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September 6, 2006

VIA E-MAIL: secretary@cftc.gov

Eileen Donovan
Acting Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

RE: Regulatory Governance - 71 Federal Register 38740 (July 7, 2006)

Dear Ms. Donovan:

HedgeStreet, Inc. ("HedgeStreet") welcomes the opportunity to comment in response to the acceptable practices under section 5(d)(15) of the Commodity Exchange Act (the "Act") ("Acceptable Practices") proposed by the Commodity Futures Trading Commission (the "Commission") in the July 7, 2006 Federal Register release ("Release"). HedgeStreet applauds the Commission in continually taking strides to update and enhance, as necessary, the current self-regulatory system in order to keep pace with the ever changing market place while ensuring market integrity and public trust in the United States futures markets.

HedgeStreet is a for-profit corporation organized under the laws of the state of Delaware. HedgeStreet is a fully electronic designated contract market ("DCM") and registered as a derivatives clearing organization ("DCO") with the Commission. HedgeStreet is a small exchange with relatively lesser trading volume than other larger exchanges. HedgeStreet currently offers both binary options and capped futures products directly to the retail public.

The passage of the Commodity Futures Modernization Act of 2000 ("CFMA") by Congress greatly improved the regulatory structure of the futures markets and enhanced competition among various new and existing market participants. Congress rejected the one-size-fits all prescriptive regulatory structure and replaced it with flexible core principles that focus on the objectives of audit trail and procedures rather than a precise methodology, while giving the Commission oversight responsibility of self-regulatory organizations ("SRO"). HedgeStreet believes that this present system of self-regulation is an effective regulatory model for the futures industry giving DCMs, like HedgeStreet, the flexibility to implement a regulatory structure while taking into consideration various factors such as the size of the DCM as well as its individual business model. For example, HedgeStreet is currently positioned differently than other exchanges. First of all, HedgeStreet currently operates as a non-intermediated DCM/DCO that allows the general public to come directly to



HedgeStreet and become members of HedgeStreet, the DCM, as well as clearing members of HedgeStreet, the DCO¹. Therefore, only HedgeStreet is authorized to handle member funds and orders on the HedgeStreet market. Secondly, HedgeStreet has contracted with the National Futures Association ("NFA") to conduct trade practice and market surveillance on trading and order data generated on HedgeStreet, review said data for any trade or market inconsistencies or exceptions and notify HedgeStreet if any apparent data anomalies are present based on such review. Thirdly, HedgeStreet is a start-up company that is funded by venture capital funds and other large investors that have an acute awareness of HedgeStreet's self-regulatory responsibilities. As a venture funded DCM/DCO directly accessible to the retail public, HedgeStreet is keenly aware that its primary responsibility is to satisfy its obligations as an SRO and has established a regulatory program designed to promote the utmost integrity in its market that compliments the unique business model of HedgeStreet.

Given this unique structure of the HedgeStreet market, HedgeStreet believes that the Acceptable Practices proposed by the Commission in the Release would create an undue burden on HedgeStreet as well as prescribe one-size-fits-all rules that are in direct conflict with the purpose of the Act, as amended by the CFMA. Though the Commission states that the Acceptable Practices provide a safe harbor for DCMs in complying with certain portions of Core Principle 15, HedgeStreet believes that setting a precedent in drafting such prescriptive requirements in the Acceptable Practices puts smaller DCMs, such as HedgeStreet, at a competitive disadvantage because the manner in which DCMs may satisfy their self-regulatory responsibilities would be severely limited. Such bright-line rules neglect to take into account the unique business model and size of a particular DCM. HedgeStreet respectfully requests that the Commission consider not implementing such prescriptive rules within the Acceptable Practices of Core Principle 15 and give each DCM the flexibility to develop rules and policies that compliment the particular DCM given its size and its business model in order to satisfy its regulatory responsibilities in accordance with the Act.

Board Composition

In the Release, the Commission proposes Board Composition Acceptable Practices which would require exchanges to have a board of directors that is comprised of at least fifty per cent "public" directors as that term is defined in the Release. This Board Composition Acceptable Practice would be quite burdensome to HedgeStreet given the current structure of the HedgeStreet board of directors.

HedgeStreet's articles of incorporation states that its board of directors will be comprised of seven (7) directors. Each director currently on the HedgeStreet board represents either a

¹ HedgeStreet requested that the Commission amend its order of designation as a DCM in September 2005 in order to be authorized to operate an intermediated market ("iMarket"). HedgeStreet's order of designation as a DCM was amended by the Commission on December 1, 2005 however, this intermediated market is not currently available.



member of HedgeStreet management or an interested shareholder of HedgeStreet, the corporation. Therefore, no HedgeStreet board member would meet the proposed definition of “public” as defined in the Release. This structure of the HedgeStreet board was reviewed by the Commission staff during the designation process in 2003 and 2004. In its Designation Memorandum to the Commission regarding HedgeStreet’s DCM application dated February 10, 2004, the Division of Market Oversight stated that, among other things, the rules HedgeStreet had in place² in order to satisfy the requirements of Core Principle 15³ were “Acceptable.” Some of these rules are briefly described below. Obligating HedgeStreet to now restructure the composition of its board in order to satisfy the “board composition of at least fifty percent public directors” proposed Board Composition Acceptable Practice would be extremely burdensome on HedgeStreet since it would be required to expend much time and financial resources to find acceptable candidates to sit on the HedgeStreet board as well as amend its articles of incorporation. However, HedgeStreet believes it has adequate controls in place that allow it to properly address any potential conflicts of interest on the HedgeStreet board in accordance with Core Principle 15 and HedgeStreet’s rules. For example, HedgeStreet Rules prohibit a member of the HedgeStreet board of directors or any disciplinary or oversight committee or subcommittee from taking part in deliberations or voting in any matter in which the board, committee or subcommittee member has an interest or has a relationship with a named party in interest.⁴ Specifically, HedgeStreet Rule 11.3 requires disclosure by board, committee, or subcommittee members of interests and relationships in certain circumstances. HedgeStreet board, committee, and subcommittee members shall not deliberate or vote on any matter in which the board, committee, or subcommittee member has an interest or has a relationship with a named party in interest and shall disclose such interests in accordance with HedgeStreet Rule 11.3⁵. The Secretary of the HedgeStreet board of directors, who is also General Counsel of HedgeStreet, has the responsibility of ensuring and documenting compliance with such HedgeStreet Rules in the board minutes, which are subject to review by the Commission during its customary rule enforcement review of HedgeStreet.

Secondly, the HedgeStreet board of directors is not involved in the day-to-day self-regulatory responsibilities of the exchange but has delegated that responsibility to the Chief Compliance Officer (“CCO”) who reports directly to the President and Chief Executive Officer of HedgeStreet. Part of the CCO’s responsibility is to manage the relationship with NFA. If NFA discovers any suspicious trading activity by members, NFA immediately notifies the CCO. In her sole discretion, the CCO or her designee investigates the circumstances surrounding the potential rule violation and informs NFA of HedgeStreet’s

² In the HedgeStreet DCM application, the relevant HedgeStreet Rules approved by the Commission were 1.6, 1.8, 9.1 and 9.3 (collectively “Conflicts Rules”). Due to subsequent amendments to the HedgeStreet rule book since February 2004, the text of these Conflicts Rules can be found in HedgeStreet Rules 2.6, 2.8, 11.1 and 11.3, respectively available at www.hedgestreet.com. No amendments to the Conflicts Rules have been made since they were originally approved by the Commission in February 2004.

³ See Staff Memorandum regarding HedgeStreet designation as a contract market dated February 10, 2004, pages 26 and 27 available at http://www.cftc.gov/dea/deahedgestreet_submissions_comments.htm

⁴ See HedgeStreet Rule 2.6 and Rule 11.3 (Dated August 16, 2006).

⁵ *Id.*



findings. If the CCO disagrees with NFA or fails to act, NFA will note such action which is subject to review by the Commission during its customary rule enforcement review of HedgeStreet or otherwise.

Therefore, HedgeStreet respectfully requests the Commission to consider the current structure of HedgeStreet including the rules in place governing the voting of board members, the role of the Chief Compliance Officer and NFA, and the undue burden HedgeStreet would be required to endure if it were required to change the entire structure of its board of directors to satisfy the proposed Board Composition Acceptable Practices.

Regulatory Oversight Committee

In the Release, the Commission proposes Regulatory Oversight Committee Acceptable Practices requiring a DCM to establish a board level Regulatory Oversight Committee ("ROC") that is comprised solely of "public directors." The establishment of a ROC would be difficult for HedgeStreet to implement at this time given both its current business model and the structure of its board of directors, however, HedgeStreet believes that its current regulatory process, including the rules and procedures described above, allow it to adequately monitor the market and minimize potential conflicts of interest in accordance with the Act.

Disciplinary Committee

In the Release, the Commission proposes Disciplinary Committee Acceptable Practices. HedgeStreet does not currently have Disciplinary Committees and instead hires hearing officers that determine whether disciplinary action should be brought against a member. However, HedgeStreet believes that such bright-line requirements are not necessary, especially since there have been no widespread inadequacies in exchange disciplinary committees as the Commission specifically acknowledges in the Release.⁶

Conclusion

HedgeStreet takes its responsibilities as a DCM and DCO very seriously and goes to great lengths to ensure market integrity and avoid conflicts of interests in accordance with the Act. HedgeStreet strongly supports the current self-regulatory structure of the United States futures markets and believes that the enactment of the CFMA was a very positive change for the futures industry. This regulatory structure has successfully prevented substantial market abuses, promoted public confidence as shown through the exploding volumes in the futures markets while allowing innovation and competition by permitting new exchanges, such as HedgeStreet, to enter the futures markets. However, the proposed Acceptable Practices in the Release seem to prescribe a pre-CFMA one-size-fits-all regulatory structure which could put smaller exchanges, such as HedgeStreet, at a competitive disadvantage by requiring it to spend monetary resources on fulfilling the

⁶ See 71 F. R. 38740, Page 38747



prescriptive requirements proposed in the Release. Therefore, HedgeStreet respectfully requests that the Commission reevaluate the proposed Acceptable Practices and continue to promote the regulatory flexibility afforded in the CFMA.

If you have questions or comments or would like further information, please do not hesitate to contact me at (650) 638-3511 or sford@hedgestreet.com.

Sincerely,

Stephanie Ford.

Stephanie Ford
Vice President, Legal and Compliance