FUTURES TRADING ACT OF 1982

REPORT

OF THE

COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY
UNITED STATES SENATE

TO ACCOMPANY

S. 2109

May 6 (legislative day, April 13), 1982.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1982
REMEDIES

(a) Arbitration.—The bill eliminates the current $15,000 ceiling on claims for which arbitration must be provided through contract markets and registered futures associations; retains the existing right of customers to elect arbitration; eliminates the provision providing for no compulsory payment except as agreed to between the parties; and broadens the term “customer” to include futures commission merchants or floor brokers who are not members of the contract market or registered futures association which conducts the arbitration proceeding. (Secs. 18 (2) and 30 (2).)

(b) Reparations.—The bill limits reparations claims to cases where the respondent is registered with the Commission; eliminates procedures required by statute, including the requirement that claims over $5,000 be heard by an Administrative Law Judge; authorizes the Commission to issue rules governing the administration of the reparations program; and extends the automatic bar to trading, which is put in effect when a final reparations award is not paid, to any party who does not pay such an award. This bar to trading previously applied only to registrants. (Sec. 28.)

Judicial review of emergency action.—The bill authorizes judicial review of Commission emergency action only in United States courts of appeal. Such review would be based only upon the information available to the Commission at the time the emergency determination is made, and the reviewing court could not enter a stay of the action or an order of mandamus unless, after notice and hearing before a panel of the Court, it determines that the agency action was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. (Sec. 24.)

User fee study and report.—The bill provides for a study by the Commission of the effect of imposing a transaction fee to offset the cost of regulating transactions under the jurisdiction of the Commission. The study would include consideration of the effect of such a fee on market liquidity, determination of the portions of the Commission budget expended for public and for private benefit, and consideration of the incidence of the fee, including the impact on producers, processors, manufacturers, and other hedgers. A report detailing the findings of the study is to be submitted to the House Agriculture Committee and the Senate Agriculture, Nutrition, and Forestry Committee by January 1, 1984. (Sec. 31.)

CONFLICTS OF INTEREST

(a) “Revolving door” provision.—The bill repeals section 2(a)(7) (B) of the Act which generally prohibits any former Commissioner or employee classified as GS-16 or higher in a position excepted from the competitive service by reason of being of a confidential or policymaking character from making any appearance before or communicated to the Commission for a period of 1 year after that individual leaves the Commission. [Subsequently enacted government-wide ethics legislation, the Ethics in Government Act of 1978 (18 U.S.C. § 207 (e)), makes comparable restrictions applicable to former Commissioners and most Senior Executive Service employees.] (Sec. 4.)

Insider trading.—The bill extends to leverage transactions the provisions in section 9(d) of the Act that prohibit Commission members and employees from engaging in commodity futures or options transactions or investment transactions in actual commodities. The bill also extends to leverage transactions the provisions in section 9(e) that prohibit Commission members and employees from inspecting nonpublic information to assist another in transactions in commodity futures, options, and physical commodities. The bill adds to those existing exempted transactions in section 9(d) transactions undertaken by independent Trustees of trust established by Commission members or employees for purposes of engaging in hedging transactions in connection with allowable farming or ranching operations and transactions involving the leasing of oil, gas, or mineral rights owned by a Commissioner or employee. The bill also permits Commission members and employees to invest in Government securities and other financial instruments if the instrument is not regulated by the Commission and no nonpublic information is used in making the investment decision. (Secs. 26 (2) and (3).)

BACKGROUND

Futures trading is a basic adjunct of the production and marketing of agricultural and other commodities, and a speculative activity engaged in by a growing number of Americans. The economic purpose of such trading and its effect upon the cash pricing system of the commodities that are traded as futures are often misunderstood by those both within and without industry. Often equally misunderstood is the role of governmental regulation of the industry.

The commodity 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 European Continent. At these fairs, trading took place at preannounced markets at fixed times and places. Early trading fairs contemplated 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 wool, 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 the 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 the financing needs 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 panics of 18th Century America.

II.

The system of agricultural futures trading developed in the United States in the 1850-1900 period in response to the rapidly increasing economic need for centralized pricing and large-scale risk bearing in agricultural marketing.

It came about first at Chicago in the mainstream of surplus grain marketing, and then at New York in the distribution and export of cotton. From the 1870's onward, the futures markets at these and other centers, by attracting many traders and increasing competition, began to provide the "common language of price" and the standard commercial practices needed for the greatly increased commerce in grains and cotton.

The large trade in futures provided a competitive system of almost continuous information for price basking and guidance in marketing and distribution. Beginning in the early period, prices from futures trading did more than disseminate a central-market price for immediate needs, such as a large cash market can provide. Futures trading projects demand and price into the future, and provides a means of appraising supply-and-demand conditions, and dealing with price risks, over time and distance. Trading in futures provides not only the market of today, but of months ahead, and affords guidance to buyers and sellers of commodities in planning ahead, and in financing and marketing commodities from one season to another.

The emerging futures trading system of the 1870's and 1880's also began to provide protection for the increased capital needed for large scale marketing of grains and cotton. More precisely, by adapting to large-scale marketing needs the principle of the hedging transaction—sales or purchases in futures against inventories or commitments in the cash commodity—price risks were so reduced or offset as to enable many merchants with limited capital to handle larger commodity requirements. Equally important, the competitive effect of many speculative buyers and sellers in the market, and the effect of hedging in maintaining effective competition among commodity handlers, began to reduce gradually the merchandising price margins involved in moving large quantities of grains and cotton.

Little, if any, of this was apparent to farmers in the early period when the frequent picture of commodity exchanges was one of unbridled speculation, recurrent market manipulations, and spectacular price fluctuations. Indeed, it was a serious question with many whether the economic services of the system in the 1870's and 1880's were not outweighed by speculative excesses and abuses of the system.

III.

The irresponsible trading and lack of effective market regulation in the early period stirred farm resentment and opposition to futures trading that still exist to a limited extent. The abuses of futures trading in this early period resulted in repeated efforts of various State legislatures, from the late 1860's onward, to abolish futures trading. In 1844, the first bill to prohibit futures trading was introduced in Congress—followed by a long succession of similar bills over the next 50 years. Matters came to a crisis in 1892-93 when both the House and Senate passed bills levying a prohibitive tax on futures contracts in grain, cotton, and certain other commodities. This legislation failed only narrowly when two-thirds approval was needed on a House motion to suspend its rules to clear the way for acceptance of minor changes in the Senate bill.

In the period from 1895 to 1920, the agitation to abolish futures trading gradually gave way to efforts directed toward regulation. This change was associated with the rising trend of farm prices in the United States and generally improved farm conditions in the 1890-1920 period. The growth during this period of effective farmers' organizations and cooperative marketing associations, and work by the U.S. Department of Agriculture for better grading methods and more uniform standards in grain and cotton, began to lay the groundwork for more stable and dependable pricing in the futures markets.

The demands for Federal regulation of futures were consistent, however, and although quieted temporarily by the restrictions on futures trading imposed by World War I, were sharply reawakened in 1920-21 by speculative excesses on the grain exchanges during the post-war period of falling prices and farm depression. This resulted in the Futures Trading Act of 1921, which was based on the taxing power under the Federal Constitution. On this basis, the regulatory legislation was declared unconstitutional by the Supreme Court, but was reintroduced in 1922 as the Grain Futures Act, based on the interstate commerce clause of the Constitution, and on this basis was declared constitutional.

IV.

The Grain Futures Act of 1922 was designed mainly to enable the Government to deal with the exchanges themselves, rather than with individual traders. To conduct futures trading lawfully, the grain ex-
changes were required to be federally licensed or "designated" as "contract markets." A condition of such designation was that the exchanges themselves would take major responsibility for the prevention of price manipulation by their members. If they failed to do so, the only recourse was the suspension or revocation of their designations, and this was scarcely advisable. Although the legislation did provide for legal action by the Government against price manipulation, some of the legal actions undertaken against alleged manipulators proved ineffectual because of limitations and loopholes in the early law. The fact-finding and investigations by the U.S. Department of Agriculture, which pointed to sources and patterns of excessive speculation and price manipulation and showed that the limited regulatory powers authorized were inadequate in dealing with these and other market abuses. Beginning in 1927, the Department began submitting recommendations to Congress for additional legislation, and these eventually resulted, after extensive congressional hearings in the 1934-36 period, in the amended legislation of the latter year.

Under these amendments of 1938, the legislation was renamed the Commodity Exchange Act and the regulatory coverage was extended to cotton and other specified commodities as well as grains. Broad additional authority was granted to deal with market abuses by traders generally as well as exchange members, to prosecute price manipulation as a criminal offense, to curb excessive speculation by the large market operator, and to extend regulation to the previously uncovered field of commodity brokerage in order to suppress cheating, fraud, and fictitious transactions in futures, which were seriously impairing the services of the market.

Between 1936 and 1968, there were several minor amendments to the Commodity Exchange Act, including amendments bringing additional commodities under regulation. In 1968, Congress made several significant changes in the Act. It required that futures commission merchants meet specified minimum financial standards, increased the penalties for certain law violations such as manipulation and embezzlement, authorized the issuance of cessation-and-desist orders, required contract markets to enforce their trading rules and contract terms, and brought under regulation livestock, livestock products, and frozen concentrated orange juice.

After the enactment of the 1968 amendments to the Commodity Exchange Act, there was a major shift to a more market-oriented economy. As a result, futures markets began to play an increasingly important role in the pricing and marketing of the Nation's commodities. As the economy experienced sharp rises in the prices of many complex price-making forces in the markets, the growing importance of futures markets was reflected in a record volume of trading and substantial increases in open contracts.

In former years, when the Federal Government had large stockpiles of the major commodities, the Government stocks had a stabilizing effect upon price. There was little fear of sharp increases in prices, for when such increases began, Government stocks were freed, thus reversing or limiting the price movement. As long as this was true, there was less need for hedging in the futures markets. A merchandiser or processor could make forward fixed-price sales commitments without too much fear of a sharp rise in prices before he obtained the commodities to fulfill his commitments. By 1974, this was no longer true. Thus, merchandisers and processors, in order to protect themselves against substantial price rises, made greater use of the futures markets for hedging purposes. Producers, who were anxious to obtain the maximum price for their commodities, likewise were hedging in the futures market whenever it appeared to them that the futures price was favorable. Banks became increasingly reluctant to provide loans to producers, merchandisers, and processors on unhedged production or inventories.

The shift to a more market-oriented economy brought the general public into the futures markets in growing numbers. Speculators were attracted to the futures markets by the wide price swings and the possibility of large profits. Such an increase in trading by the speculative public, while useful to hedges, brought with it potential problems. It was feared that relatively less affluent individuals, for whom commodities speculation presented unacceptable risks, might be brought into the market for tax and other reasons, and that the temptation to engage in fictitious and prearranged trades would be great.

In the early 1970's, consumers were becoming increasingly aware that futures markets had a direct effect on such matters as their grocery bills and the costs of their homes. Properly operating futures markets helped to hold down consumer prices by reducing middleman costs. Improperly operating futures markets, however, could have the opposite effect. In order to assure that futures markets operated properly, and that the prices consumers pay were not artificially high, careful and efficient supervision of the markets was essential.

While the futures markets in a number of agricultural commodities had been regulated in varying degrees since 1929, many large and important futures markets were completely unregulated by the Federal Government prior to 1974. These included such agricultural and forestry commodities as coffee, sugar, cocoa, lumber, and plywood, plus various metals, including the highly sensitive silver market, and markets in a number of foreign currencies. A person trading in one of the then unregulated futures markets needed the same protection afforded to those trading in the regulated markets. Whether a commodity was grown, mined, or created, or whether it was produced in the United States or outside the United States, made little difference to those in this country who bought, sold, processed, or used the commodity, or to the United States consumers whose prices were affected by the futures market in that commodity.

By 1974, there were indications that futures markets would be further expanded to cover additional goods and services. Discussions were underway concerning futures markets in such things as home mortgages and ocean freight. It was apparent that a regulatory agency could not be expected to oversee the rapidly expanding and complex futures markets without additional tools with which to do the job, and without proper organization and funding. In addition to providing the tools that the regulatory body would need to prevent violations and to discipline violators directly, its role in supervising exchanges would
have to be substantially expanded. Exchanges were going to have to perform their regulatory role better in order to provide a viable market in which the public could have confidence. The Federal regulatory agency needed the authority to require that exchanges do so.

By 1974, the volume of futures trading had increased dramatically. The economic importance of that market was much larger than that of those persons holding corporate futures trading to the general public and to the Nation had reached a level that warranted the creation of an independent agency to regulate the marketplace. It was time to establish a regulatory authority in the commodity field similar to the Securities and Exchange Commission to regulate trading in both agricultural and non-agricultural goods and services in the public interest. Congress consequently enacted the Commodity Futures Trading Act of 1974.

The Commodity Futures Trading Commission Act of 1974 constituted a significant and substantial revision of the Commodity Exchange Act. In 1974, Congress extended the coverage of the Act to include not only the previously unregulated commodities, but also all other goods and articles, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in. Congress also created the Commodity Futures Trading Commission as an independent agency to administer the Commodity Exchange Act and granted the Commission exclusive jurisdiction over transactions involving futures contracts and certain other commodity-related activities.

The expansion in the scope of the Commodity Exchange Act and the creation of the Commission were designed to accomplish two basic goals: (1) to provide a uniform regulatory structure covering all futures trading both the regulated and previously unregulated commodities and (2) to allow for the extension of the economic benefits of futures trading under this structure to those areas of commerce where the risk-shifting and price-discovery functions of futures markets might prove to be of value. In this connection, the 1974 amendments authorized the Commission to establish a new definition for the term "bona fide hedging" to replace the Act's previous definition.

In addition to granting the Commission exclusive jurisdiction over all forms of commodity futures trading, the 1974 amendments extended the Commission's jurisdiction to two other forms of commodity instruments: commodity options involving those commodities that had not been regulated prior to 1974 and leverage transactions for the delivery of gold or silver bullion or bulk gold or silver coins. The 1974 amendments also prohibited option transactions involving those agricultural commodities enumerated in the Act prior to 1974. However, options involving the previously unregulated commodities and to any future terms and conditions prescribed by the Commission are

The 1974 amendments also gave the Commission new oversight responsibilities and powers over the Nation's commodity exchanges. For example, the Commission was empowered to designate a board of trade as a contract market for trading futures contracts in a commodity only if the board demonstrates that such trading will not be contrary to the public interest. Upon designation, a contract market must permit delivery of the commodity that is the subject of trading on that market at such delivery points as the Commission may prescribe as will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of the commodity in interstate commerce. The Commodity Futures Trading Commission was authorized to review and approve all bylaws, rules, or regulations issued by the contract market that relate to terms and conditions in contracts of sale or to other trading requirements, except those relating to the setting of levels of margin. The Commission was also authorized to alter or supplement any bylaw, rule, or regulation of a contract market, insofar as necessary or appropriate, by rule, regulation, or order.

The 1974 amendments strengthened the sanctions available should the Commission find that a contract market or any employee, director, officer, or agent of such market is violating or has violated the Act or Commission rules adopted thereunder. The Commission may issue a cease and desist order and assess a civil penalty of not more than $500,000 for each such violation. The Commission was empowered to review disciplinary or denial of membership (or other form of access) actions taken by exchanges. The Commission was also granted broad power to direct a contract market to take such steps as the Commission determines are necessary to maintain or restore orderly trading in or liquidation of any futures contract, when the Commission has reason to believe that a market emergency exists.

The Commodity Futures Trading Commission Act of 1974 also brought the activities of three classes of commodity professionals under regulation for the first time. Congress made it unlawful for an individual to act as a commodity trading advisor or commodity pool operator unless registered with the Commission. In addition, Congress required the registration of persons associated with futures commission merchants who solicit or accept customer orders or who supervise persons engaged in that activity.

In an attempt to bring about inexpensive and expedient adjudication of customer claims, Congress authorized the creation of two extrajudicial forums for resolution of customer complaints. First, each contract market was required to provide a fair and equitable procedure for the voluntary settlement by arbitration or otherwise of customers' claims and grievances not in excess of $15,000. Second, the Commission was directed to establish a reparation procedure for adjudicating customer complaints brought against commodity professionals.

Additional customer protection was contemplated by the provisions of the 1974 amendments that (1) authorized the Commission to determine whether and on what terms dual trading practices of floor brokers and futures commission merchants should be permitted, and (2) broadly proscribed fraudulent and deceptive practices by commodity trading advisors and pool operators.

The 1974 amendments greatly expanded the enforcement tools available under the Act. The Commission was empowered to sue in Federal district court for injunctive relief where it appeared that a person
had engaged, was engaging, or was about to engage, in conduct constituting a violation of the Act or the regulations thereunder. In addition, the dollar amount of penalties that could be imposed for violations was increased to $100,000.

In 1974, Congress determined that futures industry participants might want to form a self-regulatory organization, patterned after the National Association for Securities Dealers, Inc. Thus, the Commission was given the authority, at its discretion, to register and oversee the operations of futures associations that would serve the public interest by, among other things, establishing proficiency examinations for professionals and taking disciplinary action against persons engaged in illegal or unethical activities.

VII.

Drawing on the experience of the Commission during its first authorization period, the Futures Trading Act of 1978 improved and strengthened the statutory tools for directly regulating and overseeing the futures markets. Also, in recognition that the Commission's efforts and programs could be complemented by greater industry self-regulation and the assistance, where appropriate, of the States and other Federal agencies, that Act augmented prior measures and contained new measures designed to bring additional resources to bear on ensuring fair and honest dealings in those markets. One of the most significant challenges facing the Commission after its creation in 1975 was the proliferation of unsound and, in many cases, unlawful practices in connection with the offer and sale to the public of commodity options traded on foreign exchanges. The Commission endeavored at great length to establish a regulatory framework for those transactions but ultimately decided to suspend most forms of options trading. The 1978 amendments to the Act codified this ban but provided for the resumption of options trading in this country after the Commission transmitted evidence of its ability to regulate such transactions to its oversight committees. The regulatory framework for a pilot program for commodity options trading is now in place and trading is expected to commence sometime in the latter half of 1982.

The frauds associated with the sale of commodity options also highlighted the need for the involvement of the States in the prosecution of violations of the Commodity Exchange Act. The States were explicitly authorized in 1978 to bring civil actions in United States district courts for injunctive relief or monetary damages against any person (other than a contract market, clearinghouse, or floor broker) for violations of the Act or any rule, regulation, or order of the Commission. This newly-granted authority supplemented, and did not displace, the ability of duly authorized State officials to proceed in State courts on the basis of alleged violations of their State's general civil or criminal antifraud statutes.

The 1978 amendments similarly recognized the interest of other Federal agencies in the activities of the Commission as the traditional vehicles for commodity trading were substantially expanded by the industry. Congress accordingly added to the Commodity Exchange Act provisions designed to ensure that the Commission maintained communications with the Department of the Treasury, the Board of Governors of the Federal Reserve System, and the Securities and Exchange Commission to keep them fully informed of, and to seek their views on, Commission activities that might be related to the responsibilities of those agencies. In addition, the Futures Trading Act of 1978 expressly provided that applications for designation as a contract market for contracts for future delivery of securities, issued or guaranteed by the United States or any agency thereof, must be submitted by the Commission to the Department of the Treasury and the Federal Reserve Board. The comments of those agencies, as well as the effect of such contracts on the debt financing requirements of the United States and the continued efficiency and integrity of the underlying market for Government securities must be considered by the Commission in approving, disapproving suspending, or revoking such designations or in taking any emergency action affecting such designated contract markets.

The 1978 amendments also provided that, before the Commission approves a change in a contract market's bylaws, rules, regulations, or resolutions, it must first publish the proposed change in the Federal Register if the contract market's proposal is of "major economic significance." These amendments accorded interested persons at least 30 days in which to comment on proposals of this type. The Commission was also empowered for the first time to require applicants for registration, and such persons associated with the applicant as the Commission may specify, to be fingerprinted as part of the application process.

Congress established the framework for an industry-wide self-regulatory organization comparable to the National Association of Securities Dealers when it enacted the Commodity Futures Trading Commission Act of 1974. The 1978 legislation included a number of additional provisions designed to foster the formation of such an organization. First, in response to the concerns of the Department of Justice that compulsory membership in a registered futures association might violate the antitrust laws, Congress expressly provided that an association could require the membership of eligible persons if the Commission finds that compulsory membership is necessary to achieve the purposes and objectives of the Commodity Exchange Act. Second, a registered futures association was authorized to perform a portion of the Commission's registration functions. Finally, the contract markets were permitted to delegate to such an association their responsibility to provide an arbitration forum for the resolution of customers' claims and grievances. Pursuant to the provisions of the Commodity Exchange Act of 1981, the National Futures Association was registered with the Commission as a registered futures association in September 1981. It is anticipated that a number of regulatory functions currently performed by the Commission will be undertaken by the National Futures Association.

The 1978 legislation also provided that the Commission may develop and implement a plan to charge and collect reasonable fees to cover the estimated cost of regulating transactions under the jurisdiction of the Commission if it first reports its intentions to, and obtains the approval of, its oversight committees. The Commission is required to include in its report information relating to the feasibility and desirability of
collecting such fees. The 1978 Act further provided that any such fees are to be deposited into the Treasury of the United States as miscellaneous receipts.

VIII.

The present Commodity Exchange Act is based upon findings and conclusions of 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 commodities in interstate commerce; (2) such transactions are susceptible to manipulation and control, and may generate sudden and unreasonable price fluctuations; and (3) 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 ensure fair practices and honest dealing on the commodity exchanges and to provide a measure of control over manipulative activity and speculative excesses that 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 of certain quantities of specified commodities at fixed prices. In effect, the Commodity Exchange Act has required that futures trading in commodities be conducted at a commodity exchange designated as "contract market" by the Commodity Futures Trading Commission. Futures trades are made by or through a member of such a commodity exchange. A separate futures market is established for each commodity traded on a contract market. The contract markets have the authority, within certain limitations, to admit members and select officers; discipline of members 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.

In order to qualify for designation as a contract market, 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) inspection of records by the Commodity Futures Trading Commission and the Department of Justice. In addition, the Commission must find that transactions for future delivery in the commodity for which designation as a contract market is sought will not be contrary to the public interest.

The Commodity Exchange Act provides many customer protections and remedies. The Act directs the Commission to promulgate and administer a regulatory program that includes registration of commodity professionals, segregation of customers' funds by futures commission merchants, establishment of dual trading guidelines, creation of a procedure for the adjudication of reparation claims, monitoring exchange arbitration procedures and disciplinary actions, and licensing of industry self-regulatory futures associations. Moreover, customers are afforded protection through the Commission's power to sue directly for injunctive relief and to invoke a full range of administrative remedies where appropriate to curb unlawful behavior.

The Commodity Futures Trading Commission was created in order to assure that a single expert agency would have the responsibility for developing a coherent regulatory program encompassing futures trading and related activities. Therefore, Congress has vested in the Commission exclusive jurisdiction to build upon the foundation provided by the Commodity Exchange Act in erecting a sound and strong Federal regulatory policy governing futures trading. (A discussion of the mechanics of futures trading is contained in appendix D.)

NEED FOR LEGISLATION

I.

The Commodity Futures Trading Commission Act of 1974 contains a "sunset" provision under which the Commission's funding authorization is limited to a fixed term of years. The 1974 Act and the Futures Trading Act of 1975 each contained funding authorizations for periods of 4 years. The "sunset" provision has afforded Congress an opportunity to reexamine and evaluate the provisions of the Commodity Exchange Act and the Commission's performance in 1978 and again in 1982.

The 1982 reauthorization is particularly timely in that it affords Congress an opportunity to revisit this area in light of the dramatic changes in the futures industry which have taken place since 1978. For example, 38 new futures contracts—ranging from gasoline and lumber to Treasury bills and Eurodollars—have been designated since the Commission's last reauthorization. (The names and addresses of commodity exchanges designated as contract markets and the commodities that these markets are designated to trade are set forth in appendices A and B.) In 1978, 33.2 million futures contracts were traded. By 1981, however, this figure had grown to 101.1 million contracts.

Similarly, the trading of futures contracts in agricultural commodities grew from 35.1 million contracts in 1978 to 54.6 million contracts in 1981. The popularity of futures contracts in financial instruments was clearly evident, as growth in the trading of these contracts outstripped all others expanding from 1.6 million contracts in 1978 to 20.1 million contracts in 1981. The trading of futures contracts in foreign currencies was also very popular, as trading grew from 1.3 million contracts in 1978 to 5.4 million contracts in 1981.

This surge in trading has been accompanied by increased use of futures markets by financial institutions and businesses to shift price risk in a manner comparable to the more traditional use of those markets by farmers and others involved in the marketing of grain and other agricultural products. The general public has also become increasingly active in the futures markets—not only as individual customers, but also through participation in professionally managed commodity pools and accounts. Not surprisingly, there has been a corresponding increase in the number of persons registered with the Commission, and in the average amount of customers' funds held in segregation to margin, guarantee or secure trades—from approximately $5 million in 1979 to approximately $8 million in 1981. (The volume of commodity
futures contracts trade for fiscal years 1975 through 1981 are set forth in appendix C.)

II.

Other events also sparked the need for new legislation in this area. Chief among these events was a jurisdictional agreement, announced December 7, 1981, between the Commodity Futures Trading Commission (CFTC or the Commission) and the Securities and Exchange Commission (SEC). This agreement clarifies the jurisdictional and regulatory responsibilities of the agencies with regard to the trading of futures contracts on securities indices, futures and options contracts on exempted securities, and options on foreign currencies. Each agency has submitted legislative proposals to its respective congressional oversight committees to implement that agency's portion of the agreement.

This agreement was made for the purpose of ending the jurisdictional ambiguity between the CFTC and SEC which has hampered the development of new financial instruments and, in part, for the purpose of defusing a potential confrontation between these agencies. The stage for confrontation was set when the SEC, at the urging of the Chicago Board Options Exchange (CBOE), approved changes in CBOE exchange rules to permit the CBOE to offer exchange-traded option contracts on Ginnie Mae securities.1 Futures contracts on Ginnie Mae securities have been traded since 1975 at the Chicago Board of Trade under the authority of the Commodity Exchange Act and the regulatory jurisdiction of the CFTC.

After the SEC entered an order granting the CBOE request to trade these option contracts, the Chicago Board of Trade filed a petition in the Seventh Circuit Court of Appeals asking that the SEC order be set aside on the basis, among other things, that these contracts were commodity option contracts and, hence, are subject to the provisions of the Commodity Exchange Act and the regulatory jurisdiction of the CFTC, rather than the securities act and the SEC. The SEC subsequently intervened in this action, taking the side of the SEC while the CFTC filed an amicus curiae brief in support of the Chicago Board of Trade position. A three-judge panel of the Seventh Circuit recently ruled that the SEC did not have jurisdiction to oversee the trading of options contracts on Ginnie Mae certificates and that the Commodity Exchange Act governed the contracts. (Board of Trade of the City of Chicago v. SEC, No. 81-1660 (7th Cir. March 24, 1982).) The jurisdictional agreement is not intended to alter the traditional regulatory roles of the CFTC and the SEC but is necessary to clarify their roles so that both may concentrate on their respective responsibilities.

III.

A further matter giving impetus to this legislation was the desire on the part of both the Commission and the States to share information and responsibility for the prosecution of certain fraudulent quasi-commodity transactions not conducted on commodity exchanges. During the past 4 years, it became clear that the Commission alone cannot be solely responsible for policing every fraudulent operation with a "commodity" theme. While present law empowers the States to file lawsuits in Federal court to enforce the provisions of the Commodity Exchange Act, to conduct investigations and compel the production of documents and to proceed in State court on the basis of any alleged violation of any State general civil or criminal anti-fraud statute, there was a belief on the part of many that more needed to be done to encourage the States to become more active in this area. In light of this need, the Committee determined to address this issue.

IV.

Another issue giving impetus to this legislation was the desire on the part of the Committee members to repeal the total statutory ban on the trading of options or agricultural commodities. The members noted that farmers could, in theory, benefit from the use of agricultural options, that the option concept had changed radically in the 46 years since the statutory ban was enacted and that regulatory structures to prevent abusive practices in this area have been greatly improved. Support for the repeal of this ban was also evident in the agricultural and commodities industries. Consequently, the Members decided to address this issue in the course of considering the bill.

DISCUSSION OF MAJOR ISSUES

CFTC-SEC Jurisdictional Agreement

I.

The bill, as reported by the Committee, contains amendments to the Commodity Exchange Act that would codify the CFTC portion of the jurisdictional agreement reached between the CFTC and the Securities and Exchange Commission. This jurisdictional agreement was developed for the purpose of resolving the jurisdictional ambiguity between the regulatory responsibilities of the CFTC and the SEC. As outlined elsewhere, this ambiguity led to an anomalous situation in which these agencies were indirectly opposing each other in court. The SEC portion of the agreement is contained in S. 2260, introduced by Senator D'Amato. That bill is being considered by the Committee on Banking, Housing, and Urban Affairs.

The desirability of a resolution by the two agencies of the issues between them has become increasingly clear. The growing demand for new products related to securities or financial instruments, either as investments or as price hedging tools, has magnified the importance of removing the jurisdictional confusion that has hampered the development of the markets for such instruments. The confusion results in part from amendments to the Commodity Exchange Act that (1) expanded the definition of "commodity" to embrace not only tangible goods but also intangible rights and interests, and (2) gave the CFTC "exclusive jurisdiction" over agreements and transactions involving futures trading in commodities, while preserving the SEC's preexisting authority over securities trading and the securities markets.

1Ginnie Mae securities are certificates that represent ownership interests in pools of Government insured residential mortgages. The owner of a Ginnie Mae certificate receives a portion of the income generated as mortgagors in the pool repay their loans, and the timely payment of principal and interest is guaranteed to the certificate holder by the Government National Mortgage Association.