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September 18, 2001

COMMENT

Via E-Mail (jwebb@cftc.gov)

Ms. Jean A. Webb
Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Rules Relating to Intermediaries of Commodity Interest Transactions;
66 *Fed. Reg.* 45221 (Aug. 28, 2001)

Dear Ms. Webb:

In the August 28, 2001 *Federal Register*, the Commodity Futures Trading Commission re-published a number of proposals primarily designed to provide intermediaries with greater flexibility in complying with Commission rules. NFA commends the Commission for its efforts in this area and is pleased to comment on these proposals.

As we stated in our August 7, 2000 comment letter to the Commission's original proposals, NFA strongly supports the Commission's initiatives to reinvent the regulatory structure in the futures industry. The Commission's proposals recognize the need for change to keep up with the technological and business developments that are invigorating the futures industry. The proposals also recognize that regulatory needs change with the type of product being traded and the nature of the investor. NFA continues to believe, however, that many of the Commission's proposals do not go far enough because they amend existing regulations rather than relying on core principles supplemented by interpretive guidance – an approach endorsed by the Commodity Futures Modernization Act of 2000 (CFMA) and supported by NFA.

Obviously, every regulation cannot be replaced with a core principle. Capital and segregation requirements, for example, must be spelled out in detail to ensure the integrity of customer funds. In many other areas, however, customers and

the markets can be adequately protected without this specificity and, in those areas, core principles can and should be used to provide intermediaries with more flexibility. NFA encourages the Commission to revisit all of its rules – including any rules amended by the Commission as a result of this proposal – as part of the intermediary study mandated by the CFMA.

Having expressed our strong support for the overall proposal, NFA would like to take this opportunity to comment on some of the specifics in the proposal.

Registration

NFA strongly supports the Commission's proposed amendment to the definition of "principal." As the Commission recognizes, the current definition is over-inclusive, often sweeping in companies and individuals who have no controlling influence over the registrant's activities. The proposed definition will alleviate the complexity related to the current holding company rules while capturing those individuals who actually have a controlling influence over a registrant's activities. We also support the conforming changes to the applicable rules under Part 4, which will limit disclosures related to business background, trading results and litigation history to those individuals who participate in making trading or operational decisions or supervise those who do so, thereby eliminating unnecessary disclosures about other individuals who simply happen to have an officer title.

NFA also supports the Commission's proposal to delete Rule 3.32 and replace it with a new paragraph (a)(2) to Rule 3.31. This proposal will make the process of adding new principals much simpler while continuing to provide the information necessary to ensure that the new principals meet the fitness requirements imposed by the Commodity Exchange Act.

NFA applauds the Commission for rethinking its position on obtaining certified financial statements from FCMs filing an initial registration application. As we stated in our August 7, 2000 comment letter, this requirement provides important protections for customer funds without imposing an undue burden on the FCM. We also continue to support the Commission's proposal to provide IBs with an alternative way to demonstrate their compliance with the financial requirements.

As the Commission notes, the CFMA allows broker-dealers, depository institutions, and institutions of the Farm Credit System to act as intermediaries on derivatives transactions execution facilities (DTFs) for qualified eligible participants without registering as FCMs or IBs. As the Commission also notes, this provision generally renders its earlier passporting proposal moot. NFA continues to believe,

however, that the registration process should be streamlined for dual securities and futures registrants by eliminating duplicate background checks even when the person services retail customers. NFA encourages the Commission to address this issue as part of the intermediary study mandated by the CFMA.

Fitness and Supervision

NFA strongly supports eliminating the current ethics training rule, which is far too detailed and administratively cumbersome. NFA also believes that the Commission's proposed approach to regulating this area in the future – a core principle supplemented by acceptable practice guidance that constitutes a safe harbor – is right on target and should be used as a model for regulation in other areas related to intermediaries.

Financial Requirements

NFA supports the Commission's proposal to look to the sophistication of the registered CTA, rather than the customer, when determining who can trade on a DTF through an FCM that does not meet the super-capital requirement. The conditions imposed by the Commission ensure that customers will be protected, since both the CTA and the FCM will be registered with the Commission and be Members of NFA and, therefore, subject to CFTC and NFA regulation. This approach is also consistent with the approach the legislation takes for commodity pools, which essentially looks at the sophistication of the CPO (through an asset test for the pool) rather than the sophistication of the participants.

Risk Disclosure and Account Statements

Although NFA agrees with the Commission that non-institutional customers should continue to receive the disclosure set forth in Rule 1.55, NFA does not believe the Commission's rule should dictate the specifics of how disclosures and consents are delivered and acknowledged. NFA would be willing to develop acceptable practices guidance in this area.

NFA looks forward to developing appropriate disclosure for retail customers trading on DTFs. If the Commission decides that it is appropriate to issue a Statement of Acceptable Practices for disclosure to institutional customers, NFA believes that the Commission should delegate that responsibility to NFA. We will, of course, work closely with the Commission and the industry in this process.

Trading Standards

The Commission's rules governing trading standards have proven to be effective without being overly burdensome, and NFA believes that retaining the current rules or replacing them with a core principle supplemented with acceptable practices guidance are both reasonable approaches. NFA is concerned, however, by the Commission's proposal to retain the current rules for contract markets while adopting a core principle for transactions on DTFs involving eligible contract participants. Since these markets may be trading the same products, or products with similar economic terms, the Commission must ensure that it does not impose stricter standards on one type of facility and therefore favor one market over the other. NFA encourages the Commission to treat these markets the same with regard to trading standards, whether it be through the existing regulations or a core principle with the appropriate guidance. NFA also believes that this is one area where there should be no distinction between institutional and non-institutional customers.

Recordkeeping

NFA fully supports the Commission's goal of encouraging greater use of information technology for recordkeeping purposes. NFA believes that the most effective way to do this is to replace Rule 1.31 with a core principle and acceptable practices guidance, which would follow the proposal NFA informally submitted to the Commission in December 1997. Specifically, the acceptable practices guidance would not contain any reference to specific technology but would require the registrant to meet general reliability and accessibility standards. NFA continues to believe that this approach provides for greater flexibility in dealing with constantly changing technology and eliminates the need to amend Rule 1.31 every time technology changes.

In this same vein, we do not agree that the Commission should codify the provisions of its Advisory relating to electronic transmission of account statements. We fully support the content of that Advisory, but codifying it reduces – rather than enhances – flexibility. We recommend that the Advisory be treated as acceptable practices guidance rather than be codified in a rule.

The Commission's proposal also gives customers and account controllers the flexibility to offset positions in their accounts using something other than the first in, first out (FIFO) method. NFA supports giving customers/account controllers this discretion provided that a customer uses a consistent approach in offsetting positions. This discretion should not be misused to permit customers to change offsetting instructions on every position, which could raise issues relating to improving delivery positions, tax avoidance, and money laundering.

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As NFA stated in its August 7, 2000 letter, NFA does not support the Commission's proposal to require CPOs and CTAs to disclose their method of offset in the disclosure document if they have instructed the FCM to offset positions using something other than the FIFO method. This disclosure is only material to a participant or client if a CPO/CTA calculates its compensation based on realized gains. If this is the case, then the CPO/CTA is already required to disclose how positions are closed out and what effect that has on fees. Therefore, amending Commission regulations to require this disclosure is unnecessary in some situations and redundant in others.

In closing, NFA is pleased with the Commission's proposal and believes it is an excellent first step in eliminating the one-size-fits-all approach to regulating the derivatives markets. NFA encourages the Commission to further evaluate these rules in connection with the intermediary study mandated by the CFMA and to provide additional flexibility in response to that study. NFA stands ready and willing to assist the Commission with the study and to develop acceptable practices guidance for the industry.

Very truly yours,

Thomas W. Sexton
Vice President and General Counsel
National Futures Association

(kpc/comments/intermediary rules)