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SENATE

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**CFTC REAUTHORIZATION ACT OF 1995**

FEBRUARY 3 (legislative day, JANUARY 30), 1995.—Ordered to be printed

Mr. LUGAR, from the Committee on Agriculture, Nutrition, and Forestry, submitted the following

**REPORT**

[To accompany S. 178]

The Committee on Agriculture, Nutrition, and Forestry, to which was referred to bill S. 178, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

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**PURPOSE OF THE LEGISLATION**

The purpose of S. 178 is to extend the authorization of appropriations for the Commodity Futures Trading Commission (“CFTC” or “Commission”) through fiscal year 2000. Existing section 12(d) of the Commodity Exchange Act (7 U.S.C. 1 et. seq.) (the “Act” or “CEA”) authorizes appropriations for fiscal years 1993 and 1994.

**BACKGROUND AND NEED**

Futures trading in the United States evolved out of forward contracting in the grain markets to organized futures exchanges prior to the Civil War. Widespread dissatisfaction among agricultural

producers, frequent price manipulations, and fraudulent “bucket shops” led to the beginning of federal regulation of futures trading in 1921. The 1929 stock market crash and fraudulent options trading ultimately resulted in the 1936 adoption of the CEA. In the CEA Congress stated that the commodity futures and options markets are important to the national interest. Their importance derives from their hedging and pricing functions which are usually cited as economic justifications for these markets. Accordingly, the “necessity for regulation” of futures markets is based on the vital role futures markets play in meeting the hedging and pricing needs of interstate commerce.

Until 1974 futures regulation covered only agricultural commodities and was carried out by the Commodity Exchange Authority of the United States Department of Agriculture (“USDA”). In the early 1970s fraud in gold and silver options, then unregulated commodities, led to concerns about the scope of federal regulation. Controversial trading by international grain firms during the great Soviet grain deal of 1972, which had been negotiated by USDA, led to concerns about the role of USDA in futures regulation.

In response to these concerns, Congress amended the CEA to create the CFTC in 1974 as the independent federal regulatory agency exclusively responsible for all commodity futures and commodity options regulation. In a form resembling other such commissions, the CFTC was established with five members nominated by the President and confirmed by the Senate for staggered five year terms. Additionally, no more than three members may be of the President’s party. Finally, one of the five commissioners is nominated by the President and confirmed by the Senate as Chairman.

The CFTC seeks to prevent manipulation, prohibit fraud, and maintain financial integrity in the futures markets. In recent years the agency also has focused attention on the encouragement of innovation in the nation’s futures markets and the internationalization of the futures markets. In accomplishing these goals the CFTC’s regulatory scheme relies on federal oversight of self-regulatory efforts supplemented with direct Commission action.

In establishing this regulatory scheme to protect the futures markets, their participants, and their hedging and pricing functions, the CEA generally provides that all contracts for future delivery, or futures, transactions occur on exchanges that are “designated contract markets” by the CFTC. In return for a designation, a commodity exchange undertakes to regulate itself and its members to prevent manipulation, prohibit fraud and assure financial integrity of transactions. The CFTC, in turn, oversees these self regulatory organizations (SROs).

To receive CFTC designation for the futures contracts they wish to list for trading, the futures exchanges must submit contract terms for CFTC approval and show that the contracts are not easily subject to manipulation and can be used for hedging or pricing purposes. In addition, trading rules must be submitted for approval and must be enforced by the exchanges.

While in general all futures must be traded on designated exchanges, a number of exceptions have been made to this provision of the CEA. For instance, forward contracts have been excluded from this requirement since its inception in 1921. Additionally, as

a part of the law that established the CFTC in 1974, certain itemized financial transactions by banks and others were exempted by the "Treasury Amendment" from CFTC jurisdiction unless these transactions occurred on futures exchanges. Finally other financial instruments, such as swaps, hybrids, and certain other financial instruments, such as swaps, hybrids, and certain energy contracts have been exempted from the exchange trading requirement and most other CFTC regulations in the past two years.

In addition to the requirement that trading occur on designated contract markets, all commodity businesses and commodity professionals must be licensed or "registered" by the CFTC. Registrants include: futures commission merchants ("FCMs"), introducing brokers ("IBs"), commodity pool operators ("CPOs"), commodity trading advisors ("CTAs"), floor brokers ("FBs"), floor traders ("FTs"), and associated persons ("APs"). As applicable, registration may require background checks, proficiency testing and ethics training. The registration process itself has been largely delegated to the National Futures Association ("NFA"), an SRO initially created to regulate registrants that were not exchange members due to Congressional, CFTC, and industry concerns about non-member retail practices.

Today, futures trading provides a diverse array of products including contracts based on agricultural products, financial instruments, metals, and energy products. The volume of commodity futures and options contracts traded on the nation's commodity exchanges exceeded half a billion transactions in 1994. The liquidity of these markets with their relatively low commissions provide efficient opportunities for hedgers and other market users. Commodity futures and options transactions directly or indirectly affect the financial well being of family farms, corporations, financial institutions, traders, and millions of individuals through pooled investments. All of this trading is carried out within a self-regulatory framework overseen and supplemented by the CFTC, an agency of fewer than 600 employees.

While the markets overseen by the CFTC have grown immensely in volume, variety of products, and diversity of users, the importance of futures trading to agriculture cannot be overstated. The development of futures trading allowed farmers to mitigate the boom and bust cycle of prices for their crops through intelligent marketing. Today, futures trading is an integral part of pricing and risk management for U.S. agriculture. Even farmers who do not use futures directly often employ options, forward contracts, basis contracts and other marketing tools which exist only because there is a viable, liquid futures market.

The volume of exchange-traded futures and commodity options contracts for agricultural commodities on U.S. exchanges totalled over 58 million transactions in 1994. This trading affected not only the market participants, but ultimately all producers, processors, merchandisers and consumers of agricultural products with prices affected by exchange trading. As the Congress reviews the current federal commodity programs through hearings, and debates on the 1995 farm bill, the pricing and risk shifting functions of the futures markets may take on even more importance as Congress reconsiders the role of the federal government in stabilizing prices and as-

suming price risks in agriculture. Hence it is vital that the futures markets are operated appropriately and are properly overseen.

#### REAUTHORIZATION

Since the establishment of the CFTC in 1974, Congress has periodically reauthorized the CFTC. In 1978, issues included fraud in "London Options," the legality of retail off-exchange transactions known as leverage transactions, and the authorization of NFA. In 1982 reauthorization included the codification of the Johnson-Shad Accord which facilitated the development of stock index futures, the authorization of agricultural options, a provision for private rights of action, a clarification of the jurisdiction of the states, and numerous other provisions. In 1986 reauthorization was less extensive, but some international enforcement issues were addressed.

In October 1987 and October 1989 the stock market dropped sharply and attention was focused on the relationship between stock index futures and the stock market. During the 1980s the development of new instruments such as swaps and hybrids focused attention on the prohibition of off-exchange futures. A federal district court decision involving an OTC oil market and a British court decision involving a municipality's purchase of swaps contracts led to legal uncertainty in the large and rapidly expanding derivative market. U.S. commodity exchanges began losing market share to foreign competitors. In 1989 the FBI announced that it had conducted an undercover investigation on the floors of the Chicago Board of Trade ("CBT") and the Chicago Mercantile Exchange ("CME") resulting in indictments of 48 individuals. In addition, a controversial emergency action by the CBT to avert a possible corner of its soybean market precipitated a sharp price drop. These events influenced and complicated the reauthorization of the CFTC which was not completed until the enactment of the Futures Trading Practices Act of 1992 ("FTPA" or "the '92 Act"). That law amended the CEA to:

\* \* \* improve the regulation of futures and options traded under rules and regulations of the Commodity Futures Trading Commission; to establish registration standards for all exchange floor traders; to restrict practices that may lead to the abuse of outside customers of the marketplace; to reinforce development of exchange audit trails to better enable the detection and prevention of such practices; to establish higher standards for service on governing boards and disciplinary committees of self-regulatory organizations; to enhance the international regulation of futures trading; to regularize the process of authorizing appropriations for the Commodity Futures Trading Commission; and for other purposes. \* \* \*

Title I of FTPA established limitations on dual trading and trading between members of broker associations. Dual trading was prohibited in all contract markets except those with low trading volumes or those exempted from the prohibition by the CFTC due to the performance of the exchange's trade monitoring system.

Title II of FTPA contained numerous provisions relating to the enhancement of regulatory and enforcement activities. Perhaps the

provision of greatest consequence was the requirement that each exchange have a trade monitoring system to detect and deter trading abuses on the exchange floor. The trade monitoring system was required to include an audit trail capable of timing trades to the nearest minute and sequencing trades. The '92 Act required enhanced audit trails to be in place in October 1995 and to be independent, unalterable, and sequenced to the extent practicable. At the time this provision was adopted, it was widely discussed and anticipated that these requirements would be met through the use of electronic hand-held devices which had not yet been developed. Despite the expenditure of substantial time and funds by the exchanges, these devices are not yet operational.

FTPA also addressed exchange governance procedures requiring that governing boards represent the diversity of constituent groups. Additionally, 20 percent of the Board members were required to be non-members. Further, exchange disciplinary committees were required to have sufficient diversity of membership to insure fairness and prevent special treatment for persons subject to disciplinary action.

FTPA contained a wide variety of additional provisions directed at anti-fraud enhancements, including requirements for the registration of floor traders, ethics training for registrants, the suspension of registrants charged with felonies, contemporaneous written records for oral orders, and the submission of NFA rules directed at telemarketing fraud. CFTC enforcement efforts were strengthened by provisions authorizing the CFTC to continue to request and cooperate with undercover operations by other federal law enforcement agencies, authorizing increased penalties, establishing new violations, authorizing the imposition of monetary penalties in conjunction with CFTC injunctive actions, and authorizing the CFTC to order restitution in administrative actions.

FTPA required new regulations governing exchange emergency actions and new exchange rules providing for the avoidance of conflicts of interest. Also, insider trading by certain SRO staff and members based on non-public material information obtained in the performance of their regulatory duties was prohibited. Finally, the CFTC was authorized to adopt rules dealing with the financial risks to registered firms in the futures industry posed by the activities of their affiliates.

Title III authorized the CFTC to assist foreign regulatory authorities in investigations and directed the CFTC to study the competitiveness of U.S. markets in comparison with foreign exchanges. Title IV provided certain technical amendments.

Title V dealt with difficult issues involving intermarket coordination. In response to concerns that had been expressed since the introduction of stock index futures more than ten years before, the Board of governors of the Federal Reserve Board was given authority to review and adjust exchange margin requirements on stock index futures and options. In response to difficult jurisdictional and regulatory issues that arose with the advent of non-traditional off-exchange instruments such as swaps, hybrids, certain forwards, and others, the Congress directed and authorized the Commission to exempt transactions in these instruments from the exchange trading requirement of the CEA and most other provisions.

For many of the rulemakings required by the '92 Act, explicit statutory deadlines for CFTC final rules were contained in FTPA. Similarly, studies required by FTPA were to be completed by dates set out in the '92 Act. As of this date, the CFTC has completed all of these FTPA requirements on a timely basis. However, experience with implementation of FTPA has been limited by the relatively short amount of time since the adoption of FTPA and by the large variety of rules adopted by the Commission.

FTPA authorized appropriations for the CFTC for only two years. The 103rd Congress adjourned without passage of an extension of the FTPA authorization of appropriations.

Given the history of exhaustive consideration prior to the adoption of the '92 Act and the extensive provisions contained in FTPA, the CFTC requested a reauthorization through fiscal year 2000 without any other changes to current law. In response to that request, Chairman Lugar, joined by Senator Leahy, introduced S. 178, the "CFTC Reauthorization Act of 1995", on January 9, 1995. As stated by Senator Lugar upon introduction of S. 178, this legislation is needed because it "provides assurance to the national and international financial markets of the continuing authority of the CFTC, continues the CFTC's responsibilities under existing law, gives adequate time to complete implementation of the extensive amendments included in \* \* \* FTPA \* \* \* and allows time for review of the effects of that implementation."

Reviewing the implementation of FTPA is important because the futures industry is a regulated industry and the exchanges and their members, and the approximately 4,000 registered firms including FCMs, IBs, CPOs, CTAs, and their approximately 55,000 registered employees are affected by the provisions of the CEA and by CFTC regulations. Congress has historically viewed the purpose of regulation to be, in important part, the maintenance of public confidence in futures trading, which in turn has been necessary to the long-term and sustained profitability of the futures industry so vital to the national economy.

#### SUMMARY OF PROVISIONS

There is only one provision of S. 178. It authorizes the appropriation of such sums as necessary to carry out the CEA for each of the fiscal years through 2000.

#### COMMITTEE CONSIDERATION

Following the introduction of the CFTC Reauthorization Act of 1995 on January 9, 1995, Chairman Lugar announced a hearing to be held on January 26, 1995 to consider S. 178 and to review the CFTC's progress in implementing the requirements of the '92 Act, as well as assess its operations generally. The CFTC was invited to testify and the four largest U.S. futures exchanges, two futures industry trade groups, and the NFA requested to give oral and written testimony to the Committee. One additional exchange, two agricultural groups, and one respondent in a CFTC enforcement action submitted written testimony.

## HEARING

At the hearing on January 26, Chairman Lugar in his opening statement addressed the development of the futures industry and remarked that the industry may face new challenges providing risk management to agriculture, an area where government programs now absorb much of the risk of volatile prices. The Chairman noted the importance of public confidence in the markets and the performance of the regulators in establishing that confidence. He further reviewed past events and the legislative history of the '92 Act. The Chairman concluded that if the Committee determined that the CFTC merits reauthorization, he hoped that the Committee would pass a bill extending the Commission's existence unencumbered by other legislation. If futures-related issues appropriate for Committee consideration arose during the next few years he said he expected the Committee would deal promptly with such issues.

The Ranking Democratic Member, Senator Leahy, stated that the passage of FTPA was one of the outstanding achievements of the Committee in recent years. He noted that he and Senator Lugar worked closely on that legislation while he was Chairman and Senator Lugar was Ranking Minority Member. Senator Leahy called FTPA landmark legislation and the toughest pro-consumer futures reform package in a generation. Finally, Senator Leahy noted the importance of a strong audit trail as well as oversight of the derivatives market.

Ms. Mary Schapiro, Chairman of the CFTC, testified orally before the Committee on behalf of the Commission and submitted written testimony for the record in support of prompt action on S. 178 in its present form. After commenting on recent developments in the futures industry, here and abroad, and on the lack of corresponding growth in CFTC staffing, she reported on the performance of the CFTC in implementing FTPA.

Chairman Schapiro began by reporting on the Commission's current rulemaking in process in response to CBT, CME and later New York Mercantile Exchange petitions for exemptive relief for markets limited to appropriate persons. In a pilot program, the CFTC proposal would offer some flexibility to exchanges in offering and trading products. And, unlike over-the-counter ("OTC") products, transactions in the pilot program will be cleared by exchange clearing houses and their pricing will be far more transparent than OTC transactions. As a part of the Commission's proposal, the CFTC requested comment on modifications to its existing exemptions for swaps as to whether there should be any limitations on the participation of municipalities and pension funds in that market.

Chairman Schapiro reported on three of the major studies mandated by FTPA and completed by the CFTC on derivatives, global competitiveness and audit trail. Further, she reported on the CFTC's recent risk assessment rules, the performance of the Commission in approving new contracts, the CTC's surveillance efforts and the agency's enforcement program. Specifically, Ms. Schapiro reported on the performance of exchange audit trails to date. Chairman Schapiro stated that the Commission will press the ex-

changes to continue their ongoing efforts to develop improvements, electronic and non-electronic, to meet the '95 requirements. She stated that the exchanges can make significant improvements to their current systems through non-electronic enhancements, and that such improvements can show that they are acting in good faith to meet the October '95 standards of independence, unalterability, and sequencing. On an enforcement matter, Chairman Schapiro reported on the joint action by the CFTC and the Securities and Exchange Commission against Bankers Trust Securities alleging fraud in the sale of OTC derivatives. That case resulted in a settlement in which Bankers Trust agreed to pay a civil monetary penalty of \$10 million and to take actions to review and modify its derivatives marketing.

Following Ms. Schapiro's testimony, Chairman Lugar asked whether she believed that the current audit trail systems could be improved to meet the enhanced audit trail requirements of FTPA or whether an electronic trading card is absolutely necessary. Chairman Schapiro responded that the CFTC had not taken the position that an electronic trading card is necessary to meet the '95 standards. Following that response, Chairman Lugar asked whether, after the exchanges have attained a level of accuracy that is extremely high, but still less than 100%, there is merit to the view that the CFTC should weigh both costs and benefits in determining the practicability of additional incremental enhancements. Chairman Schapiro responded that she thought the statute offers flexibility in the provision that improvements need to be made to the extent practicable, and that her view is that cost is certainly an issue in determining practicability. In a third question related to audit trail, Chairman Lugar asked Ms. Schapiro whether the CFTC was committed to giving the exchanges guidance as to what they need to do to show good faith in meeting the October '95 audit trail requirements. Chairman Schapiro replied that the CFTC was committed to working with the exchanges and that she believed that non-electronic enhancements will show good faith toward meeting the enhanced requirements.

Focusing on another area, Chairman Lugar noted that the CFTC exemptions should have resolved most of the jurisdictional concerns about swaps, hybrids, and forwards. He asked whether, given the exemption from oversight and regulation, the Commission's residual anti-fraud authority has been sufficient to allow action where absolutely necessary. Chairman Schapiro prefaced her response by noting that most of the derivatives problems that received public attention in the last year, such as Orange County, were not problems involving futures-like derivatives but were rather problems that involve investment strategies utilizing over-leveraging in government securities. Nevertheless, she believes that the Commission's decision to retain anti-fraud authority in the swaps exemption was a wise one.

Ms. Schapiro responded to a question by Chairman Lugar by stating that the exchanges had implemented rules requiring public governors and diversity on exchange boards. Chairman Schapiro stated that the CFTC would be doing a review of the effectiveness of the exchange governance provisions of FTPA and promised when it was completed to provide that review to the Chairman.

In response to further questions from Chairman Lugar, Ms. Schapiro stated that the Commission's enforcement program had become more effective and that it was using virtually every tool available to it. Finally, Chairman Schapiro stated that the CFTC is as talented, as hard working and as expert as the staff of any financial regulator.

Senator Leahy, the Ranking Democratic Member, took over the questioning and returned to the audit trail issue. After expressing his pleasure that the CFTC is committed to a strong audit trail, Senator Leahy asked whether Ms. Schapiro felt the good faith exception provided exchanges flexibility to design something that works for them. Chairman Schapiro stated that the law provides exactly the kind of flexibility that the agency and the exchanges need to make progress and to improve without being held to an impossibly high standard. Further, in response to the Ranking Democratic Member, Chairman Schapiro stated that she believed all of the exchanges could ultimately meet the enhanced audit trail standards. Also in regard to audit trail issues, Senator Leahy asked whether improvements to the hand-held devices being developed by the exchanges include additions unnecessary to meet audit trail requirements. A brief discussion followed about the business benefits that might accrue through the implementation of electronic devices beyond the regulatory benefits. In response to further questions from Senator Leahy, Chairman Schapiro stated the standards in the '92 Act are good standards and should not be diminished. Further, she stated that the law provides very significant flexibility to strive toward those standards, but not to hold anybody to a standard that is impracticable or impossible. Chairman Schapiro stated that costs and benefits and common sense are all part of making the determination of what is practicable. In response to Senator Leahy, Ms. Schapiro stated that she believed that ultimately all of the exchanges can meet the 1995 standards of independent, automatic, continuous, precise, and unalterable with significant enhancements to existing systems. Finally, Chairman Schapiro stated that it would be a mistake to diminish the standards and that we should be aiming for the best possible audit trail consistent with practicability.

Senator Cochran then took over the questioning and asked whether, in light of the changing emphasis of this new Congress, Chairman Schapiro intended to undertake a review of regulations that have been issued by the CFTC under FTPA to see whether some should be modified, rescinded or rewritten. Ms. Schapiro responded that the agency would undertake such a review, that she had already written a number of major industry participants requesting their views, and further that the agency was planning a series of public roundtable discussions over the next two years to discuss particular regulations. In response to a question from Senator Cochran as to whether she would recommend any changes in the law to support this regulatory review, Chairman Schapiro stated that the Commission is completely supportive of S. 178 as written, but that if the agency discovers legislative changes are necessary to address regulatory reforms that she would not hesitate to return to the Committee. Finally, in response to questions from Senator Cochran, Chairman Schapiro reported on the rapid re-

sponse the agency is now making to contract market applications and that specifically the application by the CME to trade contracts based on the Mexican peso was filed only three weeks ago, has already been published in the Federal Register, and has been shared with other regulators.

Senator Heflin raised the issue of a tax on futures transactions. Chairman Schapiro stated that the Commission has not taken a position on a transaction tax. However, she stated her own personal concern about funding the CFTC at an adequate level to carry out its responsibilities. She recognized the problems that may arise from the imposition of a transaction tax including global competition. Following that issue, Senator Heflin asked whether there were any developments toward the establishment of minimum standards for foreign markets. Chairman Schapiro discussed the CFTC's participation in the International Organization of Securities Commissions and stated that the CFTC regulatory program is the model for both emerging and developed markets. Finally, Senator Heflin addressed the swaps market and after some discussion asked whether from a historical viewpoint the swaps market resembles the futures market prior to regulation.

The Committee next heard testimony from a panel consisting of John F. Sandner, Chairman, CME; accompanied by William Brodsky, President, CME; Patrick Arbor, Chairman, CBT; accompanied by Thomas Donovan, President, CBT; Daniel Rappaport, Chairman, NYMEX; Patrick Thompson, President, NYMEX; and Bennett J. Corn, President, Coffee, Sugar & Cocoa Exchange, Inc.

As he began his testimony Mr. Sandner stated that he had to change his remarks after hearing the testimony of the CFTC Chairman and her responses to questions. He praised the "mindset" brought out by the questions and answers.

Mr. Sandner discussed the growth of the CME and the role that it has taken to set compliance and surveillance standards. He noted the international character of his exchange, the growth of foreign markets, and the potential movement of U.S. business overseas to countries without regulators and with legislators with the "mindset" of encouraging economic growth. He addressed the last reauthorization of the CFTC and the relationship between the agency and the industry. He concluded his oral remarks by stating that, in view of the remarks by CFTC Chairman Schapiro, that the CME was totally in support of a simple, one-line reauthorization.

In his written testimony Mr. Sandner also was supportive of S. 178, but expressed concerns about a number of issues including audit trail, the CME's petition for exemptive relief, transaction taxes, and a potential merger of the CFTC and the SEC. Mr. Sandner reiterated his support for a broader reorganization of the structure of U.S. financial regulation and supplied the Committee with copies of an exchange proposal that was widely discussed during the last Congress.

Mr. Arbor testified that the CBT unequivocally supports a very speedy reauthorization of the CFTC. Mr. Arbor discussed the CBT's concern about audit trail requirements and described the operation and capability of the existing CBT audit trail system. He then summarized the exchange views on the FTPA requirements that go into effect in October of this year. In discussing this issue, Mr. Arbor

noted that the October 1995 requirements have been a source of some confusion and concern; that exchanges have spent more than \$15 million to try to develop new technology to meet those requirements, including the electronic hand-held trading card called AUDIT; that no one knows whether those technological efforts will successfully meet the October 1995 requirements; and that all exchanges testifying agree that AUDIT, which is scheduled to be tested on certain exchanges this year, will not be ready to be deployed in the near future and certainly will not be ready to be deployed in time to meet the October 1995 requirements. Mr. Arbor stated that the CBT wants to proceed with AUDIT under a sensible, rational, business strategy.

Subsequently, Mr. Arbor urged the Committee to do a complete review of the regulatory structure of the futures markets in view of the changing nature of the markets and foreign competition. He also noted the advantages of transparency and exchange clearing over the OTC market, but expressed concern that a transaction tax would disadvantage exchange trading. In his written statement, Mr. Arbor listed a number of outstanding issues and potential concerns including regulations of dual trading, the process for approval of new contracts and rules, the existing ban on single stock futures, litigation with respect to the "Treasury Amendment", and the exemptive authority granted to the CFTC.

Mr. Rappaport testified as to the role NYMEX plays as the world's largest energy exchange and the world's largest precious metals exchange. He urged the Congress to insist on rigorous cost-benefit analyses of regulation and to be sensitive to the global competitive pressures faced by the domestic futures industry.

Mr. Rappaport supported the one-line reauthorization. He then discussed how each exchange has its own audit trail system and described the NYMEX system. He expressed approval of the CFTC's approach to this issue.

Mr. Rappaport concluded with a statement of his concerns about foreign competition when the London Metals Exchange, a market with no price transparency, no audit trail, and a margin system based solely on credit, decided to open warehouses for delivery on their contract at five locations in the United States.

Mr. Corn testified that his exchange firmly supported the proposed reauthorization of the CFTC. He also discussed his exchange's experience with its efforts to meet the enhanced audit trail standards and its own unique approach to devising a better audit trail. Finally, he discussed some innovative approaches his exchange has taken recently following the delays occurring in the development of electronic hand-held devices.

Chairman Lugar asked Mr. Sandner to describe his exchange's experience in limiting dual trading on its own initiative.

Mr. Leahy asked Mr. Arbor about the development of AUDIT and whether one of the reasons that it was not fully ready was that the exchange had added some other functions to the system that were unrelated to audit trail requirements. Mr. Arbor discussed the current system and AUDIT. He stated that the exchange has always tried to work on AUDIT as a business tool as well as an audit system.

In response to a question from Senator Leahy, Mr. Rappaport pledged to work with the CFTC to come into compliance with the October 1995 audit trail requirements.

Senator Warner asked the panel of witnesses how they would look up a simply amendment to the effect that, as a part of this reauthorization, the Commission would go back and review its rules within a stipulated time period and give the private sector an opportunity to comment. Mr. Sandner responded that the futures markets and their participants have changed greatly since the current regulatory structure and regulations were adopted and that industry believes the structure should be revisited. Nevertheless, he stated that he was comfortable with the new CFTC Chairman and that he was confident that she would be going back and looking at the regulations. Mr. Arbor added that his exchange shared the philosophy that existing regulations should be reviewed, however, they did not wish to impair the speedy reauthorization of the agency in any way.

Mr. Brodsky then addressed the Committee remarking on his career in the securities industry before joining the futures industry. He noted that in the securities industry the existence of the SEC is a foregone conclusion and that the issue was really a financial appropriations issue. The committees of jurisdiction would carry out periodic oversight hearings, or where needed, consider particular legislation. He felt that was a better process and that futures legislation should be handled the same way.

Chairman Lugar then commented on the difficult process that reauthorization can be when it involves protracted philosophical discussions to try to restructure the entire industry and the Commission. However, the Chairman stated that the Committee needs to conduct oversight and stated that it was his intent as Chairman to conduct oversight and to keep in contact with all interested parties.

The next panel to testify included Mr. Robert Wilmouth, President, NFA; Mr. Peter Karpen, Chairman, Futures Industry Association; accompanied by John Damgard, President, FIA; Mr. John R. Frawley, Jr., Chairman, Managed Futures Association; accompanied by John Gaine, General Counsel, MFA.

Mr. Wilmouth first testified in support of the CFTC reauthorization. Then he discussed the nature of NFA, its members, their employees, and noted that NFA is entirely paid for by the futures industry. Mr. Wilmouth stated that NFA has four basic responsibilities: NFA develops and enforces customer protection rules to ensure that its members are observing the highest possible ethical standards; NFA prevents unethical firms and individuals from entering the futures industry by performing the registration function on behalf of the CFTC; NFA protects customers by educating them about the futures markets and the risks involved in that market so that the customers can make informed investment decisions; and NFA provides customers with an arbitration forum to resolve disputes. Mr. Wilmouth said that there is one thing that sets NFA apart from the other witnesses before the Committee today and apart from the self-regulatory body in the securities industry: regulation is not part of what NFA does, it is all that it does. Mr. Wilmouth commented favorably on several provisions of the 1992 Act which specifically involved NFA including telemarketing rules,

public directors, and the registration of floor traders. The Chairman noted that the Ranking Democratic Member and he have been meeting with Mr. Wilmouth on futures issues for nearly two decades and that he appreciates Mr. Wilmouth's experience and wisdom.

Mr. Karpen testified in support of the CFTC reauthorization and stated that the FIA continues to support the provisions of the 1992 Act. He discussed several issues including the CFTC exemptive authority, risk assessment, audit trail, dual trading and exchange governance. He was particularly supportive of the need for accurate audit trails and expressed concern about the extent to which diversity had been achieved on exchange boards.

Mr. Frawley also testified in support of the reauthorization of the CFTC. Mr. Frawley represents substantial users of the futures markets as managers of funds for both private and institutional investors. Managed futures has been a large and growing segment of the futures industry for several years. He noted the value of NFA at a time when resources were scarce for the CFTC. He commended both the NFA and the CFTC for the jobs they were doing and noted that the CFTC considered both the needs of protecting U.S. customers and the need for international competitiveness.

The Kansas City Board of Trade, The American Cotton Shippers Association, The National Grain and Feed Association, and The National Grain Trade Council submitted statements in support of the reauthorization of the CFTC. One respondent in an injunctive action filed by the CFTC in U.S. District Court submitted a statement alleging excessive and improper activities by CFTC staff in the course of the investigation and litigation against his firm.

Chairman Lugar announced the scheduling of the Markup for S. 178 for February 1, 1995, and adjourned the hearing.

#### MARKUP

On February 1, 1995, the Committee held a business meeting to consider S. 178. Chairman Lugar opened the meeting with a statement reiterating his support for the reauthorization contained in S. 178. He addressed the concerns that had been raised by some exchanges about the implementation of the enhanced audit trail requirements in FTPA scheduled to go into effect in October of this year. However, Chairman Lugar noted that in the testimony of the CFTC Chairman, and in her responses to questions, it was made clear that the CFTC has not held that an electronic hand-held device is necessary to meet the enhanced requirements. Further, he noted that the CFTC Chairman had assured the Committee that, after the exchanges met a minimum acceptable level of compliance, further incremental improvements would only be required as practicable and that the cost of the improvements would certainly be an issue in determining what is practicable. He reported that by the end of the hearing all witnesses present supported the reauthorization without amendments.

Chairman Lugar stated his expectation that the Committee would want to conduct vigorous oversight and consider futures legislation as needed. But he urged that if the Committee concluded that the CFTC merits reauthorization, S. 178 be reported out, unencumbered by amendments.

No amendments were offered. Senator Cochran made a motion to favorably report the bill. By voice vote, S. 178 was ordered reported favorably by the Committee.

SECTION-BY-SECTION ANALYSIS

SECTION 1. SHORT TITLE

Section 1 provides that this Act may be cited as the "CFTC Reauthorization Act of 1995".

SECTION 2. AUTHORIZATION OF APPROPRIATIONS

Section 2 amends section 12(d) of the Commodity Exchange Act to authorize appropriations such sums as are necessary to carry out its provisions for each of the fiscal years 1995 through 2000.

COST ESTIMATE

In accordance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the Committee has included the cost estimate provided by the Congressional Budget Office.

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, February 1, 1995.*

Hon. RICHARD G. LUGAR,  
*Chairman, Committee on Agriculture, Nutrition, and Forestry,  
U.S. Senate, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 178, the CFTC Reauthorization Act of 1995.

Enactment of S. 178 would not affect direct spending or receipts. Therefore, pay-as-you-go procedures would not apply to the bill.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

ROBERT D. REISCHAUER, *Director.*

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

1. Bill number: S. 178.
2. Bill title: CFTC Reauthorization Act of 1995.
3. Bill status: As ordered reported by the Senate Committee on Agriculture, Nutrition, and Forestry on February 1, 1995.
4. Bill purpose: S. 178 would authorize the appropriation of such sums as are necessary for the Commodities Futures Trading Commission (CFTC) for the fiscal years 1995–2000.
5. Estimated cost to the Federal Government: Funds for CFTC have been appropriated for 1995, and the estimate assumes that no additional appropriation will be necessary for this fiscal year. Because the bill does not provide a specific authorization, the table shows two alternative authorization levels for fiscal years 1996–2000—the 1995 appropriation for CFTC without adjustment for anticipated inflation and the 1995 appropriation with adjustment for inflation. Outlay estimates are based on historical spending rates

for this program and assume that appropriations will be provided before the start of each fiscal year.

[By fiscal years, in millions of dollars]

	1995	1996	1997	1998	1999	2000
Without adjustment for inflation:						
Estimated authorization level .....	0	49	49	49	49	49
Estimated outlays .....	0	42	49	49	49	49
With adjustment for inflation:						
Estimated authorization level .....	0	51	53	56	58	60
Estimated outlays .....	0	44	53	55	57	60

The costs of this bill fall within budget function 370.

6. Comparison with spending under current law: The fiscal year 1995 appropriation for CFTC activities is \$49 million. If appropriations were to remain at the 1995 level, projected spending would not exceed the amount under current law. If appropriations were to increase each year to reflect anticipated inflation, budget authority and outlays would exceed the levels under current law by amounts growing to \$11 million in 2000.

7. Pay-as-you-go considerations: None.

8. Estimated cost to State and local governments: None.

9. Estimate comparison: None.

10. Previous CBO Estimate: None.

11. Estimate prepared by: John Webb.

12. Estimate approved by: Paul N. Van de Water, Assistant Director for Budget Analysis.

REGULATORY IMPACT STATEMENT

In compliance with paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee made the following evaluation of the regulatory impact that would be incurred in carrying out S. 178.

Because S. 178 merely authorizes appropriations and makes no substantive changes in the CEA, S. 178 does not have a regulatory impact.

CHANGES IN EXISTING LAW

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, changes in existing law made by the bill S. 178, as ordered to be reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

COMMODITY EXCHANGE ACT

SEC. 12. [(d) There are authorized to be appropriated to carry out this Act—

- (1) \$53,000,000 for fiscal year 1993; and
- (2) \$60,000,000 for fiscal year 1994.]

*(d) There are authorized to be appropriated such sums as necessary to carry out this Act for each of the fiscal years 1995 through 2000.*

