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OFFICE OF THE SECRETARIAT  
September 11, 1998

**VIA FACSIMILE (202) 418-5521 AND OVERNIGHT MAIL**

Ms. Jean A. Webb  
Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

**COMMENT**

SEP 11 4 26 PM '98  
COMMODITY FUTURES  
TRADING COMMISSION  
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Re: Over-the-Counter Derivatives Concept Release

Dear Ms. Webb:

On May 6, 1998, the Commodity Futures Trading Commission ("Commission") requested comments on a concept release regarding its comprehensive regulatory reform effort designed to update the agency's oversight of both exchange and off-exchange markets, in particular, its approach to the over-the-counter ("OTC") derivatives markets. National Futures Association ("NFA") welcomes this opportunity to comment on the Commission's concept release. However, given the fact that NFA does not regulate these markets, NFA's comments will be limited to the two issues that are within our expertise: self-regulation and the need for a uniform definition of a sophisticated customer.

Over the past decade, the financial world has been revolutionized by an exponential increase in the use of complex financial tools known as OTC derivatives. Today, the notional value of the derivatives markets is estimated in the trillions of dollars. Given this growth, it is appropriate to examine the important questions raised by this concept release and engage in a healthy exchange of ideas. However, due to the highly transportable nature of these markets, the Commission must be sensitive to the need for legal certainty in the markets in conducting this dialogue. Therefore, NFA applauds the Commission's assurances that any changes to the regulations will be prospective only and urges the Commission to seek the widest range of input - from the industry, the public, other regulators and Congress - before taking any final action on the complex issues being discussed.



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NFA recognizes that the sophistication of the participants in the OTC derivatives markets must be a primary factor in determining the appropriate level of regulation. Based on our own 15 years of experience as an industry-wide self-regulatory body, we also feel that any regulation of the OTC markets should be primarily self-regulation. As you know, self-regulation has proven to be very effective in the futures industry and has also been successful in other industries. See Administrative Conference of the United States, Federal Agency Use of Audited Self-Regulation as a Regulatory Technique (1993). Self-regulatory organizations administer a wide range of rules and regulations governing everything from capital formation and capital requirements to registration and record keeping. These rules and regulations are applied in a rapidly changing business environment. Self-regulatory bodies are particularly well suited to react quickly to changing regulatory needs. Self-regulatory organizations retain a more informal structure with less bureaucracy. Such a framework provides a greater degree of flexibility. This is an especially important advantage of self-regulation in situations where new products cut across industry lines.

Self-regulation has the potential to provide greater incentives for compliance because the rules and regulations are drafted by persons with an intimate knowledge of the industry and tailored to the conditions of that particular industry. Moreover, industry members review and comment on proposed rules and regulations. The rules and regulations, therefore, are perceived by the regulated entities, because of their participation, as more reasonable and more fair. In addition, certain types of conduct are more effectively regulated by the regulated entity itself.

Indeed, the Derivatives Policy Group ("DPG") created a voluntary oversight framework for the OTC derivatives markets and its participants. The DPG is a form of a self-regulatory organization. Though not subject to federal oversight, DPG promotes free but fair markets through its guidelines. This organization is tailored specifically to the market and its participants. Most of the participants in the OTC derivatives markets have the sophistication and wherewithal to protect themselves. Thus, a voluntary association may be appropriate for such markets given the participants' sophistication, their capacity to evaluate the risks and rewards, and their ability to assess their counterparties and/or intermediaries.

Voluntary self-regulation does, of course, have its drawbacks, since industry participants cannot be forced to become members or to comply with the standards adopted by the self-regulatory organization. However, given the highly sophisticated clientele involved in the OTC derivatives markets and the likelihood that they may refuse to deal with firms that do not comply with these self-regulatory initiatives, voluntary self-regulation



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may work in the OTC derivatives markets. We also note that there have not been any widespread regulatory problems since the DPG adopted its voluntary guidelines.

The Commission asked for comments on whether the definition of eligible swap participant should be revised. In NFA's opinion, the answer to that question is "yes." On June 5, 1998, NFA petitioned the Commission to adopt a uniform definition for those types of customers who are generally considered sophisticated, describing those customers covered by the uniform definition as "enumerated persons." Having several different definitions provides inconsistent results. It also creates administrative inefficiencies and possible confusion for FCMs attempting to apply the definition in different contexts.

The proposed uniform definition generally follows the definition of eligible swap participant currently found in CFTC Regulation 35.1 but with several modifications including:

- Imposing a \$5 million asset requirement on investment companies, to be consistent with the asset requirement imposed on commodity pools;
- Broadening the qualifications for natural persons to allow them to meet either the current test for eligible swap participants or the current test for qualified eligible participants and expanding the category for natural persons to include sole proprietorships and self-directed benefit plans;
- Including CPOs, CTAs, floor brokers and floor traders;
- Including investment advisers registered under the Investment Advisor's Act of 1940; and
- Expanding the list of money managers who can provide management advice to ERISA plans, or their foreign equivalents, to include the foreign equivalents of regulated investment advisors and CTAs.

NFA believes that the proposed definition of "enumerated person" appropriately describes and identifies those persons and entities that qualify as appropriate persons



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under § 4(c) of the Commodity Exchange Act ("CEA") and should be considered eligible swaps participants.

NFA appreciates this opportunity to comment on the Commission's approach to regulation of the OTC derivatives markets. NFA urges the Commission to give serious consideration to these comments and to the comments of entities that participate in the OTC derivatives markets.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Daniel J. Roth', written over a horizontal line.

Daniel J. Roth  
General Counsel

/pjf(LtrsWebb-Otcderivatives.KMG)