futures associations should be carried out exclusively by the Commission. Such associations would create an unnecessary layer of regulation, would tend to become pressure organizations forcing all in the commodity industry to join, and could make effective regulation by the Commission more difficult.

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With the new authority given to the Commission by this bill, particularly the customers' reparation procedure under which it will handle customers' complaints of financial loss arising from violations of the Act, there seems no need for such futures associations.

As presently drafted, this bill would create a Federal Commodity Account Insurance Corporation which would insure individual customers' accounts. While we support the insuring of these accounts, we favor locating such financial protection within the existing framework of the Securities Investors Protection Corporation. The SIPC, established by Congress in 1970, already provides the kinds of protection envisioned in Title III. We believe this approach would provide better service to the customers because in many cases brokerage firms deal in both securities and commodities.

In the event of a firm's insolvency or bankruptcy, the customer would need to deal with only one liquidator and one insurer rather than two. Furthermore, a unified insurance approach under SIPC could also be carried out much more efficiently and without unnecessary duplication.

The bill provides for an effective date 180 days after enactment. The setting up of the new Commission, the designation of the new contract markets, the registration of new futures commission merchants and floor brokers and several other matters should be completed prior to that date. We recommend that the bill provide authority under which the commissioners can be appointed and the organizational work started soon after the legislation is signed by the President. This will enable the Commission to begin full operation on the effective date of the, legislation.

Enclosed as an addendum to this report is language which would implement the changes we recommend.

There is enclosed a schedule showing the estimated cost of the enactment of this legislation for the first five fiscal years.

The Office of Management and Budget advises that there is no objection to the presentation of this report and that enactment of this proposed legislation would be consistent with the Administration's objectives.

Sincerely,

EARL L. BUTZ, Secretary.

Enclosures.

ADDENDUM

On page 2, line 7, insert the phrase "within the Department of Agriculture" after the word "established."

On page 4, line 16, insert a comma after the phrase "level V" and delete the word "and": on line 17, insert "and" after the comma and delete the phrase "and a General Counsel" ; and on lines 19 and 20, delete the phrase "attorneys, special experts, administrative law judges, clerks, and".

On page 5, delete lines 12 through 17. On page 5, line 18, insert a comma after the word "executive", delete the word "and" and insert after the word "administrative" the phrase ", and regulatory", and in line 24, delete the word "solely" and insert after the word "Commission" the following:

unless delegated by the Commission to the Chairman or other official or employee of the Commission or the Department of Agriculture.

On page 5, delete line 25, and delete lines 1 through 6 on page 6.

On page 7, line 13, delete the word "All" and substitute the word "Such", and in

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line 17, insert after the word "Act" the phrase "as the Secretary of Agriculture may determine".

Delete Section 106 of the bill (page 15, lines 15 through 25, and page 16, lines 1 through 10).

On page 33, line 4, insert the following immediately before the period:

and thereafter the Commission shall disapprove, after appropriate notice and opportunity for hearing, any such by-law, rule, regulation or resolution which the Commission finds at any time is in violation of the provisions of this Act or the regulations of the Commission.

Delete Title IV of the bill (page 60, line 9, through page 75, line 19).

On page 77, line 6, insert the following immediately before the period:

and by deleting the word "so" and inserting the words "by the Commission" immediately before the semi-colon at the end of such section.

On page 78, lines 25 and 26, amend Section 512 to read as follows:

Section 512. This Act shall become effective one hundred and eighty days after enactment. Activities necessary to implement the changes effected by this Act may be carried out after the date of enactment and before as well as after the effective date. Such activities may include, but are not limited to, appointment of the members of the Community Futures Trading Commission, designation of boards of trade as contract markets, registration of futures commission merchants, floor brokers and other persons required to be registered under the Act, and approval or modification of bylaws, rules, regulations, and resolutions of contract markets.

Both Dr. Yeutter's testimony and the February 8 letter were directed to H.R. 11955, the bill then pending before the Committee. H.R. 13113 superceded H.R. 11955 and incorporated the Committee's amendments to the original bill. A number of the Department's suggested amendments were approved by the Committee and made a part of H.R. 13113.

CURRENT AND FIVE SUBSEQUENT FISCAL YEAR COST ESTIMATE

Pursuant to Clause 7 of Rule XIII of the Rules of the House of Representatives, the Committee estimates the cost to be incurred by the Federal Government during the current and the five subsequent fiscal years as a result of the enactment of this legislation would be \$ 25,593,000. This figure represents a five year estimate, 1975 through 1979 fiscal years. No current year (FY 1974) costs are contemplated since the new Commission could not become operational within that time.

The Department of Agriculture formally submitted the following cost chart to accompany their report on the bill, H.R. 11955, reflecting the additional costs expected to be incurred upon enactment of new legislation. However, the estimate is not entirely applicable since it was directed to H.R. 11955 and further contemplated that all Administration amendments would be adopted by the Committee. It incorrectly assumes, as a result, that facilities of the U.S.D.A. General Counsel and the Agricultural Marketing Service would be utilized by the new Commission. Under H.R. 13113, the new Commission would be required to have its own legal staff and administrative services separate and apart from U.S.D.A. The departmental chart is included for information as a comparable estimate of costs:

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COMMODITY EXCHANGE AUTHORITY

LEGISLATIVE PROGRAM PROJECTIONS

[In thousands of dollars]

Source: USDA.

The Committee estimate of \$ 25,593,000 is based on the provisions of H.R. 13113. The Committee five year estimate follows:

COMMODITY FUTURES TRADING COMMISSION

COST PROJECTIONS UNDER PRESENT LAW AND H.R. 13113

[In thousands of dollars]

Source: House Committee on Agriculture.

CHANGES IN EXISTING LAW

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman) :

COMMODITY EXCHANGE ACT, AS AMENDED

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,
That this Act may be cited as the "Commodity Exchange Act."

SEC. 2. (a) (1) For the purposes of this Act, "contract of sale" shall be held to include sales, agreements of sale, and agreements to sell. The word "person" shall be construed to import the plural or singular, and shall include individuals, associations, partnerships, corporations, and trusts. The word "commodity" shall mean wheat, cotton, rice, corn,

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oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, [onions,] *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice [.] *and all other goods and articles, except onions as provided in P.L. 85-839, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in: Provided, That the Commission shall have exclusive jurisdiction of transactions dealing in, resulting in, or relating to contracts of sale of a commodity for future delivery, traded or executed on a domestic board of trade or contract market or on any other board of trade, exchange, or market: And provided further, That nothing herein contained shall supersede or limit the jurisdiction at any time conferred on the Securities Exchange Commission or other regulatory authorities under the laws of the United States or restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with the laws of the United States.* The term "future delivery" as used herein, shall not include any sale of any cash commodity for deferred shipment or delivery. The words "board of trade" shall be held to include and mean any exchange or association, whether incorporated or unincorporated, of persons who shall be engaged in the business of buying or selling any commodity or receiving the same for sale on consignment. The act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent, or other person. The words "interstate commerce" shall be construed to mean commerce between any State, Territory, or possession, or the District of Columbia, and any place outside thereof; or between points within the same State, Territory, or possession, or the District of Columbia, but through any place outside thereof, or within any Territory or possession, or the District of Columbia. The words "cooperative association of producers" shall mean any cooperative association, corporate or otherwise, not less than 75 per centum in good faith owned or controlled, directly or indirectly, by producers of agricultural products and otherwise complying with an Act of Congress of February 18, 1922 (U.S.C. 1934 ed., title 7, secs. 291 and 292), as now or hereafter amended, including any organization acting for a group of such associations and owned or controlled by such associations, provided that business done for or with the United States of America, or any agency thereof, shall not be considered either member or nonmember business in determining the compliance of any such association with said Act of Congress of February 18, 1922. The words "member of a contract market" shall mean and include individuals, associations, partnerships, corporations, and trusts owning or holding membership in, or admitted to membership representation on, a contract market or given members' trading privileges thereon. The words "futures commission merchant" shall mean and include individuals, associations, partnerships, corporations, and trusts engaged in soliciting

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or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom. The words "floor broker" shall mean any person who, in or surrounding any "pit", "ring", "post", or other place provided by a contract market for the meeting of persons similarly engaged, shall purchase or sell for any other person any commodity for future delivery on or subject to the rules of any contract market. [The words "the Commission" shall mean the Commodity Exchange Commission, consisting of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General, or an official or employee of each of the executive departments concerned, designated by the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General, respectively; and the Secretary of Agriculture or his designee shall serve as Chairman.] *The words "the Commission" shall mean the Commodity Futures Trading Commission established under paragraph (2) of this subsection. The term "commodity trading advisor" shall mean any person who, for compensation or profit, engages in the business of advising others, either directly or through publications or writings, as to the value of commodities or as to the advisability of trading in any commodity for future delivery on or subject to the rules of any contract market, or who, for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning commodities; but does not include (1) any bank or trust company, (2) any newspaper reporter, newspaper columnist, newspaper editor, lawyer, accountant, or teacher, (3) any floor broker or futures commission merchant, (4) the publisher of any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation including their employees, (5) any contract market, and (6) such other persons not within the intent of this definition as the Commission may specify by rule, regulation, or order: Provided, That the furnishing of such services by the foregoing persons is solely incidental to the conduct of their business or profession. The term "commodity pool operator" shall mean any person en-*

gaged in a business which is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market, but does not include such persons not within the intent of this definition as the Commission may specify by rule or regulation or by order.

(2) There is hereby established a Commodity Futures Trading Commission to be composed of five Commissioners consisting of the Secretary of Agriculture and four members selected from the general public, who shall be appointed by the President, by and with the advice and consent of the Senate. The President shall separately nominate, for appointment by and with the advice and consent of the

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Senate, one of the five Commissioners to serve as Chairman of the Commission during the term of said Commissioner, or, in the case of the Secretary of Agriculture, during the time he continues in office. The Secretary whether acting as a Commissioner or as the Chairman of the Commission, may designate an official of the Department of Agriculture who is serving at not less than executive level IV to act in his behalf in the performance of his duties under this Act. Not more than two of the members of the Commission selected from the general public shall be members of the same political party. No Commissioner or any employee of the Commission shall participate, directly or indirectly, in any contract market operations or transactions of a character subject to regulation by the Commission. Each public Commissioner shall hold office for a term of five years and until his successor shall have been appointed and shall have qualified, except that he shall not so continue to serve beyond the expiration of the next session of Congress subsequent to the expiration of said fixed term of office: Provided, That any Commissioner appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed for the remainder of such term: And provided further, That the first public Commissioners taking office after the enactment of this paragraph shall continue in office for terms of two, three, four, and five years, respectively, the term of each to be designated by the President.

(3) Any Commissioner may be removed by the President for neglect of duty or malfeasance in office. A vacancy in the Commission shall not impair the right of the remaining Commissioners to exercise all the powers of the Commission.

(4) The Commission shall have an official seal, which shall be judicially noticed.

(5) The Commission shall meet as often as necessary but in no event shall it have less than one regular meeting per month. Additional meetings may be called by the Chairman at any time or by any two members of the Commission upon three days' notice. The Commission is authorized to promulgate such rules and regulations as it deems necessary to govern the operating procedures and conduct of the business of the Commission.

(6) Public members of the Commission shall be compensated at the daily rate of pay of executive level IV for each day or part thereof spent in the performance of official duties.

(7) The Commission shall have a Secretary who shall report directly to it and who shall carry out such administrative and other duties as are assigned by the Commission or by members thereof.

(8) The Commission shall have a General Counsel who shall report directly to it and who shall serve as its legal advisor. The Commission shall also appoint such other attorneys as may be necessary, in the opinion of the Commission, to assist the General Counsel, represent the Commission in all disciplinary proceedings pending before it, assist the Department of Justice in handling litigation in courts of law concerning the Commission, and perform such other legal duties and functions as the Commission may direct.

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(9) The Commission shall have an Executive Director who shall report directly to it and perform such functions and duties as the Commission may prescribe.

(10) Each Commissioner shall be furnished appropriate office space and secretarial and clerical help required to fulfill his responsibilities as a Commissioner.

(b) For the purpose of this Act (but not in any wise limiting the foregoing definition of interstate commerce) a transaction in respect to any article shall be considered to be in interstate commerce if such article is part of that current of commerce usual in the commodity trade whereby commodities and commodity products and byproducts thereof are sent from one State with the expectation that they will end their transit, after purchase, in another, including, in addition to cases within the above general description, all cases where purchase or sale is either for shipment to another State, or for manufacture within the State and the shipment outside the State of the products resulting from such manufacture. Articles normally in such current of commerce shall not be considered out of such commerce through resort being had to any means or device intended to remove transactions in respect thereto from the provisions of this Act. For the purpose of this paragraph the word "State" includes Territory, the District of Columbia, possession of the United States, and foreign nation.

SEC. 3. Transactions in commodities involving the sale thereof for future delivery as commonly conducted on boards of trade and known as "futures" are affected with a national public interest; that such transactions are carried on in large volume by the public generally and by persons engaged in the business of buying and selling commodities and the products and byproducts thereof in interstate commerce; that the prices involved in such transactions are generally quoted and disseminated throughout the United States and in foreign countries as a basis for determining the prices to the producer and the consumer of commodities and the products and byproducts thereof and to facilitate the movements thereof in interstate commerce; that such transactions are utilized by shippers, dealers, millers, and others engaged in handling commodities and the products and byproducts thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price; that the transactions and prices of commodities on such boards of trade are susceptible to speculation, manipulation, and control, and sudden or unreasonable fluctuations in the prices thereof frequently occur as a result of such speculation, manipulation, or control, which are detrimental to the producer or the consumer and the persons handling commodities and the products and byproducts thereof in interstate commerce, and that such fluctuations in prices are an obstruction to and a burden upon interstate commerce in commodities and the products and by-products thereof and render regulation imperative for the protection of such commerce and the national public interest therein.

SEC. 4. It shall be unlawful for any person to deliver for transmission through the mails or in interstate commerce by telegraph, telephone, wireless, or other means of communication any offer to make or execute, or any confirmation of the execution of, or any quotation

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or report of the price of, any contract of sale of any commodity for future delivery on or subject to the rules of any board of trade in the United States, or for any person to make or execute such contract of sale, which is or may be used for (a) hedging any transaction in interstate commerce in any commodity or the products or byproducts thereof, or (b) determining the price basis of any such transaction in interstate commerce, or (c) delivering any commodity sold, shipped, or received in interstate commerce for the fulfillment thereof, except, in any of the foregoing cases, where such contract is made by or through a member of a board of trade which has been designated by the [Secretary of Agriculture] *Commission* as a "contract market", as hereinafter provided, and if such contract is evidenced by a record in writing which shows the date, the parties to such contract and their addresses, the property covered and its price, and the terms of delivery : *Provided*, That each board member shall keep such record for a period of three years from the date thereof, or for a longer period if the [Secretary of Agriculture] *Commission* shall so direct, which record shall at all times be open to the inspection of any representative of the [United States Department of Agriculture] *Commission* or the United States Department of Justice.

SEC. 4a. (1) Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity. For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by order, proclaim and fix such limits on the amount of trading which may be done or positions which may be held by any person under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market as the Commission finds are necessary to diminish, eliminate, or prevent such burden. In determining whether any person has exceeded such limits, the positions held and trading done by any persons directly or indirectly controlled by such person shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were

held by, or the trading were done by, a single person. Nothing in this section shall be construed to prohibit the Commission from fixing different trading or position limits for different commodities, markets, futures, or delivery months, or different, trading limits for buying and selling operations, or different limits for the purposes of subparagraphs 2 (A) and (B) of this section or from exempting transactions normally known to the trade as "spreads" or "straddles" or *arbitrage* or from fixing limits applying to such transactions or positions different from limits fixed for other transactions or positions. *The word "arbitrage" shall be defined to mean the same as a "spread" or "straddle".*

(2) The Commission shall in such order fix a reasonable time (not to exceed ten days) after the order's promulgation; after which, and

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until such order is suspended, modified, or revoked, it shall be unlawful for any person --

(A) directly or indirectly to buy or sell, or agree to buy or sell, under contracts of sale of such commodity for future delivery on or subject to the rules of the contract market or markets to which the order applies, any amount of such commodity during any one business day in excess of any trading limit fixed for one business day by the Commission in such order for or with respect to such commodity; or

(B) directly or indirectly to hold or control a net long or a net short position in any commodity for future delivery on or subject to the rules of any contract market in excess of any position limit fixed by the Commission for or with respect to such commodity: *Provided*, That such position limit shall not apply to a position acquired in good faith prior to the effective date of such order.

(3) No order issued under paragraph (1) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions [.] *as such terms are defined by the Commission by order consistent with the purposes of this Act.* [For the purposes of determining the bona fide hedging transactions or positions of any person under this paragraph (3), they shall mean sales of, or short positions in, any commodity for future delivery on or subject to the rules of any contract market made or held by such person to the extent that such sales or short positions are offset in quantity by the ownership or purchase of the same cash commodity by the same person or, conversely, purchases of, or long positions in, any commodity for future delivery on or subject to the rules of any contract market made or held by such person to the extent that such purchases or long positions are offset by sales of the same cash commodity by the same person. There shall be included in the amount of any commodity which may be hedged by any person --

[(A) the amount of such commodity such person is raising, or in good faith intends or expects to raise, within the next twelve months, on land (in the United States or its Territories) which such person owns or leases;

[(B) an amount of such commodity the sale of which for future delivery would be a reasonable hedge against the products or byproducts of such commodity owned or purchased by such person, or the purchase of which for future delivery would be a reasonable hedge against the sale of any product or byproduct of such commodity by such person;

[(C) an amount of such commodity the purchase of which for future delivery shall not exceed such person's unfilled anticipated requirements for processing or manufacturing during a specified operating period not in excess of one year: *Provided*, That such purchase is made and liquidated in an orderly manner and in accordance with sound commercial practice in conformity with such regulations as the Secretary of Agriculture may prescribe.

[(4) This section shall apply to a person that is registered as a futures commission merchant or as a floor broker under authority of

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this Act only to the extent that transactions made by such person are made on behalf of or for the account or benefit of such person. This section shall not apply to transactions made by, or on behalf of, or at the direction of, the United States, or a duly authorized agency thereof.]

SEC. 4b. It shall be unlawful (1) for any member of a contract market, or for any correspondent, agent, or employee of any member, in or in connection with any order to make, or the making of any contract of sale of any commodity in interstate commerce, made, or to be made, on or subject to the rules of any contract market, for or on behalf of any other person, or (2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made, or to be made, on or subject to the rules of any contract market, for or on behalf of

any other person if such contract for future delivery is or may be used for (a) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (b) determining the price basis of any transaction in interstate commerce in such commodity, or (c) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof --

(A) to cheat or defraud or attempt to cheat or defraud such other person;

(B) willfully to make or cause to be made to such other person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof;

(C) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order to contract or the disposition or execution of any such order or contract, or in regard to any act of agency performed with respect to such order or contract for such person; or

(D) to bucket such order, or to fill such order by offset against the order or orders of any other person, or willfully and knowingly and without the prior consent of such person to become the buyer in respect to any selling order of such person, or become the seller in respect to any buying order of such person.

Nothing in this section or in any other section of this Act shall be construed to prevent a futures commission merchant or floor broker who shall have in hand, simultaneously, buying and selling orders at the market for different principals for a like quantity of [cotton] *commodity* for future delivery in the same month, from executing such buying and selling orders at the market price: *Provided*, That any such execution shall take place on the floor of the exchange where such orders are to be executed at public outcry across the ring and shall be duly reported, recorded, and cleared in the same manner as other orders executed on such exchange[.] *And provided further*, *That such transactions shall be made in accordance with such rules and regulations as the Commission may promulgate regarding the manner of the execution of such transactions.*

SEC. 4c. (a) It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity, which is or may be used for (1) hedging any transaction

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in interstate commerce in such commodity or the products or byproducts thereof, or (2) determining the price basis of any such transaction in interstate commerce in such commodity, or (3) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof --

(A) if such transaction is, is of the character of, or is commonly known to the trade as, a "wash sale", "cross trade", or "accommodation trade", or is a fictitious sale;

[(B) if such transaction is, is of the character of, or is commonly known to the trade as, a "privilege", "indemnity", "bid", "offer", "put", "call", "advanced guaranty", or "decline guaranty", or]

(B) if such transaction involves any commodity specifically set forth in section 2(a) (1) of this Act, prior to the enactment of the Commodity Futures Trading Commission Act of 1974, and if such transaction is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advanced guaranty", or "decline guaranty", or

(C) if such transaction is used to cause any price to be reported, registered, or recorded which is not a true and bona fide price.

Nothing in this section shall be construed to prevent the exchange of futures in connection with cash commodity transactions or of futures for cash commodities, or of transfer trades or office trades if made in accordance with board of trade rules applying to such transactions and such rules shall not have been disapproved by the [Secretary of Agriculture] *Commission*. Nothing in this section or section 4b shall be construed to impair any State law applicable to any transaction enumerated or described in such sections.

(b) No person shall offer to enter into, enter into, or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this Act, but not specifically set forth in section 2 (a) (1) of this Act, prior to the enactment of the Commodity Futures Trading Commission Act of 1974", which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", "decline guaranty", contrary to any rule, regulation, or order of the Commission prohibit-

ing any such transaction or allowing any such transaction under such terms and conditions as the Commission may prescribe: *Provided, That any such order, rule, or regulation may be made only after notice and opportunity for hearing: And provided further, That the Commission may set different terms and conditions for different markets.*

SEC. 4d. It shall be unlawful for any person to engage as futures commission merchant in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery, or involving any contracts of sale of any commodity for future delivery, on or subject to the rules of any contract market unless

(1) such person shall have registered, under this Act, with the [Secretary of Agriculture] *Commission* as such futures commission

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merchant and such registration shall not have expired nor been suspended nor revoked; and

(2) such person shall, whether a member or nonmember of a contract market, treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the trades or contracts of any customer of such person, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held: *Provided, however, That such money, securities and property of the customers of such futures commission merchant may, for convenience, be commingled and deposited in the same account or accounts with any bank or trust company or with the clearing house organization of such contract market, and that such share thereof as in the normal course of business shall be necessary to margin, guarantee, secure, transfer, adjust, or settle the contracts or trades of such customers of resulting market positions, with the clearinghouse organization of such contract market or with any member of such contract market, may be withdrawn and applied to such purposes, including the payment of commissions, brokerage, interest, taxes, storage and other charges, lawfully accruing in connection with such contracts and trades: Provided, further, That such money may be invested in obligations of the United States, in general obligations of any State or of any political subdivision thereof, and in obligations, fully guaranteed as to principal and interest by the United States, such investments to be made in accordance with such rules and regulations and subject to such conditions as the [[Secretary of Agriculture] *Commission* may prescribe.*

It shall be unlawful for any person, including but not limited to any clearing agency of a contract market and any depository, that has received any money, securities, or property for deposit in a separate account as provided in paragraph (2) of this section, to hold, dispose of or use any such money, securities, or property as belonging to the depositing futures commission merchant or any person other than the customers of such futures commission merchant.

SEC. 4e. It shall be unlawful for any person to act as floor broker in executing any orders for the purchase or sale of any commodity for future delivery, or involving any contracts of sale of any commodity for future delivery on or subject to the rules of any contract market unless such person shall have registered, under this Act, with the [Secretary of Agriculture] *Commission* as such floor broker and such registration shall not have expired nor been suspended nor revoked.

SEC. 4f. (1) Any person desiring to register as futures commission merchant or as floor broker hereunder shall be registered upon application to the [Secretary of Agriculture] *Commission*, which application shall be made in form and manner to be prescribed by the [Secretary

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of Agriculture] *Commission* giving such information and facts as the [Secretary of Agriculture] *Commission* may deem necessary concerning the business in which the applicant is or will be engaged including, in the case of applications of futures commission merchants, the names and addresses of the managers of all branch offices and of all correspondents and agents engaged in soliciting or accepting on behalf of such applicants any order for the purchase or sale of any commodity for future delivery on or subject to the rules of any board of trade, and including also the names of its officers and partners, if a partnership, and of its officers, directors, and stockholders, as the [Secretary of Agriculture] *Commission* may direct, if a corporation. Such person, when registered hereunder, shall likewise continue to report and furnish to the [Secretary of Agriculture] *Commission* the above-mentioned information and such other information pertaining to his business as the [[Secretary of Agriculture] *Commission* may require. All registrations shall expire on the

31st day of December of the year for which issued, and shall be renewed upon application therefor unless the registration has been suspended (and the period of such suspension has not expired) or revoked after notice and hearing as prescribed in this Act.

(2) Notwithstanding any other provisions of this Act, no person desiring to register as futures commission merchant shall be so registered unless he meets such minimum financial requirements as the [Secretary of Agriculture] *Commission* may by regulation prescribe as necessary to insure his meeting his obligations as a registrant, and each person so registered shall at all times continue to meet such prescribed minimum financial requirements: *Provided*, That such minimum financial requirements will be considered met if the applicant for registration or registrant is a member of a contract market and conforms to minimum financial standards and related reporting requirements set by such contract market in its bylaws, rules, regulations or resolutions and approved by the [Secretary of Agriculture] *Commission* as adequate to effectuate the purposes of this paragraph

SEC. 4g. Every person registered hereunder as futures commission merchant or floor broker shall make such reports as are required by the [Secretary of Agriculture] *Commission* regarding the transactions and positions of such person, and the transactions and positions of the customers thereof, in commodities for future delivery on any board of trade in the United States or elsewhere; shall keep books and records pertaining to such transactions and positions in such form and manner and for such period as may be required by the [Secretary] *Commission*; and shall keep such books and records open to inspection by any representative of the [United States Department of Agriculture] *Commission* or the United States Department of Justice.

SEC. 4h. It shall be unlawful for any person

(1) to conduct any office or place of business anywhere in the United States or its territories for the purpose of soliciting or accepting any orders for the purchase or sale of any commodity for future delivery, or for making or offering to make any contracts for the purchase or sale of any commodity for future delivery, or for conducting any dealings

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in commodities for future delivery, that are or may be used for --

(A) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or

(B) determining the price basis of any such transaction in interstate commerce, or

(C) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof,

if such orders, contracts, or dealings are executed or consummated otherwise than by or through a member of a contract market; or

(2) falsely to represent such person to be a member of a contract, market, or the representative or agent of such member, or to be a futures commission merchant registered under this Act, or the agent of such registered futures commission merchant, in soliciting or handling any order or contract for the purchase or sale of any commodity in interstate commerce or for future delivery, or falsely to represent in connection with the handling of any such order or contract that the same is to be or has been executed on, or by or through any member of, any contract market.

SEC. 4i. It shall be unlawful for any person to make any contract for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market unless such person shall report or cause to be reported to the properly designated officer in accordance with the rules and regulations of the [Secretary of Agriculture] *Commission* (1) whenever such person shall directly or indirectly make such contracts with respect to any commodity, or any future of such commodity, during any one day in an amount equal to or in excess of such amount as shall be fixed from time to time by the [Secretary of Agriculture] *Commission*; and (2) whenever such person shall directly or indirectly have or obtain a long or short position in any commodity or in any future of such commodity, equal to or in excess of such amount as shall be fixed from time to time by the [Secretary of Agriculture] *Commission*. Such person shall keep books and records of all futures transactions and positions coming within the provisions of (1) and (2) hereof, and shall keep books and records of such cash or spot transactions in such commodity entered into, and inventories and purchase and sale commitments of such commodity held, in any month in which such person is required to make any report under the provision of (1) or (2), as the [Secretary of Agriculture] *Commission* may require. Such books and records shall show complete details concerning all such transactions, positions, inventories and commitments, including the names and addresses of all persons having any interest therein, and shall be open at all times to inspection by any representa-

tive of the [United States Department of Agriculture] Commission or the United States Department of Justice. For the purposes of this section, the futures and cash or spot transactions and positions of any person shall include such transactions and positions of any persons directly or indirectly controlled by such person.

SEC. 4j. (1) The Commission shall within six months after the effective date of this Act, and subsequently when it determines that changes are required, make a determination, after notice and opportunity for hearing, whether or not a floor broker may trade for his own account or any account in which such broker has trading discretion, and also

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execute a customer's order for future delivery and, if the Commission determines that such trades and such executions shall be permitted, the Commission shall further determine the terms, conditions, and circumstances under which such trades and such executions shall be conducted: Provided, That any such determination shall, at a minimum, take into account the effect upon the liquidity of trading of each market: And provided further, That nothing herein shall be construed to prohibit the Commission from making separate determinations for different contract markets when such are warranted in the judgment of the Commission, or to prohibit contract markets from setting terms and conditions more restrictive than those set by the Commission.

(2) The Commission shall within six months after the effective date of this Act, and subsequently when it determines that changes are required, make a determination, after notice, and opportunity for hearing, whether or not a futures commission merchant may trade for its own account or any proprietary account, and, if the Commission determines that such trades shall be permitted the Commission shall, after notice and opportunity for hearing, further determine the terms, conditions, and circumstances under which such trades shall be conducted: Provided, That any such determination, at a minimum shall take into account the effect upon the liquidity of trading of each market: And provided further, That nothing herein shall be construed to prohibit the Commission from making separate determinations for different contract markets when such are warranted in the judgment of the Commission, or to prohibit contract markets from setting terms and conditions more restrictive than those set by the Commission.

SEC. 4k. (1) It shall be unlawful for any person to be associated with any futures commission merchant or with any agent of a futures commission merchant as a partner, officer, or employee (or any person occupying a similar status or performing similar functions), in any capacity which involves (a) the solicitation or acceptance of customer's orders (other than in a clerical capacity) or (b) the supervision of any person or persons so engaged unless such person shall have registered, under this Act, with the Commission and such registration shall not have expired nor been suspended (and the period of suspension has not expired) nor revoked, and it shall be unlawful for any futures commission merchant or any agent of a futures commission merchant to permit such a person to become or remain associated with him in any such capacity if such futures commission merchant or agent knew or should have known that such person was not so registered or that such registration had expired, been suspended (and the period of suspension has not expired) or revoked: Provided, That any individual who is registered as a floor broker or futures commission merchant (and such registration is not suspended or revoked) need not also register under these provisions; and

(2) Any person desiring to be so registered shall make application to the Commission in the form and manner prescribed by the Commission giving such information and facts as the Commission may deem necessary concerning the applicant. Such person, when registered hereunder, shall likewise continue to report and furnish to the Commission such information as the Commission may require. Such registration shall expire two years after the effective date thereof, and

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shall be renewed upon application therefor unless the registration has been suspended (and the period of such suspension has not expired) or revoked after notice and hearing as prescribed in section 6(b) of this Act: Provided, That upon initial registration the effective period of such registration shall be set by the Commission, not to exceed two years from the effective date thereof and not to be less than one year from the effective date thereof: And, provided further, That the Commission may, by regulation, specify such terms and conditions as it deems appropriate to protect the public interest, wherein exception to a written proficiency examination incident to registration shall be afforded an individual who has demonstrated, through training and experience, a required degree of proficiency and skill to protect the interests of customers of the futures commission merchant or associate of such futures commission merchant as provided herein.

SEC. 41. It is hereby found that the activities of commodity trading advisors and commodity pool operators are affected with a national public interest in that, among other things --

(1) their advice, counsel, publications, writings, analyses, and reports are furnished and distributed, and their contracts, solicitations, subscriptions, agreements, and other arrangements with clients take place and are negotiated and performed by the use of the mails and other means and instrumentalities of interstate commerce;

(2) their advice, counsel, publications, writings, analyses, and reports customarily relate to and their operations are directed toward and cause the purchase and sale of commodities for future delivery on or subject to the rules of contract markets; and

(3) the foregoing transactions occur in such volume as substantially to affect transactions on contract markets.

SEC. 4m. It shall be unlawful for any commodity trading advisor or commodity pool operator, unless registered under this Act, to make use of the mails or any means or instrumentality of interstate commerce in connection with his business as such commodity trading advisor or commodity pool operator: Provided, That the provisions of this section shall not apply to any commodity trading advisor who, during the course of the preceding twelve months, has not furnished commodity trading advice to more than fifteen persons and who does not hold himself out generally to the public as a commodity trading advisor.

SEC. 4n. (1) Any commodity trading advisor or commodity pool operator, or any person who contemplates becoming a commodity trading advisor or commodity pool operator, may register under this Act by filing an application with the Commission. Such application shall contain such information, in such form and detail, as the Commission may, by rules and regulations, prescribe as necessary or appropriate in the public interest, including the following:

(A) the name and form of organization, including capital structure, under which the applicant engages or intends to engage in business; the name of the State under the laws of which he is organized; the location of his principal business office and branch offices, if any; the names and addresses of all parties,

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officers, directors, and persons performing similar functions or, if the applicant be an individual, of such individual; and the number of employees;

(B) the education, the business affiliations for the past ten years, and the present business affiliations of the applicant and of his partners, officers, directors, and persons performing similar functions and of any controlling person thereof;

(C) the nature of the business of the applicant, including the manner of giving advice and rendering of analyses or reports;

(D) the nature and scope of the authority of the applicant with respect to clients' funds and accounts;

(E) the basis upon which the applicant is compensated; and

(F) such other information as the Commission may require to determine whether the applicant is qualified for registration.

(2) Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission, or within such shorter period of time as the Commission may determine.

(3) All registrations under this section shall expire on the 30th day of June of each year, and shall be renewed upon application, therefor subject to the same requirements as in the case of an original application.

(4)(A) Every commodity trading advisor and commodity pool operator registered under this Act shall maintain books and records and file such reports in such form, and manner as may be prescribed by the Commission. All such books and records shall be kept for a period of at least three years, or longer if the Commission so directs, and shall be open to inspection by any representative of the Commission or the Department of Justice. Upon the request of the Commission, every registered commodity trading advisor and commodity pool operator shall furnish the name and address of each client, subscriber, or participant, and submit samples or copies of all reports, letters, circulars, memorandums, publications, writings, or other literature or advice distributed to clients, subscribers, or participants, or prospective clients, subscribers, or participants.

(B) Unless otherwise authorized by the Commission by rule or regulation, all commodity trading advisors and commodity pool operators shall make a full and complete disclosure to their subscribers, clients or participants of all futures market positions taken or held by the individual principals of their organization.

(5) Every commodity pool operator shall regularly furnish statements of account to each participant in his operations. Such statements shall be in such form and manner as may be prescribed by the commission and shall include complete information as to the current status of all trading accounts in which such participant has an interest.

(6) The Commission is authorized, without hearing, to deny registration to any person as a commodity trading advisor or commodity pool operator if such person is subject to an outstanding order of the Commission denying to such person trading privileges on any contract market, or suspending or revoking the registration of such person as a commodity trading advisor, commodity pool operator, futures commission

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merchant, or floor broker, or suspending or expelling such person from membership on any contract market.

(7) The Commission after hearing may by order deny registration, revoke or suspend the registration of any commodity trading advisor or commodity pool operator if the Commission finds that such denial, revocation, or suspension is in the public interest and that --

(A) the operations of such person disrupt or tend to disrupt orderly marketing conditions, or cause or tend to cause sudden or unreasonable fluctuations or unwarranted changes in the prices of commodities; or

(B) such commodity trading advisor or commodity pool operator, or any partner, officer, director, person performing similar function, or controlling person thereof --

(i) has within ten years of the issuance of such order been convicted of any felony or misdemeanor involving the purchase or sale of any commodity or security, or arising out of any conduct or practice of such commodity trading advisor or commodity pool operator or affiliated person as a commodity trading advisor or commodity pool operator; or

(ii) at the time of the issuance of such order, is permanently or temporarily enjoined by order, judgment or decree of any court of competent jurisdiction from acting as a commodity trading advisor, commodity pool operator, futures commission merchant, or floor broker, or as an affiliated person or employee of any of the foregoing, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of commodities or securities.

(C) any partner, officer, or director of such commodity trading advisor or commodity pool operator, or any person performing a similar function or any controlling person thereof is subject to an outstanding order of the Commission denying trading privileges on any contract market to such person, or suspending or revoking the registration of such person as a commodity trading advisor, commodity pool operator, futures commission merchant, or floor broker, or suspending or expelling such person from membership on any contract market.

SEC. 4o. (1) It shall be unlawful for any commodity trading advisor or commodity pool operator registered under this Act, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly --

(A) to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or

(B) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

(2) It shall be unlawful for any commodity trading advisor or commodity pool operator registered under this Act to represent or imply in any manner whatsoever that he has been sponsored, recommended, or approved, or that his abilities or qualifications have in any respect been passed upon, by the United States or any agency or officer thereof: Provided, That this section shall not be construed to

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prohibit a statement that a person is registered under this Act as a commodity trading advisor or commodity pool operator, if such statement is true in fact and if the effect of such registration is not misrepresented.

SEC. 4p. The Commission may specify by rules and regulations appropriate standards with respect to training, experience, and such other qualifications as the Commission finds necessary or desirable to insure the fitness of futures commission merchants, floor brokers, and those persons associated with futures commission merchants or floor brokers. In connection therewith, the Commission may prescribe by rules and regulations the adoption of written proficiency examinations to be given to applicants for registration as futures commission merchants, floor brokers, and those persons associated with futures commission merchants or floor brokers, and the establishment of reasonable fees to be charged to such applicants to cover the administration of such examinations. The Commission may further prescribe by rules and regulations that in lieu of examinations administered by the Commission, registered futures associations registered under section 16 of this Act or contract markets may adopt written proficiency examinations to be given to applicants for registration as futures commission merchants, floor brokers, and those persons associated with futures commission merchants or floor brokers, and charge reasonable fees to such applicants to cover the administration of such examination.

SEC. 5. The [Secretary of Agriculture] *Commission* is hereby authorized and directed to designate any board of trade as a "contract market" when, and only when, such board of trade complies with and carries out the following conditions and requirements:

(a) When located at a terminal market where any cash commodity of the kind specified in the contracts of sale of commodities for future delivery to be executed on such board is sold in sufficient volumes and under such conditions as fairly to reflect the general value of the commodity and the differences in value between the various grades of such commodity, and where there is available to such board of trade official inspection service approved by the Secretary of Agriculture *or the Commission* for the purpose: *Provided*, That any board of trade not so located shall be designated as a "contract market" if such board of trade provides for the delivery of commodities on such contracts at a delivery point or points and upon terms and conditions approved by the [Secretary of Agriculture.] *Commission*.

(b) When the governing board thereof provides for the making and filing by the board or any member thereof, as the [Secretary of Agriculture] *Commission* may direct, of reports in accordance with the rules and regulations, and in such manner and for and at such times as may be prescribed by the [Secretary of Agriculture,] *Commission*, showing the details and terms of all transactions entered into by the board, or the members thereof, either in cash transactions or transactions for future delivery consummated on or subject to the rules of a board of trade, and when such governing board provides, in accordance with such rules and regulations, for the keeping of a record by the board or the members of the board of trade, as the [Secretary of

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Agriculture] *Commission* may direct, showing the details and terms of all cash and future transactions entered into by them, consummated on or subject to the rules of a board of trade, such record to be in permanent form, showing the parties to all such transactions, including the persons for whom made, any assignments or transfers thereof, with the parties thereto, and the manner in which said transactions are fulfilled, discharged, or terminated. Such record shall be required to be kept for a period of three years from the date thereof, or for a longer period if the [Secretary of Agriculture] *Commission* shall so direct, and shall at all times be open to the inspection of any representative of the [United States Department of Agriculture] *Commission* or United States Department of Justice.

(c) When the governing board thereof provides for the prevention of dissemination by the board or any member thereof, of false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce.

(d) When the governing board thereof provides for the prevention of manipulation of prices and the cornering of any commodity by the dealers or operators upon such board.

(e) When the governing board thereof does not exclude from membership in, and all privileges on, such board of trade, any duly authorized representative of any lawfully formed and conducted cooperative association of producers having adequate financial responsibility which is engaged in any cash commodity business, if such association has complied, and agrees to comply, with such terms and conditions as are or may be imposed lawfully on other members of such board: *Provided*, That no rule of a contract market shall forbid or be construed to forbid the return on a patron-

age basis by such cooperative association to its bona fide members of moneys collected in excess of the expense of conducting the business of such association.

(f) When the governing board provides for making effective the final orders or decisions entered pursuant to the provisions of paragraph (b) of section 6, and the orders issued pursuant to the provisions of section 5a of this Act, and for compliance in all other respects with the requirements applicable to such board of trade under this Act.

(g) When such board of trade demonstrates that the prices involved in transactions for future delivery in the commodity for which designation as a contract market is sought are, or reasonably can be expected to be, generally quoted and disseminated as a basis for determining prices to producers, merchants, or consumers of such commodity or the products or byproducts thereof or that such transactions are, or reasonably can be expected to be, utilized by producers, merchants, or consumers engaged in handling such commodity or the products or byproducts thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price.

SEC. 5a. Each contract market shall --

(1) promptly furnish the [Secretary of Agriculture] *Commission* copies of all bylaws, rules, regulations, and resolutions made or issued by it or by the governing board thereof or any committee, and of all changes and proposed changes therein;

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(2) keep all books, records, minutes and journals of proceedings of such contract market, and its governing board, committees, subsidiaries, and affiliates in a manner that will clearly describe all matters discussed by such contract market, governing board, committees, subsidiaries and affiliates and reveal any action taken in such matters, and allow inspection at all times by any authorized representative of the [United States Department of Agriculture] *Commission* or United States Department of Justice of all such books, records, minutes and journals of proceedings. Such books, records, minutes and journals of proceedings shall be kept for a period of three years from the date thereof, or for a longer period if the [Secretary of Agriculture] *Commission* shall so direct;

(3) require the operators of warehouses in which or out of which any commodity is deliverable on any contract for future delivery made on or subject to the rules of such contract market, to make such reports, keep such records and permit such warehouse visitation as the [Secretary of Agriculture] *Commission* may prescribe. Such books and records shall be required to be kept for a period of three years from the date thereof, or for a longer period if the [Secretary of Agriculture] *Commission* shall so direct, and such books, records, and warehouses shall be open at all times to inspection by any representative of the [United States Department of Agriculture] *Commission* or United States Department of Justice;

(4) when so directed by order of the [Secretary of Agriculture,] *Commission*, provide for a period, after trading in contracts of sale of any commodity for future delivery in a delivery month has ceased, during which contracts of sale of such commodity for future delivery in such month may be satisfied by the delivery of the actual cash commodity.

Whenever, after due notice and opportunity for hearing, the [Secretary of Agriculture] *Commission* finds that provision for such a period of delivery for any one or more commodities or markets would prevent or tend to prevent "squeezes" and market congestion endangering price stability, [he] *it* shall, by order, require such period of delivery (which shall be not less than three nor more than ten business days) applicable to such commodities and markets as [he] *it* finds will prevent or tend to prevent such "squeezes" and market congestion: *Provided, however*, That such order shall not apply to then existing contracts;

(5) require the party making delivery of any commodity on any contract of sale of such commodity for future delivery to furnish the party obligated under the contract to accept delivery, written notice of the date of delivery at least one business day prior to such date of delivery. Whenever, after due notice and opportunity for hearing, the [Secretary of Agriculture] *Commission* finds that the giving of longer notice of delivery is necessary to prevent or diminish unfair practices in trading in any one or more commodities or markets, [he] *it* shall by order require such longer notice of delivery (which shall be not more than ten business days) applicable to such commodities and markets as

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[he] *it* finds will prevent or diminish unfair practices: *Provided, however*, That such order shall not apply to then existing contracts;

(6) require that all contracts of sale of any commodity for future delivery on such contract market shall provide for the delivery thereunder of commodities of grades conforming to United States standards, if such standards shall have been officially promulgated [:] *and adopted by the Commission;*

(7) require that receipts issued under the United States Warehouse Act (U.S.C., 1934 ed., title 7, secs. 241-273) shall be accepted in satisfaction of any futures contract, made on or subject to the rules of such contract market, without discrimination and notwithstanding that the warehouseman issuing such receipts is not also licensed as a warehouseman under the laws of any State or enjoys other or different privileges than under State law: *Provided, however,* That such receipts shall be for the kind, quality, and quantity of commodity specified in such contract and that the warehouse in which the commodity is stored meets such reasonable requirements as may be imposed by such contract market on other warehouses as to location, accessibility, and suitability for warehousing and delivery purposes;

(8) enforce all bylaws, rules, regulations, and resolutions, made or issued by it or by the governing board thereof or any committee, which relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relate to other trading requirements, and which have [not been disapproved by the Secretary of Agriculture pursuant to paragraph (7) of section 8a] *been approved by the Commission pursuant to paragraph (12) of section 5a* of this Act; and revoke and not enforce any such bylaw, rule, regulation, or resolution, made, issued, or proposed by it or by the governing board thereof or any committee, which has been [so] *disapproved by the Commission;* [and]

(9) enforce all bylaws, rules, regulations, and resolutions made or issued by it or by the governing board thereof or by any committee, which provide minimum financial standards and related reporting requirements for futures commission merchants who are members of such contract market, and which have been approved by [the Secretary of Agriculture.] *the Commission;*

(10) *permit the delivery of any commodity, on contracts of sale thereof for future delivery, of such grade or grades, at such point or points and at such quality and locational price differentials as will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce. If the Commission after investigation finds that the rules and regulations adopted by a contract market permitting delivery of any commodity on contracts of sale thereof for future delivery, do not accomplish the objectives of this subsection, then the Commission shall notify the contract market of its finding and afford the contract market an opportunity to make appropriate changes in such rules and regulations. If the contract*

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market within sixty days of such notification fails to make the changes which in the opinion of the Commission are necessary to accomplish the objectives of this subsection, then the Commission after granting the contract market an opportunity to be heard, may change or supplement such rules and regulations of the contract market to achieve the above objectives: Provided, That any order issued under this paragraph shall not apply to contracts of sale for future delivery in any months in which contracts are currently outstanding and open: And provided further, That no requirement for an additional delivery point or points shall be promulgated following hearings until the contract market affected has had notice and opportunity to file exceptions to the proposed order determining the location and number of such delivery point or points; and

(11) *provide a fair and equitable procedure through arbitration or otherwise for the settlement of customer's claims and grievances against any member or employee thereof: Provided, That (i) the use of such procedure by a customer shall be voluntary, (ii) the procedure shall not be applicable to any claim in excess of \$ 5,000, (iii) the procedure shall not result in any compulsory payment except as agreed upon between the parties, and (iv) the term "customer" as used in this subsection shall not include a futures commission merchant or a floor broker; and*

(12) *submit to the Commission for its approval all bylaws, rules, regulations, and resolutions made or issued by such contract market, or by the governing board thereof or any committee thereof which relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relate to other trading requirements except those relating to the setting of levels of margin, and the Commission shall approve such bylaws, rules, regulations, and resolutions upon a determination that such bylaws, rules, regulations, and resolutions are not in violation of the provisions of this Act or the regulations of the Commission and thereafter the Commission shall disapprove, after appropriate notice and opportunity for hearing, any and bylaw, rule, regulation, or resolution which the Commission finds at any time is in violation of the provisions of this Act or the regulation of the Commission.*

SEC. 5b. The failure or refusal of any board of trade to comply with any of the provisions of the Act, or any of the rules, regulations, or order of [the Secretary of Agriculture or] the Commission thereunder, shall be cause for suspending for a period not to exceed six months or revoking the designation of such board of trade as a "contract market" in accordance with the procedure and subject to the judicial review provided in paragraph (a) of section 6 of this Act.

SEC. 6. Any board of trade desiring to be designated a "contract market" shall make application to the [Secretary of Agriculture] *Commission* for such designation and accompany the same with a showing that it complies with the above conditions, and with a sufficient assurance that it will continue to comply with the above requirements. In the event of a refusal to designate as a "contract market"

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any board of trade that has made application therefor, such board of trade shall be afforded an opportunity for a hearing before the Commission, with the right to appeal an adverse decision after such hearing to the court of appeals as provided for in other cases in paragraph (a) of this section.

(a) The Commission is authorized to suspend for a period not to exceed six months or to revoke the designation of any board of trade as a "contract market" upon a showing that such board of trade is not enforcing or has not enforced its rules of government made a condition of its designation as set forth in section 5 of this Act or that such board of trade, or any director, officer, agent, or employee thereof, otherwise is violating or has violated any of the provisions of this Act or any of the rules, regulations, or orders of [the Secretary of Agriculture or] the Commission thereunder. Such suspension or revocation shall only be after a notice to the officers of the board of trade affected and upon a hearing: *Provided*, That such suspension or revocation shall be final and conclusive, unless within fifteen days after such suspension or revocation by the Commission such board of trade appeals to the court of appeals for the circuit in which it has its principal place of business, by filing with the clerk of such court a written petition praying that the order of the Commission be set aside or modified in the manner stated in the petition, together with a bond in such sum as the court may determine, conditioned that such board of trade will pay the costs of the proceedings if the court so directs. The clerk of the court in which such a petition is filed shall immediately cause a copy thereof to be delivered to [the Secretary of Agriculture, who shall thereupon notify the other members of] the Commission and file in the court the record in such proceedings, as provided in *section 2112 of title 28, United States Code*. The testimony and evidence taken or submitted before the Commission, duly filed as aforesaid as a part of the record, shall be considered by the court of appeals as the evidence in the case. The proceedings in such cases in the court of appeals shall be made a preferred cause and shall be expedited in every way. Such a court may affirm or set aside the order of the Commission or may direct it to modify its order. No such order of the Commission shall be modified or set aside by the court of appeals unless it is shown by the board of trade that the order is unsupported by the weight of the evidence or was issued without due notice and a reasonable opportunity having been afforded to such board of trade for a hearing, or infringes the Constitution of the United States, or is beyond the jurisdiction of the Commission.

(b) If the [Secretary of Agriculture] *Commission* has reason to believe that any person (other than a contract market) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any contract market, or has willfully made any false or misleading statement of a material fact in any registration application or any report filed with the [Secretary of Agriculture] *Commission* under this Act, or willfully omitted to state in any such application or report any material fact which is required to be stated therein, or otherwise is violating or has violated any of the provisions of this Act or of the rules, regulations,

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or orders of [the Secretary of Agriculture or] the Commission thereunder, [he] *it* may serve upon such person a complaint stating [his] *its* charges in that respect, which complaint shall have attached or shall contain therein a notice of hearing, specifying a day and place not less than three days after the service thereof, requiring such person to show cause why an order should not be made prohibiting him from trading on or subject to the rules of any contract market, and directing that all contract markets refuse all trading privileges to such person, until further notice of the [Secretary of Agriculture] *Commission*, and to show cause why the registration of such person, if registered as futures commission merchant or any person associated therewith as described in *section 4k of this Act, commodity trading advisor, commodity pool operator* or as floor broker hereunder, should not be suspended or revoked. Said hearing may be held in Washington, District of Columbia, or elsewhere, before the [Secretary of Agriculture] *Commission* or before a [referee]

Administrative Law Judge designated by the [Secretary of Agriculture] *Commission*, which [referee] *Administrative Law Judge* shall cause all evidence to be reduced to writing and forthwith transmit the same to the [Secretary of Agriculture.] *Commission*. For the purpose of securing effective enforcement of the provisions of this Act, and for the purpose of any investigation or proceedings under this Act, the provisions, including penalties, of the Interstate Commerce Act, as amended and supplemented (49 U.S.C. 12), relating to the attendance and testimony of witnesses and the production of documentary evidence, are made applicable to the power, jurisdiction, and authority of [the Secretary of Agriculture (or any person designated by him),] the *Commission*, and any [referee] *Administrative Law Judge* designated pursuant to the provisions of this Act, and to any person subject thereto. Upon evidence received, the [Secretary of Agriculture] *Commission* may prohibit such person from trading on or subject to the rules of any contract market and require all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order, and, if such person is registered as futures commission merchant or any person associated therewith as described in section 4k of this Act, commodity trading advisor, commodity pool operator or as floor broker hereunder, may suspend, for a period not to exceed six months, or revoke, the registration of such person[.], and may assess such person a civil penalty of not more than \$ 100,000 for each such violation. Notice of such order shall be sent forthwith by registered mail or by certified mail or delivered to the offending person and to the governing boards of said contract markets. After the issuance of the order by the [Secretary of Agriculture.] *Commission*, as aforesaid, the person against whom it is issued may obtain a review of such order or such other equitable relief as to the court may seem just by filing in the United States court of appeals of the circuit in which the petitioner is doing business a written petition, within fifteen days after the notice of such order is given to the offending person, praying that the order of the [Secretary of Agriculture] *Commission* be set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the [Secretary of Agriculture] *Commission* and thereupon the [Secretary of Agriculture] *Commission* shall file in the court the record theretofore made,

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as provided in section 2112 of Title 28, United States Code. Upon the filing of the petition the court shall have jurisdiction to affirm, to set aside, or modify the order of the [Secretary of Agriculture.] *Commission*, and the findings of the [Secretary of Agriculture] *Commission* as to the facts, if supported by the weight of evidence, shall in like manner be conclusive.

(c) If any person (other than a contract market) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any contract market, or otherwise is violating or has violated any of the provisions of this Act or of the rules, regulations, or orders of [The Secretary of Agriculture, or] the *Commission* thereunder, the [Secretary] *Commission* may, upon notice and hearing, and subject to appeal as in other cases provided for in paragraph (b) of this section, make and enter an order directing that such person shall cease and desist therefrom, and, if such person thereafter and after the lapse of the period allowed for appeal of such order or after the affirmance of such order, shall fail or refuse to obey or comply with such order, such person shall be guilty of misdemeanor and, upon conviction thereof, shall be fined [not less than \$ 500 nor more than \$ 10,000] not more than \$ 100,000, or imprisoned for not less than six months nor more than one year, or both, except that if such failure or refusal to obey or comply with such order involves any offense within paragraph (a) or (b) of section 9 of this Act, such person shall be guilty of a felony and, upon conviction thereof, shall be subject to the penalties of said paragraph 9(a) or 9(b) : *Provided*, That any such cease and desist order against any respondent in any case of manipulation of, or attempt to manipulate, the price of any commodity shall be issued only in conjunction with an order issued against such respondent under section 6(b) of this Act. Each day during which such failure or refusal to obey or comply with such order continues shall be deemed a separate offense.

(d) *In determining the amount of the money penalty assessed under paragraph (b) of this section, the Commission shall consider: In the case of a person whose primary business involves the use of the commodity futures market -- the appropriateness of such penalty to the size of the business of the person charged, the extent of such person's ability to continue in business, and the gravity of the violation; and in the case of a person whose primary business does not involve the use of the commodity futures market -- the appropriateness of such penalty to the net worth of the person charged, and the gravity of the violation. If the offending person upon whom such penalty is imposed, after the lapse of the period allowed for appeal or after the affirmance of such penalty, shall fail to pay such penalty the Commission shall refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court.*

SEC. 6a. (1) No board of trade which has been designated as a "contract market" shall exclude from membership in, and all privileges on, such board of trade, any association or corporation engaged in cash commodity business having adequate financial responsibility which is organized under the cooperative laws of any State, or which has

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been recognized as a cooperative association of producers by the United States Government or by any agency thereof, if such association or corporation complies and agrees to comply with such terms and conditions as are or may be imposed lawfully upon other members of such board, and as are or may be imposed lawfully upon a cooperative association of producers engaged in cash commodity business, unless such board of trade is authorized by the Commission to exclude such association or corporation from membership and privileges after hearing held upon at least three days' notice subsequent to the filing of complaint by the board of trade: *Provided, however,* That if any such association or corporation shall fail to meet its obligations with any established clearing house or clearing agency of any contract market, such association or corporation shall be ipso facto debarred from further trading on such contract market, except such trading as may be necessary to close open trades and to discharge existing contracts in accordance with the rules of such contract market applicable in such cases. Such Commission may prescribe that such association or corporation shall have and retain membership and privileges, with or without imposing conditions, or it may permit such board of trade immediately to bar such association or corporation from membership and privileges. Any order of said Commission entered hereunder shall be reviewable by the court of appeals for the circuit in which such association or corporation, or such board of trade, has its principal place of business, on written petition either of such association or corporation, or of such board of trade, under the procedure provided in paragraph (a) of section 6 of this Act, but such order shall not be stayed by the court pending review.

(2) No rule of any board of trade designated as a contract market shall forbid or be construed to forbid the payment of compensation on a commodity-unit basis, or otherwise, by any federated cooperative association to its regional member-associations for services rendered or to be rendered in connection with any organization work, educational activity, or procurement of patronage, provided no part of any such compensation is returned to patrons (whether members or nonmembers) of such cooperative association, or of its regional or local member-associations, otherwise than as a dividend on capital stock or as a patronage dividend out of the net earnings or surplus of such federated cooperative association.

[SEC. 6b. If any contract market is not enforcing or has not enforced its rules of government made a condition of its designation as set forth in section 5 of this Act, or if any contract market, or any director, officer, agent, or employee of any contract market otherwise is violating or has violated any of the provisions of this Act or any of the rules, regulations, or orders of the Secretary of Agriculture or the Commission thereunder, the Commission may, upon notice and hearing and subject to appeal as in other cases provided for in paragraph (a) of section 6 of this Act, make and enter an order directing that such contract market, director, officer, agent, or employee shall cease and desist from such violation, and if such contract market, director, officer, agent, or employee thereafter and after the lapse of the period allowed for appeal of such order or after the affirmance of such order,

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shall fail or refuse to obey or comply with such order, such contract market, director, officer, agent, or employee shall be guilty of a misdemeanor and, upon conviction thereof, shall be fined not less than \$ 500 nor more than \$ 10,000 or imprisoned for not less than six months nor more than one year, or both. Each day during which such failure or refusal to obey such order continues shall be deemed a separate offense.]

SEC. 6b. If any contract market is not enforcing or has not enforced its rules of government made a condition of its designation as set forth in section 5 of this Act, or if any contract market, or any director, officer, agent, or employee of any contract market otherwise is violating or has violated any of the provisions of this Act or any of the rules, regulations, or orders of the Commission thereunder, the Commission may, upon notice and hearing and subject to appeal as in other cases provided for in paragraph (a) of section 6 of this Act, make and enter an order directing that such contract market, director, officer, agent, or employee shall cease and desist from such violation, and assess a civil penalty of not more than \$ 100,000 for each such violation. If such contract market, director, officer, agent, or employee, after the entry of such a cease and desist order and the lapse of the period allowed for appeal of such order or after the affirmance of such order, shall fail or refuse to obey or comply with such order, such contract market, director, officer, agent, or employee shall be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than \$

100,000 or imprisoned for not less than six months nor more than one year, or both. Each day during which such failure or refusal to obey such cease and desist order continues shall be deemed a separate offense. If the offending contract market or other person upon whom such penalty is imposed, after the lapse of the period allowed for appeal or after the affirmance of such penalty, shall fail to pay such penalty, the Commission shall refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court. In determining the amount of the money penalty assessed under this section, the Commission shall consider the appropriateness of such penalty to the net worth of the offending person and the gravity of the offense, and in the case of a contract market shall further consider whether the amount of the penalty will materially impair the contract market's ability to carry on its operations and duties.

SEC. 6c. Whenever it shall appear to the Commission that any contract market or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of this Act or any rule, regulation, or order thereunder, or is in a position to effectuate a "squeeze" or corner or otherwise restrain trading in any commodity for future delivery, the Commission may notify the Attorney General, and the Attorney General may bring an action in the proper district court of the United States or the proper United States court of any territory or other place subject to the jurisdiction of the United States, to enjoin such act or practice, or to enjoin the continued maintenance of such a position, or to enforce compliance

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with this Act, or any rule, regulation or order thereunder, and said courts shall have jurisdiction to entertain such actions: Provided, That no restraining order or injunction for violation of the provisions of this Act shall be issued ex parte by said court. Upon a proper showing, a permanent or temporary injunction or restraining order shall be granted without bond. Upon application of the Attorney General, the district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall also have jurisdiction to issue writs of mandamus, or orders, affording like relief, commanding any person to comply with the provisions of this Act or any rule, regulation, or order of the Commission thereunder, including the requirement that such person take such action as is necessary to remove the danger of violation of this Act or any such rule, regulation, or order: Provided, That no such writ of mandamus, or order affording like relief, shall be issued ex parte. Any action under this section may be brought in the district wherein the defendant is found or is an inhabitant or transacts business or in the district where the act or practice occurred, is occurring, or is about to occur, or where such position is maintained, and process in such cases may be served in any district in which the defendant is an inhabitant or wherever the defendant may be found.

SEC. 7. Any board of trade that has been designated a contract market in the manner herein provided may have such designation vacated and set aside by giving notice in writing to the [Secretary of Agriculture] Commission requesting that its designation as a contract market, be vacated, which notice shall be served at least ninety days prior to the date named therein as the date when the vacation of designation shall take effect. Upon receipt of such notice the [Secretary of Agriculture] Commission shall forthwith order the vacation of the designation of such board of trade as a contract market, effective upon the day named in the notice, and shall forthwith send a copy of the notice and [his] its order to all other contract markets. From and after the date upon which the vacation became effective the said board of trade can thereafter be designated again a contract market by making application to the [Secretary of Agriculture] Commission in the manner herein provided for an original application.

SEC. 8. For the efficient execution of the provisions of this Act, and in order to provide information for the use of Congress, the [Secretary of Agriculture] Commission may make such investigations as [he] it may deem necessary to ascertain the facts regarding the operations of boards of trade and other persons subject to any of the provisions of this Act, whether prior or subsequent to the enactment of this Act, and may publish from time to time, in [his] its discretion, the result of such investigation and such statistical information gathered therefrom as [he] it may deem of interest to the public, except data and information which would separately disclose the business transactions of any person and trade secrets or names of customers: Provided, That nothing in this section shall be construed to prohibit the [Secretary of Agriculture] Commission from making or issuing such reports as [he] it may deem necessary relative to the conduct of any board of trade or of the transactions of any person found guilty of violating

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the provisions of this Act under the proceedings prescribed in section 6 of this Act: *Provided further*, That the [Secretary of Agriculture] *Commission* in any report may include the facts as to any actual transaction. The [Secretary of Agriculture,] *Commission*, upon [his] *its* own initiative or in cooperation with existing governmental agencies, shall investigate marketing conditions of commodities and commodity products and byproducts, including supply and demand for these commodities, cost to the consumer, and handling and transportation charges. [He] *It* shall likewise compile and furnish to producers, consumers, and distributors, by means of regular or special reports, or by such methods as [he] *it* may deem most effective, information respecting the commodity markets, together with information on supply, demand, prices, and other conditions in this and other countries that affect the markets.

Notwithstanding the foregoing provisions of this section or of any other law, the [Secretary of Agriculture] *Commission* may, in [his] *its* discretion, from time to time disclose and make public the names and addresses of all traders on the boards of trade on the commodity markets with respect to whom the [Secretary] *Commission* has information, and any other information in the possession of the [Department of Agriculture] *Commission* relating to the amount of commodities purchased or sold by each such trader; and when requested by any committee of either House of Congress, acting within the scope of its jurisdiction, shall furnish to such committee and make public the names and addresses of all traders on such boards of trade with respect to whom the [Secretary] *Commission* has information, and any other information in the possession of the [Department of Agriculture] *Commission* relating to the amount of commodities purchased or sold by each such trader; and when requested by any department or agency of the Executive Branch of the Government of the United States, acting within the scope of its jurisdiction, may, in [his] *its* discretion, furnish to such department or agency any information in the possession of the [Department of Agriculture] *Commission* obtained in connection with the administration of this Act: *Provided, however*, That information so furnished to any such department or agency shall not be disclosed by such department or agency except in any action or proceeding under the laws of the United States to which it, or the [Secretary of Agriculture,] *Commission*, or the United States is a party.

The Commission shall submit to the Congress a written report within one hundred and twenty days after the end of each fiscal year detailing the operations of the Commission during such fiscal year. The Commission shall include in such report such information, data, and recommendations for further legislation as it may deem advisable with respect to the administration of this Act and its powers and functions under this Act.

The Comptroller General of the United States shall conduct reviews and audits of the Commission and make reports thereon. For the purpose of conducting such reviews and audits the Comptroller General shall be furnished such information regarding the powers, duties, organizations, transactions, operations, and activities of the Commission

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as he may require and he and his duly authorized representatives shall, for the purpose of securing such information, have access to and the right to examine any books, documents, papers, or records of the Commission except that in his reports the Comptroller General shall not include data and information which would separately disclose the business transactions of any person and trade secrets or names of customers, although such data shall be provided upon request by any Committee of either House of Congress acting within, the scope of its jurisdiction.

SEC. 8a. The [Secretary of Agriculture] *Commission* is authorized --

(1) to register futures commission merchants *and persons associated therewith as described in section 4k of this Act, commodity trading advisors, commodity pool operators* and floor brokers upon application in accordance with rules and regulations and in form and manner to be prescribed by the [Secretary of Agriculture] *Commission*; and

(2) to refuse to register any person --

(A) if the prior registration of such person has been suspended (and the period of such suspension shall not have expired) or has been revoked;

(B) if it is found, after opportunity for hearings, that the applicant is unfit to engage in the business for which the application for registration is made, (i) because such applicant, or, if the applicant is a partnership, any general partner, or, if the applicant is a corporation, any officer or holder of more than 10 per centum of the stock, at any time engaged in any practice of the character prohibited by this Act or was convicted of a felony in any State or Federal court, or was debarred by any agency of the United States from contracting with the United States, or the applicant willfully made any material false or misleading statement in his application or willfully omitted to state any material fact in connection with the application, or (ii) for other good cause shown; or

(C) in the case of an applicant for registration as futures commission merchant, if it is found after opportunity for hearing, that the applicant has not established that he meets the minimum financial requirements under section 4f of this Act:

Provided, That pending final determination under clause (B) or (C), registration shall not be granted: and *Provided further*, That the applicant may appeal from a refusal of registration under clause (B) or (C) in the manner provided in paragraph (b) of section 6 of this Act; and

(3) in accordance with the procedure provided for in paragraph (b) of section 6 of this Act, to suspend or revoke the registration of any person registered under this Act if cause exists under subparagraph (2) (B) or (C) which would warrant a refusal of registration of such person, and to suspend or revoke the registration of any futures commission merchant who shall knowingly accept any order for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract

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market from any person if such person has been denied trading privileges on any contract market by order of the [Secretary of Agriculture] *Commission* under the provisions of paragraph (b) of section 6 of this Act and the period of denial specified in such order shall not have expired; and

(4) to fix and establish from time to time reasonable fees and charges for registrations and renewals thereof; and

(5) to make and promulgate such rules and regulations as, in the judgment of the [Secretary of Agriculture,] *Commission*, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this Act;

(6) to communicate to the proper committee or officer of any contract market and to publish, notwithstanding the provisions of section 8 of this Act, the full facts concerning any transaction or market operation, including the names of parties thereto, which in the judgment of the [Secretary of Agriculture] *Commission* disrupts or tends to disrupt any market or is otherwise harmful or against the best interests of producers and consumers; and

[(7) to disapprove any bylaw, rule, regulation, or resolution made, issued or proposed by a contract market or by the governing board thereof or any committee which relates to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relates to other trading requirements, when he finds that such bylaw, rule, regulation, or resolution violates or will violate any of the provisions of this Act, or any of the rules, regulations, or orders of the Secretary of Agriculture or the Commission thereunder.]

(7) to alter or supplement the rules of such contract market insofar as necessary or appropriate by rule or regulation or by order, if after making the appropriate request in writing to a contract market that such contract market effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such contract market has not made the changes so required, and that such changes are necessary or appropriate for the protection of persons producing, handling, processing, or consuming any commodity traded for future delivery on such contract market, or the product or byproduct thereof, or for the protection of traders or to insure fair dealing in commodities traded for future delivery on such contract market. Such rules, regulations, or orders may specify changes with respect to such matters as:

(A) terms or conditions in contracts of sale to be executed on or subject to the rules of such contract market;

(B) the form or manner of execution of purchases and sales for future delivery;

(C) other trading requirements, excepting the setting of levels of margin;

(D) safeguards with respect to the financial responsibility of members;

(E) the manner, method, and place of soliciting business, including the content of such solicitations; and

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(F) the form and manner of handling, recording, and accounting for customers' orders, transactions, and accounts; and

(8) to make and promulgate such rules and regulations with respect to those persons registered under this Act, who are not members of a contract market, as in the judgment of the Commission are reasonably necessary to protect the

public interest and promote just and equitable principles of trade, including but not limited to the manner, method, and place of soliciting business, including the content of such solicitation; and

(9) (A) to direct the contract market, whenever it has reason to believe that the amount of deliverable supplies, the number of open contracts, the relative size of individual traders' positions, the amount and direction of price movements in cash and futures markets, the impact of government edicts and regulations, the existence of a market emergency, or any other such market factor creates a condition which threatens orderly trading in, or liquidation of, any futures contract, to take such action as in the Commission's judgment is necessary to maintain or restore orderly trading in, or liquidation of, any futures contract. Such actions may include, but are not limited to, the following:

- (1) Limit trading to liquidation only;
- (2) Extend the expiration date of a futures contract;
- (3) Extend the time for making deliveries in fulfillment of a futures contract;
- (4) Order liquidation of all or part of any open contracts under such terms as the Commission deems necessary;
- (5) Suspend trading;
- (6) Order the fixing of a settlement price for the liquidation of a futures contract; and
- (7) Any other action necessary to prevent significant intervention or manipulation by a foreign government.

(B) as used herein, the term "market emergency" shall be defined to mean significant intervention of foreign governments in the futures market, war or other national emergency, price controls, export embargoes, or any other significant disruption of normal commercial processes which can reasonably be deemed to affect futures transactions: Provided, That nothing herein shall be deemed to limit the meaning or interpretation given by a contract market to the terms "market emergency", "emergency" or equivalent language in its own bylaws, rules, regulations, or resolutions.

SEC. 8b. It shall be unlawful for any person, against whom there is outstanding any order of the [Secretary of Agriculture] Commission prohibiting him from trading on or subject to the rules of any contract market, to make or cause to be made in contravention of such order, any contract for future delivery of any commodity, on or subject to the rules of any contract market.

SEC. 9. (a) It shall be a felony punishable by a fine of not more than [\$ 10,000] \$ 100,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any futures commission

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merchant, or any employee or agent thereof, to embezzle, steal, purloin, or with criminal intent convert to his own use or the use of another, any money, securities, or property having a value in excess of \$ 100, which was received by such commission merchant to margin, guarantee, or secure the trades or contracts of any customer of such commission merchant or accruing to such customer as the result of such trades or contracts. The word "value" as used in this paragraph means face, par, or market value, or cost price, either wholesale or retail, whichever is greater.

(b) It shall be a felony punishable by a fine of not more than [\$ 10,000] \$ 100,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any contract market, or to corner or attempt to corner any such commodity, or knowingly to deliver or cause to be delivered for transmission through the mails or in interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce.

(c) Except as provided in paragraphs (a) and (b) of this section, it shall be a misdemeanor punishable by a fine of not more than [\$ 10,000] \$ 100,000 or imprisonment for not more than one year, or both, together with the costs of prosecution, for any person to violate the provisions of section 4, section 4a, section 4b, section 4c, section 4d, section 4e, section 4h, section 4i, section 4k, section 4m, section 4o, or section 8b, or to fail to evidence any contract mentioned in section 4 of this Act by a record in writing as therein required.

(d) It shall be a felony punishable by a fine of not more than \$ 10,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any Commissioner of the Commission or any employee or agent

thereof, to participate, directly or indirectly, in any transaction in commodity futures or any transaction referred to in section 4c(B) of this Act, or for any such person to participate, directly or indirectly, in any transaction in an actual commodity: Provided, That such prohibition against any transaction in an actual commodity shall not apply to a transaction in which such person sells an agricultural commodity which he has produced in connection with his own farming or ranching operations nor to any transaction in which he sells livestock which he has owned at least three months. With respect to such excepted transactions, the Commission shall require any Commissioner of the Commission or employee or agent thereof who participates in any such transaction to notify the Commission thereof in accordance with such regulations as the Commission shall prescribe and the Commission shall make such information available to the public.

(e) It shall be a felony punishable by a fine of not more than \$ 10,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any Commissioner of the Commission or any employee or agent thereof who, by virtue of his employment or

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position, acquires information which may affect or tend to affect the price of any commodity futures or commodity and which information has not been made public to impart such information with intent to assist another person, directly or indirectly, to participate in any transaction in commodity futures, any transaction in an actual commodity, or in any transaction referred to in section 4c(B) of this Act.

SEC. 10. If any provision of this Act or the application thereof to any person or circumstances is held invalid, the validity of the remainder of the Act and of the application of such provisions to other persons and circumstances shall not be affected thereby.

SEC. 11. Omitted as obsolete.

[SEC. 12. The Secretary of Agriculture may cooperate with any department or agency of the Government, any State, Territory, District or possession, or department, agency, or political subdivision thereof, or any person; and shall have the power to appoint, remove, and fix the compensation of such officers and employees, not in conflict with existing law, and make such expenditures for rent outside the District of Columbia, printing, telegrams, telephones, law books, books of reference, periodicals, furniture, stationery, office equipment, travel, and other supplies and expenses as shall be necessary to the administration of this Act in the District of Columbia and elsewhere, and there are hereby authorized to be appropriated, out of any moneys in the Treasury not otherwise appropriated, such sums as may be necessary for such purposes.]

SEC. 12. (a) The Commission may cooperate with any department or agency of the Government, any State, territory, district, or possession, or department, agency, or political subdivision thereof, or any person.

(b) The Commission shall have the authority to employ such investigators, special experts, administrative law judges, clerks, and other employees as it may from time to time find necessary for the proper performance of its duties and as may be from time to time appropriated for by Congress. The Commission may employ experts and consultants in accordance with section 3109 of title 5 of the United States Code, and compensate such persons at rates not in excess of the maximum daily rate prescribed for GS-18 under section 5332 of title 5 of the United States Code. The Commission shall also have authority to make and enter into contracts with respect to all matters which in the judgment of the Commission are necessary and appropriate to effectuate the purposes and provisions of this Act.

(c) All of the expenses of the Commissioners, including all necessary expenses for transportation incurred by them while on official business of the Commission shall be allowed and paid on the presentation of itemized vouchers therefor approved by the Commission.

(d) In order to perform its responsibilities under the Act, the Commission may partially or jointly utilize the facilities and services of employees of the Department of Agriculture at cost, and in the event that suitable space is not available at the Department of Agriculture, the Commission may rent suitable offices for its use.

(e) The executive, administrative, and regulatory functions of the Commission, including functions of the Commission with respect to

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(i) the appointment and: supervision of personnel employed under the Commission, (ii) the distribution of business among such personnel and among administrative units of the Commission, and (iii) the use and expenditure of funds, shall be exercised solely by the Commission: Provided, That the Commission may delegate such functions as it determines necessary to carry out the provisions and purposes of the Act to employees of the Commission.

(f) The Commission shall exercise all functions with respect to the preparation of budget estimates and with respect to the distribution of appropriated funds according to major programs and purposes. Commission budgets shall be forwarded to the Secretary of Agriculture solely for transmission with the Department of Agriculture's budget request to the Congress.

(g) There are hereby authorized to be appropriated out of any moneys in the Treasury, not otherwise appropriated, such sums as may be necessary for the purposes of this Act.

SEC. 13. (a) Any person who commits, or who willfully aids, abets, counsels, commands, induces, or procures the commission of, a violation of any of the provisions of this Act, or any of the rules, regulations or orders issued pursuant to this Act, or who acts in combination or concert with any other person in any such violation, or who willfully causes an act to be done or omitted which if directly performed or omitted by him or another would be a violation of the provisions of this Act or any of such rules, regulations, or orders may be held responsible in administrative proceedings under this Act for such violation as a principal.

(b) Nothing in this Act shall be construed as requiring [the Secretary of Agriculture or] the Commission to report minor violations of this Act for prosecution, whenever it appears that the public interest does not require such action.

SEC. 14. (a) *Any person complaining of any violation of any provision of this Act or any rule, regulation, or order thereunder by any person registered under section 4d, 4e, 4k, or 4m of this Act may, at any time within nine months after the cause of action accrues, apply to the Commission by petition, which shall briefly state the facts, whereupon, if, in the opinion of the Commission, the facts therein contained warrant such action, a copy of the complaint thus made shall be forwarded by the Commission to the respondent, who shall be called upon to satisfy the complaint, or to answer it in writing, within a reasonable time to be prescribed by the Commission.*

(b) If there appear to be, in the opinion of the Commission, any reasonable grounds for investigating any complaint made under this section, the Commission shall investigate such complaint and may, if in its opinion the facts warrant such action, have said complaint served by registered mail or by certified mail or otherwise on the respondent and afford such person an opportunity for a hearing thereon before an Administrative Law Judge designated by the Commission in any place in which the said person is engaged in business: Provided, That in complaints wherein the amount claimed as damages does not exceed the sum of \$ 2,500, a hearing need not be held and proof in support of the complaint and in support of the respondent's

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answer may be supplied in the form of depositions or verified statements of fact.

(c) After opportunity for hearing on complaints where the damages claimed exceed the sum of \$ 2,500 has been provided or waived and on complaints where damages claimed do not exceed the sum of \$ 2,500 not requiring hearing as provided herein, the Commission shall determine whether or not the respondent has violated any provision of this Act or any rule, regulation, or order thereunder.

(d) In case a complaint is made by a nonresident of the United States, the complainant shall be required, before any formal action is taken on his complaint, to furnish a bond in double the amount of the claim conditioned upon the payment of costs, including a reasonable attorney's fee for the respondent if the respondent shall prevail, and any reparation award that may be issued by the Commission against the complainant on any counterclaim by respondent: Provided, That the Commission shall have authority to waive the furnishing of a bond by a complainant who is a resident of a country which permits the filing of a complaint by a resident of the United States without the furnishing of a bond.

(e) If after a hearing on a complaint made by any person under subsection (a) of this section, or without hearing as provided in subsections (b) and (c) of this section, or upon failure of the party complained against to answer a complaint duly served within the time prescribed, or to appear at a hearing after being duly notified, the Commission determines that the respondent has violated any provision of this Act, or any rule, regulation, or order thereunder the Commission shall, unless the offender has already made reparation to the person complaining, determine the amount of damage, if any, to which such person is entitled as a result of such violation and shall make an order directing the of-

fender to pay to such person complaining such amount on or before the date fixed in the order. If, after the respondent has filed his answer to the complaint, it appears therein that the respondent has admitted liability for a portion of the amount claimed in the complaint as damages, the Commission under such rules and regulations as it shall prescribe, unless the respondent has already made reparation to the person complaining, may issue an order directing the respondent to pay to the complainant the undisputed amount on or before the date fixed in the order, leaving the respondent's liability for the disputed amount for subsequent determination. The remaining disputed amount shall be determined in the same manner and under the same procedure as it would have been determined if no order had been issued by the Commission with respect to the undisputed sum.

(f) If any person against whom an award has been made does not pay the reparation award within the time specified in the Commission's order, the complainant, or any person for whose benefit such order was made, may within three years of the date of the order file in the district court of the United States for the district in which he resides or in which is located the principal place of business of the respondent, or in any State court having general jurisdiction of the parties, a petition setting forth briefly the causes for which he claims

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damages and the order of the Commission in the premises. The orders, writs, and processes of the district courts may in these cases run, be served, and be returnable anywhere in the United States. Such suit in the district court shall proceed in all respects like other civil suits for damages, except that the findings and orders of the Commission shall be prima-facie evidence of the facts therein stated, and the petitioner shall not be liable for costs in the district court, nor for costs at any subsequent state of the proceedings, unless they accrue upon his appeal. If the petitioner finally prevails, he shall be allowed a reasonable attorney's fee, to be taxed and collected as a part of the costs of the suit.

(g) Either party adversely affected by the entry of a reparation order by the Commission may, within thirty days from and after the date of such order, appeal therefrom to the district court of the United States for the district in which said hearing was held. Provided, That in cases handled within a hearing in accordance with subsections (b) and (c) of this section or in which a hearing has been waived by agreement of the parties, appeal shall be to the district court of the United States for the district in which the respondent is located. Such appeal shall be perfected by the filing with the clerk of said court a notice of appeal, together with a petition in duplicate which shall recite prior proceedings before the Commission and shall state the grounds upon which the petitioner relies to defeat the right of the adverse party to recover the damages claimed, with proof of service thereof upon the adverse party. Such appeal shall not be effective unless within thirty days from and after the date of the reparation order the appellant also files with the clerk a bond in double the amount of the reparation awarded against the appellant conditioned upon the payment of the judgment entered by the court, plus interest and costs, including a reasonable attorney's fee for the appellee, if the appellee shall prevail. Such bond shall be in the form of cash, negotiable securities having a market value at least equivalent to the amount of bond prescribed, or the undertaking of a surety company on the approved list of sureties issued by the Treasury Department of the United States. The clerk of the court shall immediately forward a copy thereof to the Commission who shall forthwith prepare, certify, and file in said court a true copy of the Commission's decision, findings of fact, conclusions, and order in said case, together with copies of the pleadings upon which the case was heard and submitted to the Commission. Such suit in the district court shall be a trial de novo and shall proceed in all respects like other civil suits for damages, except that the findings of fact and order or orders of the Commission shall be prima-facie evidence of the facts therein stated. Appellee shall not be liable for costs in said court. If appellee prevails he shall be allowed a reasonable attorney's fee to be taxed and collected as a part of his costs. Such petition and pleadings certified by the Commission upon which decision was made by it shall upon filing in the district court constitute the pleadings upon which said trial de novo shall proceed subject to any amendment allowed in that court.

(h) Unless the registrant against whom a reparation order has been issued shows to the satisfaction of the Commission within five days from the expiration of the period allowed for compliance with such

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order that he has either taken an appeal as herein authorized or has made payment in full as required by such order, he shall be prohibited from trading on all contract markets and his registration shall be suspended automatically at the expiration of such five-day period until he shows to the satisfaction of the Commission that he has paid the amount therein specified with interest thereon to date of payment: Provided, That if on appeal the appellee prevails or if the appeal is dismissed the automatic prohibition against trading and suspension of registration shall become effective at

the expiration of thirty days from the date of judgment on the appeal, but if the judgment is stayed, by a court of competent jurisdiction the suspension shall become effective ten days after the expiration of such stay, unless prior thereto the judgment of the court has been satisfied.

(i) The provisions of this section shall not become effective until one year after the date of its enactment: Provided, That claims which arise within nine months immediately prior to the effective date of this section may be heard by the Commission after such one year period.

SEC. 16. (a) Any association of persons may be registered with the Commission as a registered futures association pursuant to subsection (b) of this section, under the terms and conditions hereinafter provided in this section, by filing with the Commission for review and approval a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below specified:

(1) Data as to its organization, membership, and rules of procedure, and such other information as the Commission may by rules and regulations require as necessary or appropriate in the public interest; and

(2) Copies of its constitution, charter, or articles of incorporation or association, with all amendments thereto, and of its bylaws, and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this section collectively referred to as the "rules of the association".

(b) An applicant association shall not be registered as a futures association unless the Commission finds, under standards established by the Commission, that --

(1) such association is in the public interest and that it will be able to comply with the provisions of this section and the rules and regulations thereunder and to carry out the purposes of this subsection;

(2) the rules of the association provide that any person registered under this Act, contract market, or any other person designated pursuant to the rules of the Commission as eligible for membership may become a member of such association, except such as are excluded pursuant to paragraph (3) or (4) of this subsection, or a rule of the association permitted under this paragraph. The rules of the association may restrict membership in such association on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest and to carry out the purpose of this section. Rules adopted by the association may provide that

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the association may, unless the Commission directs otherwise in cases in which the Commission finds it appropriate in the public interest so to direct, deny admission to, or refuse to continue in such association any person if (i) such person, whether prior or subsequent to becoming registered as such, or (ii) any person associated with in the meaning of "associated person" as set forth in section 4(k) of this Act, whether prior or subsequent to becoming so associated, has been and is suspended or expelled from a contract market or has been and is barred or suspended from being associated with all members of such contract market, for violation of any rule of such contract market;

(3) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall be admitted to or continued in membership in such association, if such person --

(A) has been and is suspended or expelled from a registered futures association or from a contract market or has been and is barred or suspended from being associated with all members of such association or from being associated with all members of such contract market, for violation of any rule of such association or contract market which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade; or

(B) is subject to an order of the Commission denying, suspending, or revoking his registration pursuant to section 6(b) of this Act (7 U.S.C. 9), or expelling or suspending him from membership in a registered futures association or a contract market, or barring or suspending him from being associated with a futures commission merchant; or

(C) whether prior or subsequent to becoming a member, by his conduct while associated with a member, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B) which is in effect with re-

spect to such member, and in entering such a suspension, expulsion, or order, the Commission or any such contract market or association shall have jurisdiction to determine whether or not any person was a cause thereof; or

(D) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person who would be ineligible for admission to or continuance in membership under clause (A), (B), or (C) of this paragraph.

(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall become a member and no natural person shall become a person associated with a member, unless such person is qualified to become a member or a person associated

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with a member in conformity with specified and appropriate standards with respect to the training, experience, and such other qualifications of such person as the association finds necessary or desirable, and in the case of a member, the financial responsibility of such a member. For the purpose of defining such standards and the application thereof, such rules may --

(A) appropriately classify prospective members (taking into account relevant matters, including type or nature of business done) and persons proposed to be associated with members.

(B) specify that all or any portion of such standard shall be applicable to any such class.

(C) require persons in any such class to pass examinations prescribed in accordance with such rules.

(D) provide that persons in any such class other than prospective members and partners, officers and supervisory employees (which latter term may be defined by such rules and as so defined shall include branch managers of members) of members, may be qualified solely on the basis of compliance with specified standards of training and such other qualifications as the association finds appropriate.

(E) provide that applications to become a member or a person associated with a member shall set forth such facts as the association may prescribe as to the training, experience, and other qualifications (including, in the case of an applicant for membership, financial responsibility) of the applicant and that the association shall adopt procedures for verification of qualifications of the applicant.

(F) require any class of persons associated with a member to be registered with the association in accordance with procedures specified by such rules (and application or document supplemental thereto required by such rules of a person seeking to be registered with such association shall, for the purposes of subsection (b) of section 6 of the Act, be deemed an application required to be filed under this section).

(5) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs.

(6) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration.

(7) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, in general, to protect the public interest, and to remove impediments to and perfect the mechanism of free and open futures trading.

(8) the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules.

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(9) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and persons associated with members and the denial of membership to any person seeking membership therein or the barring of any person from being associated with a member. In any proceeding to determine whether any member or

other person shall be disciplined, such rules shall require that specific charges be brought; that such member or person shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include --

(A) a statement setting forth any act or practice in which such member or other person may be found to have engaged, or which such member or other person may be found to have omitted:

(B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation.

(C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade.

(D) a statement setting forth the penalty imposed. In any proceeding to determine whether a person shall be denied membership or whether any person shall be barred from being associated with a member, such rules shall provide that the person shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial or bar which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial or bar is based.

(10) the rules of the association for a fair and equitable procedure through arbitration or otherwise for the settlement of customer's claims and grievances against any member or employee thereof: Provided, That (i) the use of such procedure by a deg. customer shall be voluntary, (ii) the procedure shall not be applicable to any claim in excess of \$ 5,000, (iii) the procedure shall not result in any compulsory payment except as agreed upon between the parties, and (iv) the term "customer" as used in this subsection shall not include a futures commission merchant or a floor broker.

(c) The Commission may, after notice and opportunity for hearing, suspend the registration of any futures association if it finds that the rules thereof do not conform to the requirements of the Commission, and any such suspension shall remain in effect until the Commission issues an order determining that such rules have been modified to conform with such requirements.

(d) In addition to the fees and charges authorized by section 8a(4) of this Act, each person registered under this Act, who is not a member of a futures association registered pursuant to this section, shall pay to the Commission such reasonable fees and charges as may be necessary to defray the costs of additional regulatory duties required to be performed by the Commission because such person is not a member of

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a registered futures association. The Commission shall establish such additional fees and charges by rules and regulations.

(e) Any person registered under this Act, who is not a member of a futures association registered pursuant to this section, in addition to the other requirements and obligations of this Act and the regulations thereunder shall be subject to such other rules and regulations as the Commission may find necessary to protect the public interest and promote just and equitable principles of trade.

(f) Upon filing of an application for registration pursuant to subsection (a), the Commission shall by order grant such registration if the requirements of this section are satisfied. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration.

(g) A registered futures association may, upon such reasonable notice as the Commission may deem necessary in the public interest withdraw from registration by filing with the Commission a written notice of withdrawal in such form as the Commission may by rules and regulations prescribe.

(h) If any registered futures association takes any disciplinary action against any member thereof or any person associated with such a member or denies admission to any person seeking membership therein, or bars any person from being associated with a member, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within thirty days after such action has been taken or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall operate as a stay of such action until an order is issued upon such

review pursuant to subsection (k) of this section unless the Commission otherwise orders, after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of affidavits and oral arguments).

(i) (1) In a proceeding to review disciplinary action taken by a registered futures association against a member thereof or a person associated with a member, if the Commission, after appropriate notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant --

(A) finds that such member or person has engaged in such acts or practices, or has omitted such act, as the association has found him to have engaged in or omitted, and

(B) determines that such acts or practices, or omission to act, are in violation of such rules of the association as have been designated in the determination of the association, the Commission shall by order dismiss the proceeding, unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omission of any act required, by any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A), or if the Commission

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determines that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that such act as is found to have been omitted is not required by such designated rule or rules, the Commission shall by order set aside the action of the association.

(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed upon a member or person associated with a member is excessive or oppressive, having due regard to the public interest, the Commission shall by order cancel, reduce, or require the remission of such penalty.

(3) In any proceeding to review the denial of membership in a registered futures association or the barring of any person from being associated with a member, if the Commission, after appropriate notice and hearing, and upon consideration of the record before the association and such other evidence as it may deem relevant, determines that the specific grounds on which such denial or bar is based exist in fact and are valid under this section, the Commission shall by order dismiss the proceeding; otherwise, the Commission shall by order set aside the action of the association and require it to admit the applicant to membership therein, or to permit such person to be associated with a member.

(j) Every registered futures association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a) of this section. Any change in or addition to the rules of a registered futures association shall be submitted to the Commission for approval and shall take effect upon the thirtieth day after such approval by the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of this section and the provisions of this Act.

(k) (1) The Commission is authorized by order to abrogate any rule of a registered futures association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or effectuate the purposes of this title.

(2) The Commission may in writing request any registered futures association to adopt any specified alteration or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested, or with such modifications of such alteration or supplement as it deems necessary if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement

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is necessary or appropriate in the public interest or to effectuate the purposes of this section, with respect to --

(A) the basis for, and procedure in connection with, the denial of membership or the barring from being associated with a member or the disciplining of members or persons associated with members, or the qualifications required for members or natural persons associated with members or any class thereof;

(B) the method for adoption of any change in or addition to the rules of the association;

(C) the method of choosing officers and directors.

(1) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or to carry out the purposes of this section --

(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered futures association, if the Commission finds that such association has violated any provisions of this title or any rule or regulation thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity tending to defeat the purposes of this section;

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered futures association any member thereof, or to suspend for a period not exceeding twelve months or to bar any person from being associated with a member thereof, if the Commission finds that such member or person --

(A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this title or any rule or regulation thereunder; or

(B) has willfully violated any provision of the Commodity Exchange Act, as amended, or of any rule, regulation, or order thereunder, or has effected any transaction for any other person who, he had reason to believe, was willfully violating with respect to such transaction any provision of such Act or rule, regulation, or order.

(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered futures association who, the Commission finds, has will fully failed to enforce the rules of the association, or has willfully abused his authority.

SEC. 17. The Commission shall take into consideration the public interest to be protected by the antitrust laws as well as the policies and purposes of this Act in issuing any order or adopting any Commission rule or regulation, or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 16 of this Act.

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APPENDIX I

THE TRADING OF FUTURES

Futures trading has experienced substantial changes since its origin relating to the scope of the market, the nature of risks, the motivation of the participants, the patterns of industry, and the refinement of futures trading and clearing practices.

The most notable difference is that in the early futures markets the primary use of the market was that of making or taking delivery of commodities, finding a buyer or seller. In contrast, today fewer than 3% of all futures contracts culminate with the delivery of the actual goods against the contract. Both commercial and speculative users of the market generally find it preferable to offset or liquidate the obligation through the initiation of opposite futures transactions rather than making or taking delivery.

EXAMPLE OF A CASH TRANSACTION

A would-be seller owning merchandise -- such as the farmer who owns 5,000 bushels of wheat -- wants to convert it to cash. He seeks as a buyer someone for whom the wheat has inherent value. The wheat has value for the grain elevator because he is in contact with potential buyers, such as the flour miller, and has the facilities to store, condition, and load out the grain and earn additional income from these services. The wheat has value for the flour miller, in turn, who is able to increase its value and utility by grinding it to flour for the baker.

The farmer's sale to the grain elevator, the elevator's sale to the wheat miller, and the miller's sale of flour to the baker are cash transactions. In each of these sales certain common elements must be agreed upon. Quality, normally based on samples, will be the major determinant of price. Quantity, usually specified by the buyer, will sometimes be negotiated, and price discounts allowed with increased quantity. The where, when, and how of delivery terms must be settled as well. And, finally, price will be determined in reference to the other terms of the contract -- quality, quantity, and the time and place of delivery. Cash contracts are usually agreements for the immediate delivery of commodities or for negotiated future delivery.

"FORWARD" CONTRACTS

A cash contract in which merchandise is not to be delivered immediately, but on an agreed upon future date, is known as a cash forward contract. A cash forward contract might have been more appropriate than the usual cash transaction for the flour miller mentioned above if his storage capacity were already fully utilized. By using a cash forward contract, the miller would be guaranteed a price but could defer the delivery until such time as he could process the wheat.

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A cash forward contract enables the buyer and the seller of commodities to properly plan for and utilize both storage and production facilities and to make commitments for deferred deliveries of the commodity or of further-processed products. The flour miller might enter into a cash forward contract to deliver flour to the baker when he could put it to immediate use, avoiding the need to store. A cash forward seller of grain or flour might not even have the grain or flour at the time he enters into the contract. Yet he can contract to sell it with the belief that he will be able to acquire the goods at a favorable price in time to satisfy the delivery requirements of his customer.

In negotiating a cash forward contract, the buyer may require a guarantee of a specific grade or quality of the commodity from the seller. In the event the seller is unable to deliver that specified grade, it is common practice for the seller and buyer to agree on alternative price adjustments. When delivery occurs, the commodity is carefully examined and its grade determined. Payment of a premium is usual when the grade is higher than the standard, or a discount in price is accepted when the grade is inferior.

FUTURES CONTRACTS

Because futures contracts evolved from cash forward contracts, they have many similar terms. A futures contract is a legally binding commitment to deliver or take delivery of a given quantity and quality of a commodity, at a price agreed upon when the contract is made, with delivery at the seller's option sometime during the specified future delivery month.

The essential difference between modern futures contracts and the cash forward contract is that both price and quality are specified at the time the futures contract is made. As with cash forward contracts, delivery against a futures contract with a commodity of a superior or inferior quality may be made at a premium over or a discount under the agreed upon price.

Standardization of futures contracts as to grade and size was a gradual evolution. Standardization allowed for the growth of the market because one futures contract became fully identical and interchangeable with all other futures contracts of the same delivery month. This interchangeability, or fungibility, meant that the original seller could offset his obligation to deliver the commodity against the contract by offsetting or liquidating the contract with an equal and opposite transaction. The standardization of terms gave the buyer of futures contracts the same ability to liquidate his obligation to take delivery by offsetting the contract with an equal sale of futures contracts.

Standardization of terms and the ability to offset contracts led to rapidly increasing use of futures markets by commercial firms and speculators. Commercial firms began to realize that futures markets could provide financial protection in addition to serving as an alternate market to selling commodities on the cash market.

HEDGING

Commercial interests, producers, merchandisers, and processors of commodities began to recognize a generally parallel pattern in price movements between the cash commodities and futures contracts for

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those commodities. News that bad weather would likely result in crop loss and tighter supplies was reflected immediately in higher cash prices as buyers sought to store up wheat in anticipation of later shortages. Futures prices were also bid higher as buyers anticipated the impact of the shortages, not only at harvest but through the balance of the marketing year.

Economic news that signaled higher-than-expected supplies, on the other hand, was immediately registered in weakening cash prices as buyers lowered their bids in anticipation of easily available supplies. At the same time, in the futures market, buyers scaled down their bids on the prospects of increased supplies.

Noting the strong tendency for both cash and futures prices to move in the same direction, roughly parallel, reacting to the same economic factors, commercial firms with involvement in both markets realized that while a single set of economic circumstances might result in a loss on cash transactions, they could be turned into a gain in futures contracts if a position were taken equal but opposite to the risk position in the cash market. A businessman lacking a commodity but committed to processing and sales agreements ran the risk that prices would rise before he could buy the commodity. He was "short" the cash commodity, and so he would take the equal but opposite "long" position and buy futures contracts.

A wheat flour miller, for instance, might be committed to deliver 500 bags of flour to a baker at a fixed price at a time in the future but might not have yet bought the wheat, lacking the space to store it until it could be processed. A sudden rise in wheat prices could spell a serious loss; his raw material costs would climb while his sales return would remain fixed. The flour miller could have some protection through the use of futures. To protect himself, or hedge his risk, he would buy wheat futures contracts, let's say 1,000 bushels or an amount that would roughly yield the amount of flour he had agreed to deliver to the baker. He would buy futures contracts in that futures delivery month closest to the time he had to buy the wheat to make the flour. When he needed it, he would buy the wheat in the cash market, manufacture the flour, and deliver it to his customer.

If wheat prices had risen, to the extent that his sales return failed to cover the increased cost of the wheat, he might be faced with smaller profits, a break-even situation, or a substantial loss if he had not hedged in futures. Although the cash cost of the wheat had risen, wiping out or cutting his profit, futures prices had also responded to the same economic factors. Wheat futures contracts would now be worth more than at the time of purchase. Given the situation of rising prices, other users of wheat, anxious to guard against further increased costs, would gladly buy futures contracts. In selling futures contracts in an equal number and in the same delivery months as those initially purchased, but at the higher price, the flour miller could recover his loss from increased costs with his gain on futures.

The risk for the producer of commodities is that the value of those commodities will deteriorate before he can market them. The risk for the processor or user of commodities is the reverse, that the supply situation will change to the point that rising prices will add costs and impair his projected profits. While the user of commodities, such as the flour miller, will use a buying, or long, hedge in future contracts to protect against rising prices, the producer or owner of commodities will use a selling, or short, hedge as a guard against declining values.

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ADVANTAGES OF FUTURES TRADING

(1) *Futures Markets Meet a Genuine Need in the Marketing of Commodities.* The nation's commodity exchanges have created an efficient way of buying and selling commodities in volume for future delivery. In doing so they have made it possible for the trade hedger to minimize his price risks whenever it suits his purposes. This is particularly important to anyone producing, distributing, or consuming any of the various farm crops. A farm commodity such as wheat, for example, is harvested in the United States within a limited few weeks of the year whereas the use of wheat is distributed throughout the entire year. As a farm crop is harvested it still must be owned, or "carried" by someone until it is consumed. Concurrent with the ownership of the commodity is the attendant cost of storing it, the cost to finance the ownership if funds must be borrowed for the purpose, and the risk of loss from an adverse price change which may occur while the commodity is owned. As a general rule, the farm producer of the commodity wishes to sell his crop soon after it is harvested. Lack of adequate farm storage facilities, the need to raise funds which can be used to pay off any loans that may have been arranged to finance costs of production, and the desire to prepare land early for raising the following year's crop all contribute toward a farmer's desire to make an early sale following the harvest period. By the same token, a processor or user (such as a cereal manufacturer or a cotton textile mill) needs an assured supply of his

raw material throughout the year. Accordingly, it is easy to understand how any system of trading which facilitates selling or buying for future delivery can fulfill a real need in the marketing of seasonal farm crops.

(2) *Large Quantities of Risk Capital are Attracted to One Location.* Not only do representatives of the various commodity trades use the futures markets for hedging purposes, but a significantly larger number of speculators is attracted to futures trading by the high leverage afforded in the use of one's funds, and by the opportunity for profit which volatile and quickly changing prices produces.

(3) *A Publicly Known, Uniform Value for a Commodity is Created.* Although futures prices in many commodities frequently change rapidly, the inter-play of buyers and sellers on a world-wide scale trading in an open, competitive market quickly establishes what a commodity is "worth" at any given moment. Since prices are disseminated via tickers and quotation boards quickly, the smallest user of the market has as much knowledge of the prevailing value of the commodity he wishes to buy or sell as the largest user. This is important since, in a free economy, price is the catalyst which facilitates the allocation of goods among potential users, and distributes output most efficiently.

(4) *An Alternate Market for the Commodity is Provided.* Any owner of an actual commodity that is traded in a futures market, finding difficulty in locating a willing buyer in the cash market, can usually market the commodity via a sale of futures followed by a physical tender during the delivery period of the commodity thus sold. With the alternate market thus existing, the liquidity of a commodity inventory is obviously increased.

(5) *The Price to the Public is Reduced.* Because hedging of price risks in a futures market enables a merchant to reduce the exposures

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he has in doing business, he is able to operate on a lower profit margin with consequent lower prices to the consumer.

(6) *The Cost of Financing Ownership of Commodities is Lowered.* With much of the risk of loss due to an adverse price change eliminated if an existing inventory of cash commodities is hedged in a futures market, banks and other lending institutions can more freely loan money to finance ownership of the inventory, and frequently at lower interest rates, than they can if the inventory is not hedged. Certainly the value of the commodity collateral furnished to secure such a loan can always quickly be determined.

(7) *Hedging is Made Possible.* One of the basic functions of a commodity futures market is to provide facilities where representatives of the commodity trades can hedge their price risks. Although the general subject of hedging is complex, hedging against price risks is accomplished when a position in the futures market is established approximately equal and opposite to the position held by the hedger in the physical (also known as the actuals or cash) market. By doing this, those who handle commodities in their business (growers, distributors, processors, etc.) can protect themselves against loss due to adverse price fluctuations. The hedge taken may involve a short futures position as an offset to actual commodities owned, or it may involve a long futures position against forward sales of cash commodities not yet in hand.

Consider, for example, the price risk problems of the cotton merchant who has just bought, say, 300 bales of cotton from a grower. The minute he takes title to the physical commodity, the risks of all price fluctuations until the cotton is sold become his. Presumably the price paid to the grower was related to the prevailing price of, say, December cotton futures. To protect himself, therefore, until the cotton is sold to a user or export buyer, the merchant sells 3 contracts of December cotton futures (300 bales) short on the New York Cotton Exchange. In doing so, the merchant has placed himself in the position of being able to price his product competitively in the market place at all times. If prices should decline, the loss on the value of the physical cotton is largely offset by the profit realized from the short position in December futures. By the same token, if prices should advance, the loss which the merchant would have to take when buying back his short December futures position is expected to be offset by the greater profit he would realize from the sale of his actual inventory. Thus the merchant has freed himself from the worry and risk of price fluctuations so that he can concentrate on his major function in the market place, viz. that of accumulating and distributing an inventory of cotton for eventual use by consumers. This would not be possible if there was not always a ready facility for trading in futures offered by one or more of the commodity exchanges.

It is important to keep in mind that the words "hedge" and "hedging" as they are used in futures trading relate only to the activity in futures markets of those who handle the physical commodity in their business. One must have a position in the physical market (either long or short), or have a future need for the physical commodity, to be able to hedge.

Hedging is not an operation used by the speculator. There are times, however, when a speculator with a long futures position may, to protect himself temporarily or to reduce his margin obligation,

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elect to take a short position in a related futures contract or market. While this is sometimes called "hedging" by many speculators, more properly such an operation is called spreading or straddling.

(8) *Dissemination of Statistical Information is Facilitated.* Organized futures exchanges act as a focal point for the dissemination of statistics, weather reports, and other information vital to the industries they serve.

HOW AN EXCHANGE FUNCTIONS

While much of the daily work of the exchange is performed by hired members of the exchange staff, most of the actions taken by an exchange require the advance approval of the exchange's Board of Directors before they can become effective. All policies of the exchange are established by its governing board, but changes in the by-laws generally require the favorable vote of a majority of the members of the exchange before becoming operative.

Operating expenses of a commodity exchange are, for the most part, defrayed by assessments and dues collected from and paid by members of the exchange. Additional revenues in most exchanges are obtained also from the rental of desk space, rentals of floor telephone booths, ticker service fees, fees for providing statistical services, etc. collected from the members who use such facilities. In some exchanges in recent years some revenue to support exchange-provided activities has also been obtained from special fees, usually a few cents per contract, collected via carrying member firms from each customer who trades in the market. In those years when revenues exceeded expenses by a wide margin, since most of the exchanges attempt to operate essentially as non-profit organizations, it is not uncommon for a few exchanges to make a pro-rata complete or partial refund of dues or fees collected from members.

EXCHANGE ORGANIZATION AND ADMINISTRATION

All existing commodity exchanges are, for the most part, associations of members formed for the purpose of providing an orderly market where trading in commodities for future delivery can take place. Membership in an exchange is a privilege (not a right) available only to individuals. An individual can, however, after making appropriate application that is later approved by the exchange, confer the privileges of his membership on a particular corporation, co-operative organization, partnership, or company by which he is employed. A member can confer the privileges of his membership on only one organization or company at a time. All applicants for membership are interviewed by the exchange-appointed Membership Committee, or Committee on Admissions as it is sometimes called, prior to referral of the application to the exchange Board of Directors for approval. Once the applicant is approved by the Board, he must then, at some exchanges, "sign the book" evidencing his agreement as a newly elected member of the exchange to abide completely by all by-laws and rules of the exchange then existing, or thereafter duly approved. If a member violates any provision of the exchange's charter, by-laws, or rules, he may be censored, fined, or even expelled by a vote of the Board of Directors as the rules of the particular exchange require.

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The transfer of an exchange membership from a retiring member to a new member is accomplished through a bid and offer "market" for memberships that is maintained by the exchange itself. A member who wishes to sell his membership will list a price offer with the secretary of the exchange, or other appropriate officer. Similarly, anyone wishing to buy a membership must either pay the lowest offering price then available, or list a counter bid price with the secretary's office. Some exchanges permit a member to purchase an additional membership on behalf of a prospective new member before the new member candidate has been approved by the Board. At the Chicago Board of Trade, however, approval by the Board of a membership candidate's application is a pre-requisite to the purchase of a membership.

Actual organization of futures exchanges tends to differ as between exchanges. In general, supervision of exchange activities is exercised through a Board of Directors, or Board of Governors as it is sometimes called. The Board of Directors is headed by a Chairman, elected from the membership, who has supreme control over all exchange operations. The Board itself is elected, usually annually, by a vote of the full membership of the exchange after, in each case, being recommended for the positions by the exchange's Nominating Committee. The title of President, Secretary, or Executive Director is generally the title which identifies the full-time paid non-member executive (he may also be a member) who performs the day to day administrative chores at the exchange and who carries out the policies

approved by the Board of Directors. The Board of Directors also is annually responsible for appointing members of the exchange who serve on the various standing and special committees. Members who serve on committees are first recommended to the Board in most cases by the Nominating Committee.

Policies of the exchange are generally formulated after debate by the various committees of members before being recommended to the Board of Directors for approval. The Board may either approve or reject policy recommendations so made. The functions of most exchanges are regulated, and exercised in some cases, through the following standing committees (by no means a complete list) :

(1) *Membership Committee.* -- This committee, in regular or special meetings, passes on the eligibility of applicants to become members of the exchange after first examining the applicant in a personal interview.

(2) *Arbitration Committee.* -- This committee of members investigates, hears, and settles disputes between members, or between members and non-members if the non-member so agrees, arising out of exchange transactions.

(3) *Business Conduct Committee.* -- This committee, vested with wide powers of investigation and supervision, undertakes to prevent attempts at price manipulation, the cornering of commodities, and exercises general regulatory supervision over the business conduct of all members of the exchange, including the conduct of corporations, partnerships, co-operative groups, or companies on which membership privileges have been conferred. Conduct of members in relation to the public at large, the state, the federal government, with respect to non-member customers, and involving the good name of the exchange comes under the purview of this committee. In exercising its

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functions, the Business Conduct Committee may, if necessary, demand that a member submit his accounting and other records to the Committee for its examination. Failure to provide the records asked for can lead to a recommendation to the Board from the committee for the expulsion or suspension of the member or members involved.

(4) *Floor Committee.* -- This committee is charged with the responsibility of settling minor disputes that occasionally arise between members while trading in any of the rings or pits on the trading floor. The committee investigates and passes upon all complaints arising from the execution of futures orders, attempts to prevent collusion between floor trading members, enforces exchange decorum on the trading floor, and generally is charged with maintaining an open and orderly market at all times the exchange is open for business. Any customer of a commission house, dissatisfied with an execution, may ask for a Floor Committee investigation and review of a particular execution to assure himself that the transaction was at a fair price. If it was not, the Floor Committee can order the floor broker to make an appropriate settlement with the customer through the commission house carrying the customer's account.

(5) *Investigation and Audits Committee.* -- Some of the larger exchanges have an Investigation and Audits Committee of members, with paid staff assistants who conduct the actual investigative work of the committee. This committee is responsible for developing information related to any alleged or suspected violation of exchange rules. Periodic examination of individual member or member-company records is made by staff representatives of the Committee to assist in producing the information needed. Based on information developed, the Committee can then supposedly prevent certain illegal practices from continuing.

KINDS OF TRADING AND FLOOR TRADING PROCEDURES

Actual trading on an exchange floor is usually handled in one or both of two ways, depending largely upon the amount of activity in a particular market at the time. The two types of trading are known as blackboard trading, and pit (or ring) trading. Not all exchanges permit, blackboard trading, but the Chicago Mercantile Exchange, and the New York Mercantile Exchange do. It is best suited for those commodities where the trading volume normally is light. In blackboard trading, bids and/or offers received by member brokers on the floor are posted on appropriate blackboards located around or above the exchange trading floor. When a new bid or offer is received, the broker with the order in hand consults the best opposing offer or bid on the blackboard. If his order is a "market" order, he will complete the transaction by indicating to the blackboard attendant that he, accepts the lowest offer or the highest bid posted. The completed transaction is then recorded by the exchange.

By far the greatest amount of futures trading, however, is conducted by open outcry of bids and offers in open pits or around open trading rings. Only members of the exchange may participate as brokers in the pits. Members who trade in the pit or around a ring may be (1) members who trade only for their own account (generally referred to as scalpers or position traders) or (2) members who trade principally

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for the account of others based on orders to buy or sell received via other members. The scalper is important to futures trading in that his bids and offers often help to broaden a particular market, thus making it possible for the larger trade hedging orders to be accommodated. A few brokers on each exchange floor may attempt to service their own private customer list for whom they trade based on orders received by phone directly to the floor, but most floor brokers, when executing an order, rarely know the name of the customer for whom they are working at that particular moment. In the composite the brokers with customer orders in hand plus the scalpers and/or position traders make up the auction market. They compete with each other for the best executions of orders in hand. The work of a floor broker can be difficult, demanding, and very tiring on a busy day.

On some exchanges, and notably on the Chicago markets, pit trading is opened each business day with general trading proceeding simultaneously in all delivery months that are open for trading. On others, the opening transactions are effected through a "call" whereby all orders in hand at the opening which can be completed in the nearest open delivery month are dealt with before proceeding on to trading in the next delivery month in rotation, etc. Advocates of an opening call allege that such trading is more orderly and can be conducted by brokers with fewer errors and less risk than when general trading in all months is permitted on an opening. Following an opening call, simultaneous trading in all months is usually permitted throughout the trading day, although the general trading on certain exchanges is sometimes interrupted hourly and at the close of trading with another "call" of the active delivery months for the purpose of establishing periodic valid quotations in relatively inactive markets. Without passing on the merits of either method of opening or closing a market, it can safely be said that both methods are in use today, and both methods work satisfactorily for the exchanges which use them.

Customer orders to buy and sell are communicated to brokers in the pit via telephone to an order clerk representing the originating firm on the floor who, in turn, sends the order via messenger to an appropriate member broker in the ring. In recent years, with the advent of computerized order control systems, it has become customary for those firms using computers to communicate order messages from the initiating office direct to the exchange trading floor, thus largely eliminating the need for many floor phone order clerks. If the order is a market order, the messenger will usually wait for an execution report from the broker and then return with it to the floor order clerk who, in turn, relays the finished transaction report by phone to his firm. If, on the other hand, the order is a limit order, and somewhat "away from the market", the messenger will leave the bid or offer with the floor trading member who, in turn, will insert the order in his "deck" of unexecuted orders filed by price and time received. Thus, as prices change, the broker always has in front of him those orders which require an execution at the prevailing price level.

ROLES PLAYED BY EACH PARTICIPANT

From the time an order originates with a futures trader until the time the trader receives a report of its execution it must, of necessity, pass through many hands.

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THE SPECULATIVE CUSTOMER

Broadly speaking, futures traders fall into two general classifications, i.e. "trade" hedging customers, and speculators. All orders which reach the trading floor originate with one or the other group of traders. The "trade" customer is the hedger who seeks, at low cost, to protect himself or his company against possible loss due to adverse price fluctuations in the market place. Speculators, on the other hand, embrace all representatives of the general public, including some institutions, plus floor scalpers and position traders, who seek financial gain by taking positions in volatile markets. The principal role of the speculator in the markets is to take the risks that the hedger is unwilling to accept. The opportunity for profit makes the speculator willing to take those risks. The activity of speculators is essential to the operation of a futures market in that the composite bids and offers of large numbers of individuals tend to broaden a market, thus making possible the execution with minimum price disturbance of the larger trade hedging orders. By increasing the number of bids and offers available at any given price level, the speculator usually helps to minimize price fluctuations rather than to intensify them. Without the trading activity of the speculative fraternity, the liquidity, so badly needed in futures markets, simply would not exist. Trading volume would be restricted materially since, without a host of speculative orders in the trading ring, many larger trade orders at limit prices would simply go unfilled.

due to the floor broker's inability to find an equally large but opposing hedge order at the same price to complete the match.

THE HEDGER

By and large, the hedger's principal activity in the economy consists of producing, distributing, processing, or consuming actual commodities in some form or other. His activity in the futures market is only incidental to that major role. Nevertheless, most futures markets would not have come into being had it not been for the need of hedgers for a vehicle that would enable them to minimize the risks of loss inherent in the ownership of physical commodities over any period of time. It should perhaps be pointed out here that when a hedger takes a short position in futures it does not, per se, mean that he intends later to make a delivery against the short contracts. By the same token, a hedger assuming a long futures position may not actually want the commodity which will be tendered to him if he holds the contract(s) to maturity. His futures positions are taken primarily to provide price insurance and most of them, like those of the average speculator, are later liquidated by offset trades. Most hedging orders tend to be larger in size than the average speculative order, and persons who control them generally are more sophisticated in their approach to markets than is the inexperienced speculator trying to reap a profit.

THE EXCHANGE

A commodity futures exchange is a non-profit association of members organized principally to provide facilities needed for the transaction of business involved in buying, selling, or otherwise marketing commodities under rules that protect the interests of all concerned.

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The exchange itself does not own any commodities, does no trading for the account of the exchange, and does nothing to determine prices that prevail in the market place. It merely provides the physical facilities needed to conduct an open auction market. An exchange's primary responsibility is to insure the existence of competitive markets free of attempts at price manipulation.

In collaboration with its various members, the exchange develops, publishes, and enforces rules of trading designed to insure that everyone participating in the markets is treated equally and fairly. Through committees of members organized for the purpose, a futures exchange also arbitrates disputes between members, and between members and non-members when asked. It establishes and fixes the details of all futures contracts traded on its floor including the delivery months in which trading is permitted, establishes initial margin and maintenance margin rates for each commodity, supervises the day to day activity of those members who participate in futures trading from rings or pits on the trading floor (floor brokers), helps to prevent or control any attempts at price manipulation, develops and enforces delivery procedures, including the designation of warehouses in which delivery can be made (warehouses "regular for delivery"), provides for exchange-licensed inspection of all commodities tendered for delivery against its short futures contracts, and generally governs all floor activity and provides those services which tend to further the business of futures trading. Suitable office space is provided for members of the exchange's paid staff, whose job it is to coordinate the above functions and implement policy decisions made by the Board.

Commodity futures exchange trading floors generally are organized on some variation of the diagram shown below (usually, however, there are multiple trading pits):

The central point is the trading ring or pit, usually a circular area, around which the floor brokers do their buying and selling. While all bids and offers must be made openly, i.e. by open outcry, in the larger trading pits, bids and offers are communicated to other brokers in the pit by means of standardized hand signals. All brokers operating in the pit have the same trading rights. As transactions are completed, an observing reporter, usually operating from a pulpit or stand adjacent to the trading pit, records each trade, or reports it by open phone to a board marker, who promptly marks it with chalk on a quotations board or posts them to electronic quote boards. Simultaneously with the recording of trades at the exchange, the prices at which contracts are traded are widely disseminated via a ticker system to other markets, brokerage offices, and other trading centers in the U.S. and abroad which subscribe to the service. Each floor broker, as he completes

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a transaction, records the purchase or sale he has just made on cards carried especially for this purpose. How much was bought or sold, from whom, and the price paid or received are all recorded on the card. At the end of the trading day, each broker's pit or trading cards serve the useful purpose of enabling him to check out with other brokers the transactions he has completed that day, before re-checking his trades with the commission house or other source from which he received his orders. The word re-checking is used because, as each order is completed, its execution and price are promptly reported by floor phone clerks back to the originating order department of some member firm which, in turn, relays the report to the buying or selling customer via the proper account executive. Most floor brokers are independent operators, but some of them now, in addition to being members of the exchange, may also be partners in a floor trading company or organization. Each floor broker usually has several telephone lines, each one a direct wire to one of his principal customer's offices.

The exchange trading floor may also have a series of bulletin boards on which important information relating to the commodities traded is posted. Often included thereon are the latest weather maps covering areas where important crops are grown. Obviously reports on rainfall, severe storms, and temperatures which affect a growing crop are important in determining price. Spot price quotations, shipments to and from major terminal markets, prices quoted for competitive products, government announcements, and similar items are also publicly displayed. In addition, a general or commodity news ticker is usually available on the floor so that no delays will occur in receiving information considered important in determining price trends.

THE FLOOR BROKER

Any exchange member is permitted to go into the pit or trading ring and trade if he wants to. It is the exchange member, however, who makes his daily living from commissions earned by executing buy and sell orders who is generally referred to as the floor broker.

Each floor broker who deals in commodities regulated by the C.E.A., while not being required to pass a qualifying examination such as that now required of an account executive, must nevertheless register annually with the C.E.A. Each approved applicant receives from the C.E.A. each year a license which permits him to function as a floor broker handling C.E.A.-regulated commodities. Any major infraction of C.E.A. rules while trading in or outside the pit can lead to a suspension of any registered floor broker's license. The floor broker who operates only in a trading ring where commodities not subject to C.E.A. regulation are traded, e.g. in the copper or silver rings on the floor of Commodity Exchange Inc., is not required to register annually with the C.E.A. He is, however, subject to all rules and by-laws of the exchange where he performs his daily task.

THE CARRYING MEMBER FIRM, OR COMMISSION HOUSE

While not every futures order executed on a trading floor passes through the hands of a commission house (some go direct from the customer to floor brokers who, in some cases, may also be members of

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the Clearing Association), a sizable percentage of the total futures order volume does. It is the commission house which "carries" an individual speculator or hedger's account, i.e. maintains a book record of each customer's open position, margin deposits, money balances, completed transactions, etc., and which also provides those facilities and personnel required to execute customer orders. In return for providing this service, the commission house collects a commission or fee as its compensation for the handling of each completed order.

1. *Organization.* -- In performing its role, the commission house serving commodity customers (not all of them do -- some handle securities exclusively) must provide not only the personnel and facilities required to execute customer orders, but also must organize its work and personnel under separate departments or branches within the commodities division of the firm in order to process the business efficiently. Such departments generally include, but are not restricted to, the following: (a) *Accounting Department* -- Keeps an accurate daily record of all customer money and trading transactions. This includes a daily check-out of all completed transactions with brokers on each trading floor, plus the preparation and delivery of special reports at the end of each trading day which, in effect, transfer the ownership of the side of each completed futures contract not owned by the firm's customer to the Clearing House.

The work of the Accounting Department also includes the daily preparation of confirms, usually delivered to each customer by mail, showing all details of each customer transaction, plus Purchase and Sale (P & S) reports of each round-turn transaction completed that day which show the total dollar cost, including commission charged on each pur-

chase made, the total dollar proceeds, less commission charged on the applicable sale, and the net dollar profit or loss to the customer. It also includes the work of preparing and mailing to each customer at the end of each month an accurate statement of the customer's open account. The statement must show, among other things, the record of money balances, the movement of money into and out of the account during the month, a record of each purchase and sale completed during the month by the customer, a record of each profit and/or loss sustained by the customer on each round-turn transaction completed during the month, and a statement of the customer's equity position as of the close on the statement date, with every open contract figured to the settlement price for that commodity and delivery month on the statement date. In most firms today much of the work of the Commodity Accounting Department is done via computers, thus eliminating many of the onerous detail tasks that formerly had to be performed by members of the department's staff; (b) *Margin Department* -- Daily calculates the equity available to each customer having an open position on the firm's books by figuring the unrealized gain or loss on each open contract when "marked to the market", i.e. figured to the exchange-posted settlement price for each contract on that day. By then adding the unrealized gain to or subtracting the unrealized loss from the customer's last ledger cash balance the customer's equity is determined. The customer's calculated equity is then related to required margin levels. If additional funds are needed, either original or maintenance margin, a margin call is prepared and

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sent, usually via the account executive, to the customer who must then respond *promptly and in full*. The margin department of any commodity brokerage firm is a key part of the organization. Unless its work is done promptly, accurately and well, substantial losses to the carrying firm can quickly occur; (c) *Order Department* -- Maintains equipment and personnel needed to communicate customer orders received by account executives to the floor broker on the floor, and to send execution reports back from the pit to the customer. Much of the order equipment used today is tied in with the firm's computers so that orders and messages can pass directly from an originating office to the trading floor, and vice versa. Order clerks and messengers on the trading floor assist in getting orders to, and reports from, the broker in the trading ring; (d) *Spot Commodities Department* -- Responsible for handling documents, collecting and paying out funds, etc. involved when a customer either makes or takes delivery of actual commodities on a futures contract. The passing on of delivery notices received to the customer having the oldest open long position in the commodity is part of this department's responsibility; (e) *Research Department* -- Through various reports issued by members of its staff, the Research Department attempts to keep the firm's customers informed and suggests trading ideas which it believes will produce a profit; (f) *Administrative Group* -- usually includes officers or partners of member commission firms to whom the firm's management has delegated responsibility for supervising the handling and policing of all customer commodity business. Under New York Mercantile Exchange rules, for example, each commission house has the responsibility of watching the nature and volume of trading in all commodity customer accounts.

2. *Customers.* -- Commodity customers of a commission house may include: (a) individual speculative traders, (b) trade hedging firms or companies, (c) floor brokers who do not belong to the Clearing House and who wish to avail themselves of the clearing facilities provided by the commission house, and (d) other commission brokerage firms which either are not members of the Clearing House, or of the exchange, or both. Commodity futures transactions introduced to a commission house by another brokerage firm, depending upon the existing agreement between the two firms, may be carried on the books of the clearing commission house either on "a disclosed basis" (under the actual names of the other firm's customers), or in an "omnibus account" (one bookkeeping and margin account accommodating all of the trades of all of the customers of the other firm, with the other firm keeping the detailed accounting records required for individual customers). The amount of the commission paid by the other firm's customers which is kept by the other firm, and by the commission house clearing the transactions, is prescribed by exchange rules, and largely depends on how the business is carried on the commission house books.

The commission house, under exchange rules, is required to "know" every customer who has an open account on its books, and must use due diligence in obtaining the necessary information. Failure to do so can lead to a charge by the exchange of improper supervision of the firm's customer business. Merely knowing the customer is not enough. The

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commission firm, through one of its accredited representatives (an officer, partner, or account executive) must investigate and know such things as the customer's reputation for integrity, the financial capacity and responsibility of the customer, the customer's trading objectives, whether commodity futures trading provides a suitable vehicle to meet those

objectives, etc. Failure to determine such facts before opening a new customer's account can easily lead to financial losses for the commission house which otherwise might have been avoided.

3. *Customer Funds.* -- Special rules govern the handling by a commission house of customer margin funds deposited with the firm to support the customer's trading activity in certain commodities. For example, customer margin funds received by the firm to margin open positions in commodities regulated by the C.E.A. cannot, by law, be mingled with funds belonging to the commission house itself. Such margin funds, plus all profits realized and unrealized on open positions in C.E.A.-regulated commodities, must be deposited in and kept separate from the firm's own funds in separate bank accounts. Customer margin funds, however, may be used by the commission house to the extent necessary to meet the margin requirements of the Clearing Houses which clear the firm's business in C.E.A. regulated commodities. These special rules applicable to customer funds used to support trading in C.E.A.-regulated commodities do not presently apply to the handling of customer margin funds deposited to support, and profits realized from, trading in commodities not regulated by the C.E.A.

THE ACCOUNT EXECUTIVE

Many of the futures orders which are executed on an exchange trading floor first pass through the hands of an account executive (sales person) employed by an exchange member firm, e.g. a commission house. It is the account executive who maintains daily contact with the firm's customers, who writes up and enters, via an order clerk, the customer orders received, and who then reports back to the customer the price or prices at which the customer's order was executed. The average account executive actually does much more than this in providing required service to customers, but the above outlines briefly the basic function he performs. To qualify for such an assignment, a commodity account executive today must first undergo a period of training in the offices of his employer. The examination which must be taken was formulated through the concerted action of all U.S. commodity exchanges, and generally tests the student's knowledge of commodity fundamentals, trading procedures, practices and regulations. Once a student has passed the examination, his registration as an approved account executive continues through his employment by various member firms, provided there has not been a lapse of more than two years in such employment.

THE CLEARING HOUSE OR CLEARING ASSOCIATION

(1) *Development of the Clearing House.* -- One of the key links in the chain of those who participate in organized futures trading is the Clearing House, or Clearing Association as it is sometimes called. If it

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were possible for all those who bought and sold futures contracts to keep in daily contact with each other, there probably would, in theory at least, be no real need for the Clearing House. Since this is not practical, some form of settlement of contract differences between those who trade had to be developed. This need intensified, of course, as total trading volume expanded. Initially brokerage firms assumed the job of determining the daily net longs, shorts, and open contracts and kept appropriate records on their books. Each morning a group of settlement clerks would gather on the floor of the C.B.T. to cross-check their records. If everything balanced as between open "owes and collects", trading for the day could then begin. By 1883, however, a rather unique system of accounting was developed at the Chicago Board of Trade which lasted until 1925. During this 42-year time span, actually two methods were used for closing trades, i.e. direct settlement, and ring settlement. A direct settlement could usually be made only when it was fairly easy to identify both the buyer and the seller as parties to the transaction. When that could be done, the party having a market loss on an open position would send a check to the Clearing House (then operated as a department of the Chicago Board of Trade) for the amount due. The party to whom a profit was due would subsequently receive a check from the Clearing House. Only the larger trades, however, could be matched this easily, so a system of rings evolved whereby a series of buyers and sellers were linked together so as to be able to settle their accounts on paper before the dispatch of Clearing House checks. Each settlement clerk would keep the rings of his own customers in his ring book. Each ring usually represented buyers and sellers of equivalent amounts of the same commodity, e.g. December wheat, and the sale price was recorded for each trade. Each sales price would then be adjusted to a "settlement price", fixed by the exchange, which closely approximated, for each delivery month and commodity, the last sale for the day. The settlement price at that time was determined after the close of trading each day by the Board, and then it was posted for all concerned parties to see. When each settlement clerk had completed making up his own rings, they were turned over to the Clearing House, and checks were subsequently collected or issued depending upon the open position of each commission house. Obviously the "owe" and "collect" column amounts at the Clearing House had to balance each day, since all participating firms were required to submit a record of their open ring dollar differences daily. The ring book

did not reveal the total number of contracts traded each day. Thus the system then in use served as an instrument in protecting the secrecy of both the dollar and bushel volume of trading each session. It was only when a separate Board of Trade Clearing Corporation was organized in 1925 that such information became general public knowledge.

(2) *Functions of the Clearing House.* -- While a commodity futures Clearing House to some degree performs a function in part like the clearing house operations in the nation's banking system, there are essential differences between the two. True, the individual trader, as the individual bank depositor, has no direct contact with the clearing organization. Moreover, the commodity clearing organization exists, in part, as does a bank check clearing operation, to facilitate the flow

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and transfers of funds which result from its member firms' execution of customer transactions. At that point, however, the similarities cease. Whereas the responsibility of guaranteeing customer transactions rests solely with the member bank in the bank check clearing operation, the commodity exchange Clearing House actually assumes the role of guaranteeing performance on each commodity futures contract which it clears. There is another major difference also. The commodity Clearing House, in handling the assignment and supervision of all deliveries on exchange futures contracts, fulfills a need and a function which has no counterpart in the bank clearing operation. Finally, through the Commodity Clearing House operation, the individual trader is able to eliminate his legal obligation as a party to a binding contract quickly and without the necessity of first obtaining agreement from the opposing original partner to his contract. This is accomplished by the offset principle, about which more will be said later. For the present, let us turn to the type of organization used by the commodity Clearing House, and to a brief outline of its method of procedure as an aid to our understanding of its functions and operation.

(3) *Operating Structure.* -- As indicated earlier, every commodity future exchange in the U.S. has an affiliated Clearing House (this is not true of all commodity exchanges in Great Britain). The Clearing House functions under the guidance of a Board of Directors, all of whom are also members of the related exchange. Members of the Board are usually selected so as to represent fairly the diverse interests of those who are members of the Clearing House, e.g. the clearing floor broker or trader, the commission house, a clearing member of the trade, etc. It is the duty of the Board to set policy, pass on the admission or expulsion of members, elect Clearing House officers annually, etc. Officers usually include a chairman and vice-chairman of the Board of Governors, a president, vice-presidents, secretary, treasurer, and their assistants. In the smaller clearing organizations some of these positions may be combined in one individual, e.g. secretary-treasurer. Of the officers, usually only the president, vice-presidents and/or the secretary have access to the transactions, open positions, and records of clearing members. This information is highly confidential. For this reason, access to such data is very limited.

The Clearing House obtains funds to support its operations from fees for clearing trades and for other services performed for its members, such as the handling of delivery notices, etc. Some revenue may also be derived from interest on invested capital, or from interest realized from the temporary investment of member guaranty fund deposits. Since such revenues, in the aggregate, are usually insufficient to bind performance on open contracts, the Clearing House requires all members to deposit original margin to secure these obligations.

At most U.S. commodity exchanges the related Clearing House is organized as a separate member corporation. At the two Mercantile exchanges the Clearing House operation is organized as a department within the exchange itself. While every member of the Clearing House must also be a member of its related commodity exchange, not all exchange members are, per se, members of the Clearing House. Applicants for Clearing House membership are carefully screened by each

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Clearing House Board, with financial strength and reputation for integrity prime considerations before approval is granted. Only those applicants who can meet the stringent financial and other requirements are approved. One of the requirements is that any clearing member must maintain an office in close proximity to the Clearing House to facilitate rapid exchange of checks, passing of delivery notices and documents, etc. Members of the Clearing House may include exchange members-partnerships, member-corporations, member-cooperative organizations, and even individual exchange members if they can qualify. As a protection for all clearing members it is not unusual for a Board of Direc-

tors to establish a maximum limit on the number of contracts which individual members can clear at any one time, as well as requiring higher original margin per contract on clearing member positions exceeding a stipulated size.

(4) *The Guaranty Deposit.* -- Approved members of a Clearing House must not only provide original and variation margin as needed to support their own or customer positions submitted for clearance, but they must also maintain with the Clearing House a sizable guaranty deposit. The guaranty deposit may not be withdrawn as long as the clearing member firm remains a member of the Clearing House. It can range from a few thousand dollars to as much as \$ 50,000, or more, depending upon the clearing organization involved. The guaranty deposit must be furnished in cash, and must be maintained freely available to the Clearing House at all times as a reserve fund which can be used, when and if necessary, to meet the financial obligations of any defaulting member. In the hands of the Clearing House the composite guaranty funds of members may be invested in very short-term U.S. Government obligations, the income from which accrues to the benefit of the Clearing House. Because the selection of members in the Clearing House is particularly rigid, because of the existence of the guaranty fund, because the Clearing House has funds of its own which can be used, and because the resources of all members of the Clearing House can be tapped, if necessary, to meet a crisis situation, the Clearing House is in the position of being strong enough financially to guarantee the financial integrity of each futures contract it accepts for clearance. While the Clearing House can and does guarantee the financial fulfillment of each futures contract cleared, it does not guarantee that the long who stands for delivery will actually receive the merchandise. This assurance is provided, as noted below, through the Clearing House member firm which is required to fulfill the terms of a futures contract even though its customer may default on a particular delivery.

The industry maintains that there have never been any instances when the failure of a Clearing House member resulted in the failure of a particular Clearing House to meet its financial obligations to the industry it served.

In the event a clearing member becomes unable to meet his financial obligations, and thus to fulfill his open contracts (such as happened at the time of the "salad oil scandal"), the following procedure is generally followed:

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- (a) All contracts open on the failed member's books are liquidated;
- (b) If, as a result of this liquidation, the member's account with the Clearing House is in deficit, any remaining margin the member had deposited at the Clearing House is first applied toward the deficit;
- (c) If the failed member's margin deposits on hand are not sufficient, his contribution to the Clearing House guaranty fund is utilized;
- (d) If the member's account is still in deficit, the surplus fund of the Clearing House, if any, may then be used at the discretion of the Clearing House Board of Directors;
- (e) If necessary, further recourse would then be made to the contributions made by all clearing members to the guaranty fund; and
- (f) Finally, if necessary, a special assessment can be made against all remaining members of the Clearing House. In any event, the remaining members would be asked, by special pro-rata assessment, to make up any deficiency in the guaranty fund resulting from depletion resulting from recourse to procedure (e) above.

Should an individual customer of a Commission House become unable to fulfill either his financial or delivery obligation to the Clearing House, the obligation must be assumed by the carrying Commission House member itself, using its own funds to make up any customer deficit, if necessary. That is why brokers insist that margin calls, once made, be answered promptly and in full. It is also the reason why the commodity account agreement of each Commission House gives the broker the right to liquidate any position of his customer, and without recourse, in the event margin calls are not promptly met.

(5) *Original and Variation Margin.* -- Each Clearing House, even though its members have been carefully selected, in addition to the guaranty deposit referred to above, requires each clearing member firm to deposit original margin funds with the Clearing House to support each open customer contract submitted for clearance. The amount of margin so required per contract is determined by the Clearing House Board and applies only to clearing members, not to their customers. The Clearing Houses of two exchanges, the Chicago Mercantile Exchange and the New York Mercantile Exchange, require full original margin from clearing members for each contract short and for each contract long. Most other Clearing Houses currently permit a clearing member firm to net customer open long and short positions when

calculating the amount of original margin due, and to deposit with the Clearing House only that margin needed to support the net position. If a clearing member's customers are long 500 contracts of May wheat while other customers of the same firm are short 400 contracts of May wheat at the same time, the exposure of the clearing member in the market place is limited to the risk associated with a net long position of only 100 contracts. This is why most Clearing Houses permit member firms to margin only their net position

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in each contract rather than the gross positions of customers both long and short.

Settlement of customer gains and losses between carrying clearing member firms is also effected through the Clearing House. At the end of each trading day the Committee on Quotations of each exchange compiles a list of "settlement prices" for that day's trading. Such prices for each delivery month usually fall within the range of prices traded on the close, although the settlement price for a particular delivery month that does not trade on the close may be nominal price fixed by the Committee. A "nominal" price is one selected, though not actually a traded price, after giving full consideration to its proper price relationship to the settlement prices for other delivery months of the same commodity which did trade on the close. It will usually represent an average between the closing bid and offer of an inactive trading month. Based on settlement prices, all clearing member firms then daily either pay to or receive from the Clearing House that amount of variation margin which their open customer positions call for when measured against the settlement price. In this way, each commission house receives cash from the Clearing House which enables it to pay out profits earned in trading by its customers. The commission house likewise must pay to the Clearing House from its own or customer funds on deposit any losses sustained that day by its customers.

Any variation margin needed, based on settlement prices for any day's trading, must be supplied by the clearing member firm to the Clearing House in the form of a certified check hand-delivered before the opening of trading the following day. Margin checks involving relatively small amounts need not be certified. If a particular market is volatile, and if the positions of certain member firms are large, the Clearing House may elect to call such firms for additional variation margin during trading hours. When and if this happens, the member clearing firm must deposit the variation margin requested within one hour. On the other hand, if the open positions of a member firm's customers, when figured to the day's settlement price, result in an equity for the member firm at the Clearing House in excess of prevailing Clearing House original margin requirements for such a position, the excess equity is either automatically paid by the Clearing House to the clearing member firm the next day or may be withdrawn by the clearing member at his request on the day following calculation of the excess.

Each Clearing House that clears commodities regulated by the C.E.A., like the commission house carrying such customer business, must maintain special bank accounts separate and apart from those in which funds owned by or received by the Clearing House to margin non-regulated commodities are deposited, to accommodate all margin deposits received in support of open positions in C.E.A.-regulated commodities.

(6) *The Clearance Procedure.* -- The work of the Clearing House actually begins after the close of trading each day. Each clearing member firm is required, following the end of trading, to report to the Clearing House a complete list of *all* buy and sell transactions,

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including the price, completed for its customers that day. *Every* contract traded must be cleared.

In the modern Clearing House the reporting of buy and sell transactions is accomplished by furnishing to the Clearing House electronic data cards on which the details of each completed contract are punched. Since all clearing members who did any trading that day must prepare and deliver such cards, the Clearing House obviously must wind up with a matching buy and sell card for each completed transaction. In the event that a misunderstanding between brokers has occurred, and a card for only one side of a trade is received by the Clearing House, if the dispute cannot immediately be resolved that transaction is rejected for clearance that day and the two brokers involved in the dispute are required to settle their differences before or on the opening of trading the next morning. Such a contract is then cleared a day late, "as of" the preceding day.

At some clearing associations, however, it is still required that clearing members supply the necessary details of completed buy and sell orders manually on a special tally sheet. When the accuracy of all reported transactions has

been verified, the Clearing House then assumes the legal and financial obligations of the "other party" to all trades. Stated another way, *the Clearing House becomes the buyer from everyone who has sold a contract, and becomes the seller to everyone who has bought a contract.* Once a trade is accepted by the Clearing House for clearance, all buyers and sellers who have open futures positions on the books of a carrying member firm thereafter must deal, via the carrying clearing house member, with the Clearing House on any particular contract, and not with each other. In other words, the Clearing House has substituted itself as the "other party" on all trades. This procedure enables the individual trader to liquidate his particular contract(s) when it suits his convenience provided, of course, he does so within the time during which open trading in the contract is still permitted. He does not have to wait until the other party to his original contract also decides to liquidate. The individual trader thus relies on the Clearing House operation to get him out of his market obligations when he has completed opposing trades in identical futures contracts. In effect, the trader has bought from the Clearing House a contract which he later sells back to the Clearing House. On the Clearing House books the two trades offset each other, and no open contract then remains. Using the principle of offset, futures traders are able to move freely into and out of the market, and without any residual obligation to the "other party" involved in either the original purchase or subsequent sale. The difference between the trader's purchase price and selling price represents his profit or loss, not, of course, including the commission charge which he must pay his broker to trade.

(7) *Handling Deliveries.* -- Approximately 3% of all futures contracts traded are normally settled by an actual delivery. While the Clearing House handles no physical commodities tendered for or received as a delivery on a futures contract, it does perform the function of distributing any notices of delivery that are issued. Its substitution method of operation, permits deliveries to be made directly by a

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short wishing to make delivery to an eligible long, even though the two parties have never traded with each other on the trading floor.

The Clearing House, by assuming the role of seller to all buyers and buyers to all sellers -- through substitution -- facilitates the making of deliveries direct from Deliverer (D) to a Receiver (R). On some exchanges, such as the Chicago Board of Trade, Receiver (R) must be the long with the oldest open position, while on other exchanges he may be selected at random by the Commission House carrying his account from among all customers who have open long positions when the delivery notice is received. The interim transactions which took place prior to delivery involving traders V, W, X, Y, and Z have no involvement in the final settlement between D and R. Through offset transactions prior to maturity, the interim buyers and sellers evened up their positions and eliminated any further obligation to perform. Thus a seller D, who has merchandise he wishes to deliver, winds up making delivery to a Receiver R who is anxious, or at least willing, to receive it.

A seller with open short contracts during a delivery month must either deliver the commodities called for by his position, or buy back in the trading ring the contracts he has sold. Delivery can be made only from a location or warehouse approved by the exchange. The option of selecting the day during a delivery month when delivery is to be made obviously must rest with the seller. He is the only one of the two parties to a contract in a position to know when the commodities to be delivered are in position for delivery and have been properly inspected. The buyer, on the other hand, only knows that if he remains long he will receive an actual delivery on some permitted day during the delivery month. He may not demand delivery on a day of his choosing, or at a delivery point of his selection. Once the seller is ready to make delivery, he asks his carrying member broker to prepare (for most commodities) and hand-deliver to the Clearing House within the time span permitted, a notice of intention to deliver. For this service the carrying broker must charge a fee. No advance notice of intention to deliver lumber is required. On the Chicago Board of Trade a delivery notice is issued the business day prior to making an actual delivery. On other exchanges, the notice of intention to deliver must be issued from one up to seven days, and in the case of sugar even longer than that, prior to the intended delivery date. The notice of intention to deliver contains all of the essential facts regarding the delivery -- the grade of the commodity, the weight to be delivered, the place where delivery will be

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made, the date of intended delivery, and the delivery price, (the settlement price of the previous day's trading session).

When a delivery notice is received by the Clearing House, the question of who shall get it must be resolved. Three general methods of selection of eligible receivers are used in practice. At the Board of Trade Clearing Corporation, the

corporation is required by rule to pass any notice received along to the clearing member which, at that time, has the oldest long customer position open on the Clearing House books. The clearing member, in turn, will pass such a notice on to that customer on its books having the oldest open long position. At certain other exchange clearing associations, the assignment of delivery notices received to eligible clearing member firms may be made on a net basis, i.e. allocation of notices is made to member firms in proportion to the size of their net long position then open on the Clearing House books. Still other exchanges permit allocation of notices to clearing members on the basis of the size of their gross open long position. Those carrying firms with the largest net or gross long position get the largest number of delivery notices, etc. Under either of these systems the clearing member receiving a delivery notice may, but he is not obligated to, pass the notice to any other long customer he wishes. If the time available for passing the notice to another clearing member is about to expire, the customer selected to receive the particular notice may be, for practical reasons, the one who can be notified of the delivery most quickly.

On some exchanges, a delivery notice, when received, must be "stopped", i.e. it cannot be passed on. On still other exchanges, and notably the Chicago Board of Trade, when a customer is notified that he has received a delivery, he can eliminate his obligation to accept it by the simple expedient, if trading for the day is still continuing, of selling an equivalent number of new futures contracts short and then passing along, via the Clearing House, the notice thus received as a delivery to another long against his new short position.

Any purchaser of a futures contract, if he has not liquidated his long position before trading in the contract expires, must accept delivery and make payment in full for the commodities delivered. He is at all times, while his position remains open, contingently liable for the full value of the contract. When a customer, wishing to receive delivery, has received a notice that he is willing to accept, he notifies his carrying clearing member firm that he is "stopping" the notice, i.e. that he will take the delivery. The carrying member, in turn, notifies the Clearing House of this fact. At that point the Clearing House undertakes to bring the deliverer, on the one hand, and the receiver, on the other, together. This is done either by exchanging the names of the deliverer and receiver with the two clearing firms involved, who then get the two parties to complete delivery arrangements and settlement directly, or by handling the actual exchange of delivery documents via the Clearing House. If the latter method is followed, the clearing member whose customer is making delivery must deliver the required documents, together with a bill for the amount due, to the Clearing House. The Clearing House, in turn, will release the documents to the receiver's

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carrying member firm upon receiving payment for the commodities thus delivered in the form of a certified check. All of this procedure must be completed within a limited time span specified in the delivery rules of each exchange. Finally, the Clearing House will turn over the certified check it has received to the delivery customer's clearing member firm which, in turn, passes the check along to its customer.

(8) *If a Speculator Receives a Delivery* -- If a speculative trader who is long nearby futures during the delivery month receives a delivery notice, he is immediately confronted with two alternative choices. He may elect either to "stop" the notice, i.e. accept delivery, or he may elect to get rid of it. If the trader decides to accept the delivery tendered, he must then pay his carrying broker the full value of the contract (not just the trading margin of about 10%), or arrange with his broker for financing that part of the total value which the trader himself, for one reason or another, is not then prepared to pay. Once the merchandise is paid for it becomes the property of the trader, but that is not the end of his problems.

Not all commodity futures contracts require delivery of the product in a storage warehouse. A potato delivery, for example, may be made in a loaded freight car on track awaiting the buyer's prompt shipping instructions.

Moreover, if the delivery is received in warm weather, arrangements must immediately be made to see that the car is kept cool, or the potatoes will spoil. Re-icing is frequently necessary. If a re-sale or movement of the cash potatoes is not arranged promptly, a re-inspection may be required before a subsequent cash market sale, or re-tender on another short futures position can be made. This is not only costly, but the trader also runs the risk that, upon reinspection, the particular carload of potatoes will fail to grade due to partial sprouting, rotting, or other deterioration. If that happens, then the trader has little choice but to offer the car of potatoes for sale in the cash market for whatever it will bring. As distressed merchandise, it will most likely find a buyer only at a sharply discounted price.

The last trading day of a futures contract month is the last day on which open positions can be settled by offset. Any positions remaining open beyond that date must be settled by actual delivery. The last notice day, or tender day as

it is sometimes called, is the last day on which notices of intention to make delivery may be issued. On some exchanges the last tender day and the last trading day are the same day, so that at the end of trading that day all shorts have either covered their positions with an offsetting purchase or they have issued a delivery notice. By the same token, all of the open longs on that day have either liquidated their long position by making an offsetting sale or have remained long so as to be in position to receive a delivery. All that remains then is for the actual exchange of delivery documents and certified checks to take place in the manner provided for by exchange

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rules, thus completing the required deliveries. On some exchanges, the last trading day occurs before actual deliveries against short positions can begin. Therefore, anyone who has not liquidated his futures position before the cessation of trading in the spot month has no choice but to make or take delivery as his position requires.

SIZE OF THE COMMODITY FUTURES BUSINESS

During 1973, the number of futures transactions on U.S. commodity exchanges totalled 51,653,494 (both sides).

The "dollar value" of the commodities is based on figures supplied by each commodity exchange on which those commodities were traded. It should be kept in mind that the "dollar value" is a somewhat theoretical amount, because it is the value if deliveries were made on all contracts traded, although, actual delivery is made on only a small percentage (possibly about 3%).

Estimated "value" of commodities traded

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COMMODITY FUTURES CONTRACTS TRADED, 1969-73 -- INCLUSIVE

See footnote at end of table.

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COMMODITY FUTURES CONTRACTS TRADED, 1969-73 -- INCLUSIVE -- Continued

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VOLUME OF FUTURES TRADING

31 Fiscal Years 1942-1943 through 1971-1972

FISCAL YEARS TOTALS

NUMBER OF TRADES (buys plus sells)

(i.e. Number of full contracts traded times two)

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APPENDIX IIⁿ¹

ⁿ¹ *Note:* The inclusion of this appendix is for the convenience of Members, their staff, and interested public. It is not, under any circumstances to be deemed a set of legal standards, nor a guide to interpretation to the present Act, H.R. 13113, or statements in the Committee report relative thereto.

CONSOLIDATED SCHEDULE OF PROPOSED INITIAL PERSONNEL FOR COMMODITY FUTURES TRADING COMMISSION

(INCLUDING COMPARISON WITH SEC)

TABLE SHOWING REQUIRED FORMAL HEARINGS BEFORE THE COMMISSION

(UNDER H.R. 13113 AND THE PRESENT CEA ACT)

See footnotes at end of table.

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TABLE SHOWING REQUIRED FORMAL HEARINGS BEFORE THE COMMISSION
(UNDER H.R. 13113 AND THE PRESENT CEA ACT) -- Continued

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CRIMINAL SANCTIONS
(UNDER EXISTING CEA ACT)

Felonies under Section 9(a) and 9(b)

1. FCMs to embezzle, steal, purloin, or with criminal intent convert customer's money, securities or property to own use.

2. Any person to manipulate or attempt to manipulate market price of commodity, corner or attempt to corner commodity, or knowingly deliver false crop or market information reports.

Misdemeanors under Section 9(c)

1. Any person to deal in commodity futures unless on contract market (See Sec. 4 (7 U.S.C. 6)).

2. Any person to engage in excessive speculation (See Sec. 4a (7 U.S.C. 6)).

3. Any person to cheat or defraud or mislead; bucket orders (See Sec. 4b (7 U.S.C. 6b)).

4. Any person to engage in wash sales, cross trades, fictitious sales; privileges; offers; puts; calls; guaranties (See Sec. 4c (7 U.S.C. 6c)).

5. Any person to engage as FCM unless so registered and segregate customers funds (See Sec. 4d (7 U.S.C. 6d)).

6. Any person to engage as FB unless so registered (See Sec. 4e (7 U.S.C. 6e)).

7. Any person to deal other than through contract market member (See Sec. 4h (7 U.S.C. 6h)).

8. Any person to fail to file reports on trading limits (See Sec. 4i (7 U.S.C. 6i)).

9. Any person to trade in spite of denial of trading ban (See Sec. 8b (7 U.S.C. 12b)).

10. Any person to fail to evidence any contract by a written record.

(UNDER H.R. 13113)

Misdemeanors

1. Failure to register account executives or supervisors (associated persons), commodity trading advisors or commodity pool operators (4k and 4m).

2. Fraud or deceit actions by commodity pool operators and commodity trading advisors (4o).

Felonies

1. Trading in futures or actual commodities by Commissioners, employees or agents of the Commission. (9 (d)).

2. Imparting inside information by Commissioners, employees or agents of the Commission for the purpose of assisting others to engage in futures or actual commodity transactions. (9(e)).

MAJOR NEW DUTIES OF THE COMMODITY FUTURES TRADING

COMMISSION UNDER H.R. 13113

TITLE I

1. Administer a customer reparation program.
2. Consider the public interest under the antitrust laws before issuing any order, rule or regulation and before requiring or approving any rule of a contract market or registered futures association.

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TITLE II

1. Designate contract markets for the currently unregulated commodities and conduct surveillance of trading on such markets.
2. Register futures commission merchants and floor brokers who deal in currently unregulated markets.
3. Register commodity trading advisors and commodity pool operators, establish standards and supervise their operations.
4. Determine the conditions under which floor brokers and futures commission merchants may trade for their own accounts.
5. Register all persons handling customer's accounts.
6. Set standards for training, experience and fitness of futures commission merchants, floor brokers and persons handling customers' accounts.
7. Review material submitted by contract markets to show that futures contracts serve an economic purpose.
8. Review the need for multiple delivery points and proposals of exchanges for the establishment of delivery points.
9. Review customer claim procedures required of contract markets.
10. Review and approve contract market rules relating to the terms and conditions of futures contracts or other trading requirements.
11. Seek injunctions to stop violations of the Act and to stop any trader from controlling futures contracts to the extent that he is effectively restraining trading.
12. Impose monetary penalties for violations of the Act.
13. Require contract markets to effectuate changes in rules and practices.
14. Promulgate special rules for persons who are not members of a contract market.
15. Direct contract markets to take action in emergency situations.

TITLE III

1. Register voluntary futures associations.
2. Review the rules and actions of registered associations, including the settlement of customers' claims.

TITLE IV

1. Regulate options trading in "unenumerated" commodities.
2. Establish speculative limits in currently unregulated commodities and make exceptions for arbitrage transactions.
3. Define hedging.

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APPENDIX III

GLOSSARYn1

n1 *Note:* The inclusion of this glossary is intended for the convenience of Members, their staff, and interested public. It is not, under any circumstances to be deemed a set of legal definitions, nor a guide to interpretation to the present Act, H.R. 13113, or statements in the Committee report relative thereto.

BASIS -- The difference between the price of the cash commodity and the price of a designated futures contract for that commodity. Some cash commodities are priced and traded in relation to futures prices.

BROKER -- One who executes the buy and sell orders of a customer for a commission.

BUCKETING -- Directly or indirectly taking the opposite side of a customer's order into the handling brokers own account or into an account in which he has an interest, without bona fide speculation on an Exchange.

CASH COMMODITY -- The physical or actual commodity as distinguished from the "futures."

CONTRACT MARKET -- Exchange or Board of Trade where futures contracts are traded and so designated by the Secretary of Agriculture under authority of the C. E. Act, Sec. 5.

CLEARING HOUSE -- The separate agency associated with a futures exchange through which futures contracts are offset or fulfilled and through which financial settlement is made (also **CLEARING ASSOCIATION**).

CLEARING MEMBER -- A member of the Clearing House or Association. Each clearing member must also be a member of the Exchange. Each member of the exchange, however, need not be a member of the clearing association. If he is not, all of his trades must be registered and eventually settled through a clearing member.

CLEARING PRICE -- see **SETTLEMENT PRICE**.

COMMERCIAL -- A company that merchandises or processes cash grain and other commodities.

COMMISSION HOUSE -- A firm that specializes in executing buying or selling orders for customers in spot or cash and/or futures markets for a commission or does not itself deal in futures or actuals.

CONTRACT GRADES -- The grades of a commodity listed in the Rules of an Exchange as those that can be used to deliver against a futures contract.

DAY ORDER -- Orders that are placed for execution, if possible, during only one trading session. If the order cannot be executed that day, it is automatically cancelled.

DELIVERY -- The tender and receipt of the actual (cash) commodity, or of warehouse receipts covering such commodity, in settlement of a futures contract.

DELIVERY MONTH -- The specified month within which a futures contract matures and can be settled by delivery.

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DIFFERENTIALS -- The price differences between grades of a commodity.

DISCRETIONARY ACCOUNT -- An account for which buying and selling orders can be placed by a broker or other person, without the prior consent of the account owner for each such individual order; a blanket agreement having been initially granted by the account owner for such action, and requires an initial customer deposit of a minimum of \$ 5,000 under present CBOT and C.M.E. Rules.

DOUBLE HEDGING -- As used by the CEA it implies a situation where a trader holds a long position in the futures market in excess of the speculative limit as an offset to a fixed price sale even though he has an ample supply of the commodity on hand to fill all sales commitments.

FLOOR BROKER -- One who is registered with the CEA as a Floor Broker who may or may not be a member of a futures commission merchant (a firm trading on the Exchange), and who executes orders for others, himself, or the futures commission merchant's house account.

FLOOR TRADER -- One who is employed by a futures commission merchant and who is not registered with the CE Auth. as Floor Broker, and who may execute only orders for the futures commission merchant's house account or for himself.

FUTURES CONTRACT -- Contracts for the purchase and sale of commodities for delivery some time in the future on an organized exchange and subject to all terms and conditions included in the Rules of that Exchange.

FUTURES COMMISSION MERCHANT -- Individuals, associations, partnerships, corporations and trusts engaging in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on and subject to the Rules of any contract market.

HEDGE -- Hedging is the sale of futures against the purchase of the cash commodity or its equivalent as protection against a price decline; or the purchase of futures against forward sales or anticipated requirements of the physical commodity as protection against a price advance.

LIFE OF CONTRACT -- The duration of the period in which trading can take place. In some cases this phrase is used to denote only the period already passed in which trading has already occurred. Example: "The life-of-contract high so far is 2.50."

LONG -- The buying side of an open futures contract. A long position is subject to receipt of the cash commodity if it is not offset with a sale of a futures contract.

INITIAL MARGIN -- Customers' funds put up as security for a guarantee of contract fulfillment, and as defined by the Rules of the Exchange.

MARGIN MAINTENANCE -- Additional funds required to be deposited by customers as the price of the commodity bought or sold fluctuates, and as defined by the Rules of the Exchange.

MARKET ORDER -- An order to buy or sell a futures contract at whatever price it is obtainable at the time it is entered in the ring.

MATURITY -- The time at which the futures contract can be settled

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by delivery of the actual commodity; the period between first day and last trading day.

MEMBERS' RATE -- The commission charge for the executing of an order for a person who is a member of and thereby has a seat on the exchange. It is less than the commission charged to a customer who does not have a seat on the exchange. A member who also belongs to the Clearing Association pays no commission for his trades. He just pays clearance and other fees.

NON-MEMBER TRADERS -- Speculators and hedgers who trade on the Exchange through a member.

OFFSET -- Usually, the liquidation of a long or short futures position by an equal and opposite futures transaction. Open positions can be offset at any time during the life of a futures contract.

OMNIBUS ACCOUNT -- An account which a member of one exchange has with, usually, a clearing member or another exchange and for which the first member is not required to disclose the names or other information concerning the one account, which actually represents the accounts of a number of customers of the first member.

OPEN CONTRACTS, OPEN INTEREST -- The obligation entered into by a party to a futures contract either to buy or to sell the commodity specified. The obligation is "open" until it is settled by an offsetting transaction or by delivery.

OPEN INTEREST -- The number of contracts which remain to be settled. It is equal to either the number of long positions in a market or the number of short positions. Since it takes both a long and a short to make one contract, the number of longs and shorts in a market are always equal.

OPTION -- Commonly but incorrectly used to indicate a specific futures delivery month.

PIT -- The place on an Exchange trading floor designated for the execution of orders.

POSITION -- To be either long or short in the market.

POSITION LIMIT -- The maximum number of futures contracts one can hold under the Rules of the CEA.

ROUND LOT -- A full contract as opposed to the smaller job lot.

ROUND TURN -- The completion of both a purchase and an offsetting sale, or a sale and an offsetting purchase.

SCALPING -- Trading for small gains, many times for less than a full cent profit. It usually involves establishing and liquidating a position quickly, possibly within the same day.

SETTLEMENT PRICE -- The daily price established by the clearing house, usually the closing price, which is used to adjust variation margin payments between clearing house and its members.

SHORT -- The selling side of an open futures contract. A short position is subject to making delivery of the cash commodity if it is not offset with the purchase of a futures contract.

SOLICITOR -- Customers' man assigned by a warehouse to obtain orders and give advice to clients.

SPECULATOR -- A person entering into futures contracts for any purpose other than hedging.

SPOT PRICE -- The price at which the physical commodity is selling.

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SPREAD -- (1) The purchase of one futures contract against the sale of another contract in a different future, a different commodity, or a different market. (2) The price difference between two futures in the same or different markets.

STRADDLE -- The usually simultaneous purchase of one. futures month and the sale of another either in the same or different commodity, or Exchange.

TELEPHONE MAN -- Man assigned to a telephone post on the floor of the Exchange, whose duty it is to represent the company by receiving and transmitting orders to the floor brokers or traders.

TRADING LIMIT -- The maximum price movement up or down permitted in one trading session under the Rules of an Exchange.

VOLUME OF TRADE -- The number of transactions occurring during a specified period of time. It may be quoted as the number of contracts traded or in the total of physical units, such as bales or bushels, pounds or dozens.

WASH TRADING -- Entering into, or purporting to enter into, transactions for the purpose of giving the appearance that purchases and sales are being or have been made without actually taking a position in the market.

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MINORITY VIEWS

We oppose H.R. 13113 because it represents a total lack of faith in our market-oriented free enterprise system involving a \$ 380 to \$ 400 billion commodity market, the primary purpose of which is to provide stability to producers and an adequate supply for consumers.

It also represents a lack of evidence . . . a lack of evidence that the new and far-ranging authorities proposed by the bill are either necessary or desirable.

It also calls for the creation of a new and greatly expanded bureaucracy to perform the duties that the present agency could more effectively and efficiently do if given ample authority and staff. Certainly a new Commission with a staff of another 1,000 people isn't needed.

As now written, H.R. 13113 could destroy the futures industry in this country. The bill gives sweeping government control over nearly every aspect of futures trading. If this legislation is passed, bureaucrats in Washington will run the market that heretofore has been an accurate reflector of economic conditions.

Section 215 of this bill is particularly dangerous for it gives the newly created 5-member Commodity Futures Commission the power to decide when it should take control of the futures industry. The new Commission could take over the market if it decides trading is fluctuating too greatly. Under this section the newly created Commission could also take over the market during times of wide market fluctuations. We would point out that price fluctuations have existed for years and are likely to continue indefinitely. These fluctuations will continue to be a fact of everyday life in the United States for some time to come. The moment the new 5-member Commission is voted into existence, it will have immediate jurisdiction for assuming direction of the commodity futures industry.

Widescale injunctive powers are also vested in the Commission under Section 211. It can halt the transactions of any market or person who "has engaged, is engaging, or is about to engage" in any act constituting a violation of the law. This power of preventive injunction raises serious constitutional questions. It is a particularly ominous threat against the right to conduct business.

Injunctions could also be issued when an individual or market is thought to be in a position to "effectuate a squeeze or corner or otherwise restrain trading." Here there need be no suspicion of intended wrongdoing. Adequate protection already exists in the CEA and the exchange rules now. The mere possession of the power to do wrong potentially will suffice to justify an injunction. This power to enjoin even in the absence of suspicion of dishonest intention is most questionable. The power is compounded by the failure of the legislation to stipulate what is meant by the phrase "squeeze, corner, or otherwise restrain trading."

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All contract markets will need Commission "licensure." To obtain it, each must prove it served an "economic purpose," otherwise the "license" can be denied.

Under Section 207, market transactions are said to have "economic purpose" when they serve the function of hedging producers, merchants, or consumers against loss through price fluctuations or serve as a reliable basis for determining prices. These are broad, subjective standards, and it will be the new Commission which decides them, not the customers whom the markets serve.

Under Section 203, the Commission will be able to put limitations on brokers and floor traders buying for their own accounts as well as for their customers. This provision is not necessary to keep brokers honest -- market considerations are much more forceful -- and its only effect will be to hurt the liquidity of the futures market.

We believe that the bill's premise displays both a lack of faith in as well as a lack of understanding of the mechanism of futures trading, and particularly the importance of speculators to the smooth functioning of the market. Speculation is the heart of the market and provides from 60 percent to 80 percent of the liquidity for futures transactions. Speculators help producers who want the highest price for their products and the consumers who want the lowest price for these same products. The speculator provides liquidity to the market place, and he levels the many peaks and valleys that would otherwise occur in the price structure in the absence of the speculator.

The new Commission will also have the power under Section 208 to finally determine the location and number of delivery points of commodities. While we feel additional delivery points are desirable, the users of the market and the exchange themselves should be the ones to determine where delivery points should be located, not the new Commission whose decision is more likely to be based on political pressures rather than economic factors. This provision alone could destroy futures trading.

Over a period of many years, futures markets have developed under a system where buyer and seller were free to carry out mutually beneficial and voluntary transactions. This free enterprise system has served superbly the farmer, the merchandiser, and the consumer.

It is especially discerning to note that those who have pushed this legislation admit that they have no real evidence of serious wrong-doing taking place on futures markets. Some have called for stricter controls on futures trading based on the premise that food price increases *may* have been caused at least in part by manipulation and speculation, but this view was totally unsupported by the testimony presented at Committee hearings.

Thus, if this bill is passed, we will have yet another unfortunate example of Congress throwing reason out the window and the takeover of yet another great example of our free enterprise system functioning without government control and interference. Liberty and economic opportunity will again be trampled under foot by big government if this bill is passed and enacted into law.

ROBERT D. PRICE,
LAMAR BAKER,
STEVE D. SYMMS,
ED. YOUNG.

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ADDITIONAL MINORITY VIEWS

I cannot support a bill that will in time add a thousand or more Federal employees to a bureaucracy already bloated beyond decent dimensions.

H.R. 13113 purports to establish a separate regulatory Commission within the U.S. Department of Agriculture. This in itself is a contradiction. How can a separate or even a half-way independent agency function within a large established agency of government?

The only thing I can see is the growth of a tremendous bureaucracy as this Commission duplicates nearly all the support services now provided to the Commodity Exchange Authority by the Department of Agriculture.

Take this example:

At present, the Office of General Counsel of the U.S. Department of Agriculture provides all the legal services of the Commodity Exchange Authority. But under this bill, the new Commission would have its own new lawyers. But do you think for one minute that the Department will reduce its legal staff?

Of course the Commission would also have its own accountants, its own investigators, its own hearing examiners, its own secretaries, and presumably its own janitors as well.

At present the CEA functions with less than 200 people, but with its new and lofty status that number can be expected to double immediately.

That, of course, is *before* the four new Commissioners (each at Grade Level IV or \$ 38,000 per annum salary rate) show up with their personal secretaries and staff. So add another couple hundred people.

Then, of course, the new Commission is going into a whole new area of regulating *non-agricultural* commodities. In order to have some expertise in these matters, another batch of lawyers, accountants, regulators, secretaries, and janitors will be needed. So add a couple hundred more folks . . . and at rates in excess of "super-grade" government salary rates.

Last but not least, someone is sure to notice that the Securities and Exchange Commission, with a staff of 1,600 people, is regulating an industry with an annual dollar volume of \$ 200 billion. Thus, it will be reasoned by the empire builders of tomorrow that the new Commodity Futures Trading Commission, which will oversee a \$ 400 billion annual trading volume, must have *at least* as many (probably twice as many) folks to carry out its new role in the national economy.

Seriously, the discussion in the Committee revealed the distinct possibility and probability that the staff of this new Commission would someday be numbered in excess of a thousand people.

I for one don't believe we need another new Commission to carry out the responsibilities that an existing agency could more efficiently and more effectively assume without placing another bureaucratic burden on the backs of America's beleaguered taxpayers.

GEORGE A. GOODLING,
LAMAR BAKER.

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