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Chicago Board of Trade

Dennis A. Dutterer
President and
Chief Executive Officer

August 7, 2000

BY E-MAIL AND CERTIFIED MAIL

Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W. - Room 9106
Washington, DC 20581

Re: Proposed Rules Concerning A New Regulatory Framework for Multilateral Transaction Execution Facilities, 65 Fed. Reg. 38986 (June 22, 2000), and Proposed Rulemaking on Bilateral Transactions, 65 Fed. 39033 (June 22, 2000)

Dear Ms. Webb:

The Chicago Board of Trade ("Board of Trade" or "CBOT®") appreciates this opportunity to comment on the proposals of the Commodity Futures Trading Commission ("Commission" or "CFTC") for a new regulatory framework for multilateral transaction execution facilities ("MTEFs") and to clarify the operation of the current swaps exemption.[1] For many years, the Board of Trade has urged the Commission to take meaningful action to streamline and modernize its regulatory regime in order to afford fair and even-handed treatment to exchange and non-exchange markets in derivatives. For many years, the Board of Trade has identified for the Commission and Congress that swaps markets and futures markets have become increasingly blurred with the same market participants trading substantially similar products under substantially dissimilar regulatory structures.

In November 1999, the President's Working Group issued a report on derivatives markets largely agreeing with those conclusions and questioning many of the fundamental regulatory underpinnings of the Commodity Exchange Act. The PWG report contemplated that the CFTC would rectify the regulatory imbalance by revamping its regulation of exchange-traded markets so long as the Commission was authorized to do so. There should be no doubt about the Commission s legal authority. As enacted in 1992, Section 4(c) of the Commodity Exchange Act gives the Commission all the authority it needs to restructure its regulatory apparatus in order to promote responsible financial innovation and fair competition in a manner that is consistent with the public interest.

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1 The CBOT is filing a separate comment letter on the CFTC's proposed rules concerning intermediaries.

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The Commission's proposal meets that standard. By returning the CFTC to the oversight role Congress originally envisioned, the proposal will provide flexible regulatory objectives for exchanges and other market participants to meet. These "Core Principles" are designed to allow each business to tailor its operations in the best way to meet those objectives while serving its customers. In effect, the Commission's proposal restrikes the proper balance between effective and expert self-regulation and watchful, prudent agency oversight. The Board of Trade very much supports the Commission's creativity and congratulates the Commission for its efforts at reform.

As with any reform project of this magnitude, review of specific details can reveal areas where further modifications would be appropriate. Two important areas illustrate this point well.

The proposal would restrict retail customer business on a Derivatives Transaction Facility to firms with $20 million in net capital. The Board of Trade seriously questions whether a specific level of net capital may reasonably be viewed as a proxy for providing effective customer protections. Many firms that have less than $20 million in net capital have unblemished records of compliance with all applicable sales practice requirements and financial rules. Those firms should not be discriminated against by precluding them from competing with larger firms for the business of retail market participants that want to trade on a DTF.

Similarly, the proposal would treat exchange members that are floor brokers and floor traders like any other individuals. Specifically, floor traders and floor brokers would be unable to perform their traditional role of providing market-making liquidity on a DTF unless they cleared their trading through clearing firms with $20 million in net capital. This unwarranted restriction would undermine the ability of exchanges to innovate and use the Commission's new framework. We urge the Commission to remedy this restriction to make the DTF category a more viable option for qualifying exchange markets.

Those kinds of unsound restrictions in the proposal are, by far, the exception not the rule. Overall, the CBOT believes the approach taken by the Commission will allow the derivatives industry to develop and innovate in a manner that preserves the essence of customer and market protections while providing the regulatory freedom to innovative businesses. The Board of Trade appreciates the direction taken by the Commission in these proposals and believes it is unquestionably a superior regulatory alternative to the current static and rigid regulation of exchanges by government prescription.

The following are specific comments on the Commission s proposal.

Exempt MTEFs

Cash-settled transactions. The proposed MTEF exemption would be available for contracts that are cash-settled, based upon an economic or commercial index or measure

beyond the control of the counterparties to the transaction and not based upon prices derived from trading in a directly corresponding underlying cash market. Proposed Rule 36.2(b)(7). We suggest deleting this prohibition against using an index or measure based on prices that correspond to an underlying cash market. Cash-settled contracts should be permitted even if its cash-settlement feature is derived from trading in a directly corresponding underlying market. Many well-regarded benchmarks are based on trading in underlying cash markets. (For example, consider the Lehman Brothers U.S. Treasury Securities Indexes, the Merrill Lynch Corporate Bond Indexes and the Dow Jones Equity Indexes.). Determining whether the prices used to calculate these measures directly correspond to an underlying cash market could be subject to reasonable differences in interpretation, making it less likely that boards of trade, facilities and entities will operate exempt MTEFs based on these indices or measures. The requirement in Proposed Rule 36.2(b)(7) that the index or measure be beyond the control of the counterparties to any transaction on an MTEF will provide sufficient protection to guard against collusion or manipulation of the index or measure.

Exemption permitted under Part 35 or Part 36. The Commission states that transactions by eligible participants in the commodities permitted for exempt MTEFs would be exempt under either Part 35 or Part 36. 65 Fed. Reg. at 38988. This statement could be interpreted to suggest that transactions on MTEFs by eligible participants could be exempt either under Part 35 or Part 36. This interpretation is wrong, of course, since proposed Part 35 explicitly provides that transactions executed on MTEFs as defined in proposed Rule 36.1 are not eligible for an exemption under Part 35. However, the Commission should make clear that the only avenues for an exemption for transactions executed on an MTEF are Part 36, Part 37 or Part 38.

Government Securities. The Commission asks in the Proposed Rulemaking whether a broad exemption to contract markets for futures on government securities gives rise to significant and undesirable opportunities for regulatory arbitrage. The Board of Trade does not believe that the contemplated MTEF structure would create undesirable regulatory arbitrage opportunities. The President's Working Group and the relevant congressional committees of jurisdiction have agreed that derivatives markets that exclude retail customers need substantially less regulation than more inclusive derivatives markets. That conclusion is premised on the belief that sophisticated, professional market participants may adequately protect themselves even if no government regulation exists, unless a serious risk of manipulation is presented. Allowing MTEFs in government securities futures is fully consistent with that emerging consensus, especially in light of the liquidity in the underlying cash market. So long as futures or options on futures on U.S. government securities are traded on an MTEF no real risk of regulatory arbitrage is presented. Instead, market participants will simply be given a choice of different levels of government regulation for this form of trading and the market will decide which level to favor with liquid trading. Government should allow sophisticated and professional market participants the freedom to make these choices.

MTEF Definition. The definition of an MTEF in proposed Rule 36.1(b) contains an exclusion for facilities with a single market-maker. The CBOT suggests that this be deleted from the MTEF definition. The Commission gives no rationale why single market-maker entities should be excluded. The only difference between a facility on which only a single firm may participate as market-maker and the currently regulated exchanges is that the currently regulated exchanges permit many single market-makers, competing among themselves, instead of a single market maker. But the Commission's approach could be read to allow a futures exchange or any other market to decide to use a single market-maker or specialist system of trading, like many securities exchanges, and avoid being considered to be an MTEF. No valid rationale has been advanced or could be advanced in support of that anomalous result.

Application of Treasury Amendment to an Exempt MTEF. The CFTC states that nothing in the proposal would affect any statutory exclusion, including the Treasury Amendment in CEA Section 2(a)(1)(A)(ii). 65 Fed. Reg. 38986. However, the proposed rules could raise a technical issue whether these exclusions continue to apply to an exempt MTEF. This is because the MTEF exemption in proposed rule 36.2 states that if an MTEF meets the Part 36 conditions it is exempt from all provisions of the Act except those cited in proposed Rule 36.3(a), which does not cite CEA Section 2(a)(1)(A)(ii). In order to eliminate any ambiguity on the application of the Treasury Amendment and any other statutory exclusions to exempt MTEFs, the statutory provisions containing those exclusions should be listed in proposed Rule 36.3(a).

The Commission also states (65 Fed. Reg. at 38989) that a facility that fits within the definition of an MTEF in Part 36 may not be a board of trade for purposes of the Treasury Amendment. Concluding that an MTEF (not an exempted MTEF) is not a board of trade for purposes of the Treasury Amendment could result in the Commission having no jurisdiction to adopt the proposed regulations as they relate to transactions otherwise subject to the Amendment's exclusion. An entity that is not a board of trade for purposes of the Treasury Amendment cannot logically be a board of trade for other purposes under the Act. The Commission's jurisdiction is limited to designating entities that are boards of trade as contract markets. See, e.g. CEA § 5. Accordingly, one of the statutory bases relied upon by the Commission as its authority for promulgating Part 36 is CEA § 8a, under which the Commission is authorized to change or supplement contract market (or board of trade) rules. Without this statutory authority, the Commission has no authority to require, for example, that an MTEF in foreign currency futures limit itself to eligible participants or that an MTEF in government securities futures may trade only certain kinds of products. In short, unless the Commission concedes that MTEFs are boards of trade within the meaning of the Treasury Amendment, it runs the risk that it is seriously undermining its own legal authority to engage in this rulemaking.

Finally, the Commission seems to infer (65 Fed. Reg. at 38989) that a non-MTEF would not be considered a board of trade under the Treasury Amendment. If that inference was intended, it is misleading for the Commission to say that nothing in the proposed rules would affect any statutory exclusion. If that inference is not intended, the Commission

should clarify its neutrality in its final rules. Either way, the Commission needs to offer more guidance to the public in this area.

Exempt MTEF Notices. Proposed Rule 36.2(f)(1) requires that an exempt MTEF on an electronic system that also lists DTF and RFE products must provide notice that the exempt MTEF transactions are not subject to CFTC regulation. The CBOT suggests that the final rule should make clear that such notice is required to be provided to the exempt MTEF participants and not to the Commission. Presumably, the notice is intended for market participants. If so, the Board of Trade questions the rationale for the "legally separate" requirement in Proposed Rule 36.2(e) since the notice to sophisticated market professionals should be sufficient to convey the fact that different levels of regulation are being applied.

Separate Physical Trading Environment. In lieu of the notices required for exempt MTEFs on electronic systems, proposed Rule 36.2(f)(2) would require that exempt MTEFs in physical trading environments must trade exempt MTEF products in a location separate from DTF and RFE products. The CBOT requests that the Commission consider imposing the notice it proposes to require for exempt electronic MTEFs on physically-traded exempt MTEFs in lieu of the physical separation requirement. The Commission has not identified how physical separation would provide any meaningful protections for market participants. Those physically trading on the physical trading facility will be well aware of the regulatory status of the products they are trading, whether or not differently regulated products are physically separated. Any participants who trade through other participants (which will include any retail customer) will never see or be present in the physical trading environment to appreciate the physical separation imposed by the Commission's rules.

Should the Commission nonetheless determine to impose a physical separation requirement, the CBOT feels strongly that any arguable benefits to be gained from physical separation can be accomplished even if different products share the same building and trading floor. In order to eliminate any confusion on how to define a location that is physically separate, the Commission should add to proposed Rule 36.2(f)(2) the words, "which location may adjoin the location for products trading pursuant to Parts 37 or 38."

Exclusive Jurisdiction. The Commission's proposal suggests that if a market is offering futures contracts or options on futures contracts on an exempt board of trade, the Commission would consider that activity to be covered by its exclusive jurisdiction provision in CEA §2(a)(1)(A)(i). Since such futures or options trading would be traded or executed on a board of trade or market, the literal terms of the CFTC's exclusive jurisdiction would apply to such trading. The Commission should confirm this legal conclusion in the preamble to its final rules on this subject.

Similarly, the Commission should confirm that any futures contract, option on futures contract or option on a physical commodity offered on the facilities of an RFE or DTF is

subject to the exclusive jurisdiction of the CFTC. In particular, the Commission must make clear that all of those transactions would be covered by the general preemption of state law found in the Commission's exclusive jurisdiction provision in CEA §2(a)(1)(A)(i) as well as the provisions of CEA §12(e). Otherwise transactions on RFEs and DTFs, as well as Exempt MTEFs, could be subject to duplicative regulation by state authorities or other federal agencies notwithstanding the CEA's long history forbidding such activity. Indeed, it would be particularly counter-productive if the Commission's efforts to reduce regulation of U.S. exchanges resulted in the creation of the misperception that state authorities could now regulate our markets.

Clearing. In the context of the ongoing legislative process, the Commission has advised Congress that it should not enact legislation that would create an unfair competitive environment for futures clearing organizations. The Board of Trade completely agrees. We are concerned, however, with one aspect of the Commission's proposal since it would allow non-futures clearing organizations to clear futures and related contracts. Unless and until Congress allows futures clearing organizations to clear non-futures products, like securities, allowing futures products to be cleared by non-futures clearing organizations creates a potentially serious competitive disparity. Of course, to the extent that the Commission determines that transactions covered under Part 35 or Part 36 of the Commission's rules are not futures, rules that would permit non-futures clearing organizations to clear those non-futures products would not be objectionable so long as futures clearing organizations could clear those products as well.

DTFs

Exchange Members as Eligible Participants. Through an apparent oversight, the Commission proposes to use the same definition of eligible participants for Part 35 and Part 37 (as well as Proposed Part 36). That would mean that a natural person who is an exchange member and acts as a floor broker or floor trader on a board of trade would not be classified as an eligible participant who is automatically eligible to trade on a DTF. Such persons could only trade on a DTF if the firm clearing their trades has $20 million in capital and complied with other requirements. We set out below our objections to the $20 million requirement, but even if that requirement is retained there is no basis to treat trades of floor brokers and floor traders in the same manner as retail public customers. Certainly floor brokers and floor traders that trade regularly on exchange markets should be considered to be as sophisticated as any market participants. For that reason, in the Commission's current Part 36 rules, floor brokers and traders are defined to be eligible participants without regard to any total or net assets test. The Commission should adopt that same formulation as set forth in current CFTC Regulation 36.1(c)(2)(x) at least for DTFs (though it would also be appropriate for exempt MTEFs as well). Imposing undue restrictions on market-makers in DTFs would seriously curtail the utility of the regulatory relief the Commission intends to afford to the exchanges.

FCM Net Capital Threshold. Proposed Part 37 would allow DTFs to permit access to the market by non-eligible traders through registered FCMs that meet certain requirements,

including having a minimum adjusted net capital of at least $20 million. This requirement is overly burdensome and has no logical link to the Commission's stated goal that non-institutional DTF transactions "be transacted through FCMs that are more capable of properly maintaining such accounts and handling the associated risk." Proposal for Intermediaries, 65 Fed. Reg. 39008, 39013 (June 22, 2000).

A threshold level of net capital is not an accurate proxy for adequate customer protections or sales practices. Nor is it even a suitable proxy for compliance with segregation and minimum financial rules. An FCM with a minimum adjusted net capital of $20 million is not automatically more or less capable of properly maintaining DTF accounts or handling the associated risk than any other FCM. Any registered FCM has been found to be fit to handle retail customer business. If the FCM is a member of an exchange, clearing organization or the National Futures Association, the firm would be subject to aggressive self-regulatory oversight. If the firm is a clearing firm, its credit is carefully monitored by its clearing organization and it may only engage in market activity proportionate to its ability to underwrite the risks posed by its customers' trades. The degree of regulation all FCMs will still face renders overkill the proposal's imposition of an arbitrary aggregate FCM net capital requirement to handle retail customer business on a DTF. It also constitutes harmful discrimination in favor of large firms at the expense of smaller FCMs who have historically proven their ability to competently and safely provide services to their customers. The anticompetitive and discriminatory aspect of this requirement calls into question whether this aspect of the proposal is consistent with the spirit and letter of the Commission s obligations under CEA §15.

The $20 million requirement also is inconsistent with other regulations. For example, an exempted MTEF subject to no CFTC regulation is permitted to allow as a participant a natural person or an entity with total assets exceeding at least $10 million. Similarly, the agricultural trade options pilot program requires that parties have a net worth of not less than $10 million in order for the exemption to apply. See Rule 32.13(g). Moreover, from a practical perspective, the $20 million requirement would exclude more than half of registered FCMs.

If the Commission decides to retain a net capital threshold, the Commission should consider an alternative means for qualifying for handling retail customer business which should bear a rational relationship to the customer protection and sales practice concerns the Commission has expressed. One way would be to look at the sales practice history of a firm. For example, proposed Rule 1.17(a)(1)(ii) could be supplemented with an alternative condition that would allow DTFs to permit access to the market by non-eligible traders through registered FCMs that (1) have been registered as FCMs for at least 3 years and (2) have a history of no sales practice violations against retail customers during the past 3 years. Any firm that is found to have committed such a violation should be suspended for one year from handling accounts for retail customers on a DTF.

The Board of Trade strongly urges the Commission to reconsider this aspect of its proposal. Firms that have been handling customer business without complaint for many

years should not be discriminated against through a ban on retail customer business on a DTF just because the firm's net capital is less than $20 million or any other specified amount. If effective customer protection is the issue, the Commission should fashion a remedy that is targeted to meet that objective and will not unfairly prevent smaller firms from competing for retail business simply due to the amount of net capital they might have.

Agricultural Product Prohibition. The Commission proposes that the agricultural commodities listed in CEA Section 1a(3) not be eligible for trading on a DTF. The CBOT believes there is no valid rationale for an across the board prohibition on agricultural contracts that might otherwise be successfully traded on a DTF. The rationale offered by the Commission is that these agricultural markets are the primary, if not the only, centralized source of price discovery and price basing for these commodities. However, the Commission's proposal maintains requirements for price transparency at all three levels of oversight. See proposed Rule 36.2(g) (exempt MTEF must provide volume, price and other trading data if CFTC issues order determining that exempt MTEF is a significant source of price discovery); proposed Rule 37.3 (requiring DTFs to provide similar data for actively traded contracts) and Core Principle # 4; and proposed Rule 38.3(b)(7) and Core Principle # 7 (requiring RFEs trading data). Moreover, many agricultural products now are traded over the Internet through networks and other electronic trading facilities that provide, or aspire to provide, additional price discovery. None of those new markets is regulated as a contract market. The Commission seems to have acknowledged that it would be wrong to treat new innovative markets that want to provide agricultural commodity price discovery like traditional contract markets. That same acceptance of innovation should cause the Commission to reconsider its refusal to permit future markets that could be developed by exchanges the ability to choose to operate under at least the flexibility of the DTF apparatus.

The proposed rules for DTFs allow the CFTC to permit the trading of contracts on a case-by-case basis, if they have a sufficiently liquid and deep cash market and a surveillance history based on actual trading experience to provide assurance that they are highly unlikely to be manipulated. Rather than categorically excluding Section 1a(3) agricultural commodities, the Commission at least should permit agricultural commodities to be traded under these case-by-case criteria once an appropriate showing has been made. Of course, part of that showing could be that a DTF would comply with some discrete portions of the core principles for RFEs, like speculative limits for example, if agricultural commodities are traded on DTFs. The Board of Trade urges the Commission to build that kind of flexibility into its final regulatory reform rules.

Compliance with Part 37 Conditions. Proposed Rule 37.2(c) states an MTEF "that applies to be, *and* is, a recognized" DTF must comply with the Part 37 conditions and must disclose to participants that the DTF transactions are subject to Part 37. Italics added. This language suggests that an MTEF must both apply and be recognized. However, elsewhere in the proposal the Commission states that boards of trade that are contract markets would be automatically eligible to become recognized DTFs. The

Commission should clarify Proposed Rule 37.2(c) to confirm the availability of this alternative way of becoming a recognized DTF.

DTF Conditions. The Board of Trade believes that Part 37 should be administered with a high degree of legal certainty to allow all MTEFs true flexibility in determining how to meet the seven Core Principles. The CBOT agrees with the Commission's goal of providing the DTFs (and RFEs) with considerable discretion to fashion specific mechanisms for meeting the flexible core principles. But those flexible standards and the proposed DTF regulatory structure also could leave the Commission with a great deal of flexibility in interpreting these Core Principles. If the Commission's future interpretations turn into rigid mandates more stringent than intended by the Commission in designing this exemption, the essence of the CFTC's proposal would be lost. Put simply, the Commission s administration of these Core Principles may rob the proposal of its greatest asset -- flexibility.

Appendix A to Part 37 confirms this point. While attempting to elucidate the meaning of the Core Principles, Appendix A actually either says that compliance with an existing Commission mandate will mean compliance with a Core Principle or extends the language of the Core Principle through additional terms that are open to interpretation and disagreement. This observation is not meant as a criticism of the words used or the concept of explanatory Appendices. It is simply a recognition that the Commission must afford the MTEF wide latitude and discretion in deciding how best to conform its market's operations to the goals of any of the Core Principles, whether for DTFs or RFEs. Otherwise, the Commission will be back in the business its proposal is designed to eliminate -- telling the exchanges how to run their operations.

The potential for undue Commission interpretive discretion will exist in any Commission proceeding to disapprove a rule, term or condition under section 5a(a)(12), to alter or supplement a rule, term or condition under section 8a(7), or any other proceeding the effect of which is to disapprove, alter, supplement, or require a recognized DTF to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action. Those proceedings would surely focus on the more open-ended standards in the Core Principles and the guidance provided in the Appendices. In order to ameliorate the need to commence any of those proceedings, the Commission's final rules should confirm that any DTF (or RFE) that adopts a reasoned interpretation of a flexible Core Principle and makes a good faith effort to satisfy that interpretation shall not have its interpretation or application disturbed or revised by the Commission.

Consistent with the flexible standards in the Core Principles, the Commission should impose a standard of review that recognizes the flexibility inherent in the DTF exemptive standards and the discretion the Commission has agreed to grant the DTFs (and RFEs) in applying those principles to their markets. Accordingly, the Board of Trade recommends that a provision be added to Part 37 (as well as Part 38) to the effect that the Commission will not disapprove a rule, term or condition under section 5a(a)(12), alter or supplement a rule, term or condition under section 8a(7), or take any other action the effect of which

is to disapprove, alter, supplement, or require a recognized DTF to adopt a specific term or condition, trading rule or procedure, or refrain from taking a specific action, unless the Commission makes a finding that the DTF (or RFE) has engaged in a serious **abuse of discretion** in meeting the conditions of proposed Rule 37.3 (or proposed Rule 38.3(b)).

This approach will go a long way toward fulfilling the goal of having the Commission act as an oversight regulator instead of a direct regulator of DTFs. For similar reasons, the Commission should structure an alternative dispute resolution mechanism to resolve disagreements about the application of Core Principles without the punitive, contentious overtones of its current statutory powers.

An additional means of guarding against the danger of a return to micro-management is to revise the terms of the conditions in proposed Rule 37.3 and to make the guidelines for the seven Core Principles more focused. For example, certain adjectives used in the guidelines in Appendix A promote possible areas of interpretive disagreement between a DTF and the CFTC, such as "effectively and affirmatively," (Core Principle #1 (a)) and "appropriate," "periodically," "proper," "timely" (Core Principle #2(a)). If the Commission agrees to give the DTF (or RFE) great deference in interpreting these adjectives or other elastic terms, they become less problematic. But if the Commission intends to reserve to itself the ability to interpret these terms as a matter of first impression, these kinds of elastic standards are likely to become regulatory brush fires or worse in the future. In that case, the CFTC should eliminate these and other similar adjectives and phrases so that a future CFTC cannot interpret these and other similarly subjective terms in a manner that effectively results in the same kind of direct regulation of DTFs as currently is applied to designated contract markets.

Transparency. The Commission's Core Principle # 4 for DTFs should be revised to mirror its proposed Core Principle # 7 on transparency for RFEs. Otherwise, it would appear that the DTFs would have a more onerous transparency burden than the RFEs, a result we understand to be directly opposite to the Commission's intent.

Recordkeeping. In explaining these proposals, the Commission stated that it intended to replace "one-size-fits-all" regulation with broad, flexible Core Principles. Proposed Core Principle # 6, however, essentially imposes the same "one-size-fits-all" recordkeeping approach required in Rule 1.31. The Commission should make clear if there is any flexibility in the application of Rule 1.31 to DTFs. If not, the CBOT suggests that there is no need to make recordkeeping a separate core principle for a DTF. Instead, proposed Rule 37.3(b)(6) should directly refer to CFTC Rule 1.31 as the acceptable practice.

Procedures for Recognition. Proposed Rule 37.4(b) lists the procedures required for a DTF seeking recognition by application. We suggest a technical revision such that recognition by application is available to "[a] board of trade, facility or entity *that has not filed a submission under Rule 37.4(a).*" The addition of this italicized language would make clear that a board of trade, facility or entity that files for recognition by certification is not required to demonstrate that it satisfies the conditions for recognition under Part 37.

RFEs

Agricultural Commodities. Proposed Part 38 would not require Commission approval of an RFE's rules and rule amendments prior to implementation, except for terms and conditions of agricultural commodities listed in Section 1a(3). However, current Rule 5.3 and proposed Rule 5.1, which permit listing contracts by exchange certification, do not prevent exchanges or RFEs from initially listing these agricultural contracts without prior approval. Moreover, permitting subsequent rules and rule amendments for these agricultural contracts without prior Commission approval would not preclude the Commission from taking action to disapprove, alter or supplement terms and conditions of any contract traded by an RFE. In short, if prior approval is not required for the initial listing of agricultural contracts, it should not be required for amendments to the terms and conditions of those contracts.

RFE Exchange Certification. Proposed Rule 5.1 would permit an RFE to list new contracts based only on an exchange certification. The certification submitted by an RFE would be required to include a statement that the contract's initial terms and conditions neither violate nor are inconsistent with any requirement of Part 38, any provision of the CEA or the Commission's regulations.

We recommend that the Commission delete the "not inconsistent with" concept from the required certification. A designated contract market has a legal obligation to comply with CEA and CFTC requirements, and it is appropriate for the Commission to require an RFE to certify that a contract's terms and conditions do not violate those requirements. It is a different matter, however, to require an RFE to represent that contract terms and conditions are "not inconsistent with" CEA or CFTC requirements. A highly subjective standard such as this could well result in reasonable differences of opinion between the Commission and an RFE as to whether a term or condition of a contract is or is not consistent with CEA and CFTC requirements -- requirements which themselves are in many cases open to disagreement as to interpretation. The risk of being second-guessed for its reasonable judgment that a contract term or condition meets the "not inconsistent with" test could likely discourage an RFE from using the Rule 5.1 certification procedures.

Certification for Rule Amendments. The Commission has proposed a provision that would permit the Commission to impose a stay during any proceeding to disapprove, alter or amend an RFE rule. Proposed Rule 1.41(c)(1)(iv). We believe that it is unnecessary and potentially detrimental for the Commission to retain the authority to stay an RFE rule. An RFE will view Commission initiation of proceedings to disapprove or alter an exchange rule as a very serious matter. As a result, an RFE can be expected to decide with due deliberation whether or not to suspend operation of the rule voluntarily, taking into account the Commission s grounds for initiating the proceeding and the potential implications to its markets based on its extensive market knowledge and the input of market users. Moreover, suspension of an RFE rule by agency action during a

disapproval proceeding could be disruptive to the marketplace. (Current Rule 5.3 permits the listing of contracts by exchange certification but contains no comparable stay provision.) Accordingly, the Board of Trade asks the Commission to delete the stay provision in Proposed Rule 1.41(c)(1)(iv).

Significant Regulatory Relief. The Commission's stated objective in proposing the new framework for RFEs was to provide significant regulatory relief to futures exchanges from current requirements that are applicable to designated contract markets. 65 Fed. Reg. at 38991. The U.S. futures exchanges face the heaviest regulatory burdens of any futures markets in the world and need just what the CFTC says it has proposed -- significant regulatory relief. The Board of Trade fears, however, that the promise of regulatory relief may not be experienced in practice. A review of the 15 RFE Core Principles and the multi-columned pages of explanatory guidance indicates that the hard work of figuring out exactly what kinds of current regulatory obligations the exchanges need not meet in the RFE category may not have been considered in sufficient detail. To that end, the Commission should develop a handful of concrete illustrations of requirements that RFE will not need to meet under the proposed framework. In that way, the Commission's illustrations could help to provide specific evidence of the significant regulatory relief the Commission and its staff contemplate.

Bilateral Transactions

The Commission's proposed expansion of its current Part 35 swaps exemption serves to underscore the need to fashion significant regulatory relief for the exchanges. The Commission s expansion would allow standardized, fungible and cleared derivatives transactions -- characteristics that courts have often found to be the legal touchstones of futures contracts -- to be exempt from virtually all of the Commodity Exchange Act's regulatory requirements. In so doing, the Commission is making a determination that futures contracts traded among eligible participants should be subject to the most modest of regulatory regimes unless traded on MTEFs as defined by the Commission.

The Commission nowhere offers, however, a logical, rational explanation of the regulatory lines it would draw. Nowhere does the Commission attempt to explain its allocation or reallocation of regulatory burdens. For example, the CFTC does not explain why a soybean futures contract needs no regulation when traded in a market with a single market-maker but needs extensive regulation when traded in a market with multiple market-makers. Similarly, the Commission does not explain why intermediaries only need to be regulated in such markets with multiple market-makers. Nor does the Commission explain how to reconcile its broad exemptive relief for energy futures traded on a system run by a single market-maker with its often-expressed position that pending congressional legislation goes too far in granting regulatory relief to energy derivatives.

In fact, the Commission s proposed expansion is, as written, commodity-neutral; it applies to derivatives in all commodities except equity securities. No explanation is offered for why the Commission would only consider a case-by-case DTF exemption for

certain commodities in the context of trading among multiple, competitive market-makers but would afford a blanket exemption where only a single market-maker exercises what could be viewed to be monopoly power. No explanation is offered for why an exempt MTEF's relief would be extended to trading of derivatives in only certain commodities but the Part 35 relief is not limited by commodity in any way. No explanation is offered for why the Commission has decided to deviate from the President's Working Group Report in this manner.

The Board of Trade has no objection to granting legal certainty to traditional privately-negotiated over-the-counter transactions. However, the Commission's proposal goes well beyond that principle by extending full exemptive relief to transactions that are indistinguishable in any meaningful way from the bulk of transactions that occur today on exchange floors and trading screens. The Commission has not articulated and could not articulate any rational basis for this discrepancy and for those aspects of its proposal that perpetuate the myth that only exchange markets need regulation under the CEA. The Board of Trade strongly urges the Commission to reconsider the regulatory and exemptive lines it is drawing and then to explain fully its rationale for drawing the lines it believes to be appropriate. After all, Congress admonished the Commission in 1992 to grant "fair and even-handed" exemptions to exchange and off-exchange markets alike under CEA §4(c). The CFTC's proposal for bilateral transactions, perhaps unwittingly, falls far short of that congressional mandate.

Conclusion

The Board of Trade greatly appreciates the Commission's efforts to reconfigure its regulatory regime. We applaud the Commission's efforts to complement regulatory reform legislation now pending in the House and Senate. The Board of Trade is hopeful that legislation will be enacted this year, addressing many of the issues covered by the Commission's proposal. In fact, the Commission's proposal has served well as a blueprint for that legislation in many respects.

Whether legislative or administrative in nature, the Board of Trade looks forward to working with the Commission to effectuate and implement regulatory relief for the exchanges. We envision a true working partnership with the Commission in which we would both strive to achieve common self-regulatory goals without imposing undue government oversight. We view the Commission's proposal as an important step in that process.

The Board of Trade thanks the Commission's staff for its hard work on this proposal. We would be happy to discuss our comments further with the Commission's staff at its convenience.

Respectfully submitted,

Dennis A. Dutterer
Interim President and Chief Executive Officer