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U.S. COMMODITY FUTURES TRADING COMMISSION

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OFFICE OF THE SECRETARY

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DIVISION OF
TRADING & MARKETS

Memorandum

- TO: The Commission
- FROM: The Division of Trading and Markets *JL*
- RE: Federal Register Release Notice Requesting Comments Concerning Proposed Rule Amendment to Commission Regulation 1.41
- RECOMMENDATION: That the Commission issue the attached Federal Register Notice of Proposed Rule Amendment.
- CONSULTED: Division of Economic Analysis *MS*
Division of Enforcement *(by Mr. Cetc. by T. Arbi T)*
Office of the Executive Director *Stendish*
Office of the General Counsel *De Weavill by Seaman*
- REVIEWED: Office of the Inspector General *ARF*
- STAFF CONTACT: David P. Van Wagner (x5481)

Attached for circulation and sign-off is a proposed Federal Register release giving notice of and requesting comments concerning a proposed rule amendment to Commission Regulation 1.41. Subject to stated conditions, the proposed rulemaking would permit contract markets with at least one non-dormant contract to place new rules and rule amendments into effect on the business day following their submission to and receipt by the Commission. The proposed rulemaking is part of the Commission's ongoing program of regulatory reform of procedures for the review of contract market rules and rule amendments.

COMMODITY FUTURES TRADING COMMISSION

Proposed Revision of the Commission's Procedure for the Review of Contract Market Rules

AGENCY: Commodity Futures Trading Commission

ACTION: Request for Comment

SUMMARY: As part of an ongoing program of regulatory reform, the Commodity Futures Trading Commission ("CFTC" or "Commission") is proposing to revise its procedures for the review of contract market rules and rule amendments. Subject to stated conditions, the proposed rulemaking would permit contract markets to place new rules and rule amendments into effect on the business day following their submission to and receipt by the Commission.

DATE: Comments must be received on or before [sixty days after publication].

ADDRESSES: Comments should be mailed to Jean A. Webb, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581; transmitted by facsimile to (202) 418-5521; or transmitted electronically to [secretary@cftc.gov].

FOR FURTHER INFORMATION CONTACT: David P. Van Wagner, Associate Director, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581. Telephone: (202) 418-5490.

SUPPLEMENTARY INFORMATION

I. Statutory and Regulatory Background

Section 5a(a)(12)(A) of the Commodity Exchange Act (“Act”) provides, among other things, that all rules¹ of a contract market that relate to terms and conditions² in futures or option contracts traded on or subject to the rules of a contract market must be submitted to the Commission for its prior approval. Section 5a(a)(12)(A) further requires that contract markets submit all other rules to the Commission for prior review. Other sections of the Act require rules addressing specified matters to be explicitly approved by the Commission.³

Pursuant to Section 5a(a)(12)(A), the Commission adopted Regulation 1.41 which sets forth procedures for the submission and review of proposed contract market rules. These procedures vary depending on the type of rule that the contract market seeks to implement. Paragraph (b) of Regulation 1.41 establishes review procedures for rules that relate to terms and conditions of a contract. Paragraph (c) of the regulation establishes review procedures for most rules that do not relate to terms and conditions.⁴ Commission Regulation 1.41 also contains

¹ Commission Regulation 1.41(a)(1) defines “rule” of a contract market to mean “any constitutional provision, article of incorporation, bylaw, rule, regulation, resolution, interpretation, stated policy, or instrument corresponding thereto, in whatever form adopted, and any amendment or addition thereto or repeal thereof, made or issued by a contract market, or by the governing board thereof or any committee thereof.”

² Commission Regulation 1.41(a)(2) defines “terms and conditions” to mean “any definition of the trading unit or the specific commodity underlying a contract for the future delivery of a commodity or commodity option contract, specification of settlement or delivery standards and procedures, and establishment of buyers’ and sellers’ rights and obligations under the contract.”

³ For example, Section 4f(b) of the Act requires that contract markets must receive Commission approval for any minimum financial standards that they establish for futures commission merchants and introducing brokers.

⁴ In Federal Register releases published on March 7, 1997, (62 FR 10434 and 62 FR 10427), the Commission adopted amendments to streamline and to expedite the procedures contained in Regulations 1.41(b) and (c). Those amendments established alternative procedures that

procedures for the filing of other types of exchange rules that may be implemented before or simultaneous to filing with the Commission. These include, among others, rules that are exempt from the requirements of Section 5a(a)(12)(A) of the Act (Regulation 1.41(d)), temporary emergency rules (Regulation 1.41(f)), and physical emergency rules (Regulation 1.41(g)).

Section 4(c) of the Act provides that “[i]n order to promote responsible economic or financial innovation and fair competition,” the Commission may exempt any agreement, contract, or transaction (or class thereof) that is otherwise subject to Section 4(a) of the Act⁵ from any of the requirements of that provision or from any other provision of the Act except Section 2(a)(1)(B). The Commission may not grant such an exemption unless it determines that the agreement, contract, or transaction would be consistent with the public interest.

Pursuant to this authority, the Commission is proposing to exempt contract markets from the rule review requirements of Section 5a(a)(12)(A) of the Act and from the regulations adopted thereunder. The Commission would continue to pursue vigorously its surveillance and enforcement activities. The Commission intends that this proposed rulemaking, and the manner in which the Commission would conduct oversight

shortened the Commission’s timeframe for reviewing contract market rules. Under these “fast track” review procedures, rule changes generally can be deemed approved, or permitted to be put into effect without Commission approval, ten days after Commission receipt, unless the Commission takes action to commence review of the rule for a 45-day period (or 75-day period in the case of rules published for comment in the Federal Register). The rules of certain non-cash settled contracts may be deemed approved forty-five days after receipt by the Commission.

⁵ Among other things, Section 4(a) of the Act prohibits any person from executing, confirming the execution of, or otherwise dealing in any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery, unless such transaction is conducted

of contract market rules adopted pursuant to such a provision, should “promote responsible economic or financial innovation and fair competition.”

II. The Proposed Amendments

A. Description of the Procedure

Proposed Commission Regulation 1.41(z) would permit contract markets⁶ to place a new rule into effect the business day after the Commission has received submission of the rule. There would be no requirement, as under current regulations, to allow for prior Commission review of the rule. The submission would have to include a brief explanation of the rule and a description of any substantive opposing views expressed by members of the contract market or others with respect to the rule. In addition, the contract market would be required to certify that the rule submitted neither violates nor is inconsistent with any provision of the Act or the Commission’s regulations. Although the form and content requirements for Regulation 1.41(z) rule filings would be more abbreviated than those for rule filings pursuant to Regulations 1.41(b) or 1.41(c), the Commission would retain its authority under Section 4(d) of the Act and other relevant provisions to conduct investigations, to gather information, and generally to oversee the contract market’s adherence with the requirements and conditions of the Act.

subject to the rules of a board of trade which has been designed by the Commission as a contract market for such commodity.

⁶ For the purposes of Regulation 1.41, the term “contract market” includes a clearing organization that clears futures contract transactions. Regulation 1.41(a)(3).

B. Eligibility for the Procedure

1. Previous Designation as a Contract Market

In a companion Federal Register release (the “Companion Release”), the Commission is adopting today a new Regulation 5.3 that establishes a similar streamlined procedure for the listing of contracts, and their subsequent amendment, without Commission prior review and approval.⁷ That procedure will be available solely to boards of trade that are designated as contract markets in at least one contract that is not dormant.⁸ In its comment letter on that proposal, the Chicago Mercantile Exchange supported this provision, noting that start-up exchanges are not appropriate for this procedure, as “the initial designation of a board of trade as a contract market entails a more lengthy review and analysis of its trading and clearing systems and its self-regulatory programs.” The Commission believes that this rationale is equally applicable to the review of rules from inactive contract markets. Accordingly, the Commission is proposing to make the Regulation 1.41(z) process available solely to contract markets which are designated in at least one non-dormant contract.

⁷ The new designation procedure was proposed on July 20, 1999. 64 FR 40528 (July 27, 1999).

⁸ See Commission Regulation 5.2.

2. Consistency with the Act and the Commission Regulations

A contract market would be required to submit a certification that the rule being implemented neither violated nor was inconsistent with any provision of the Act or the Commission regulations. This is the standard used by the Commission in determining whether to disapprove a rule.⁹ Thus, the Regulation 1.41(z) procedure would not be available for contract market rules that, in the absence of some type of Commission exemption, would violate, or be inconsistent with the Act or the Commission regulations. For example, under Regulation 1.38(a), transactions are required to be executed in an open and competitive manner. Regulation 1.38(a), however, also permits exchanges to adopt rules for the execution of non-competitive transactions so long as such rules are submitted to and approved by the Commission. Thus, Regulation 1.38(a) reserves to the Commission the authority to determine what types of trading procedures need not meet the open and competitive requirement. Accordingly, non-competitive trading rules, such as certain block trading procedures, would not qualify for the Regulation 1.41(z) process because, absent affirmative Commission approval under Regulation 1.38, they would violate a provision of the regulations.

C. Legal Certainty

In the Companion Release, the Commission is adopting a provision that makes clear that, among other things, contracts listed pursuant to Rule 5.3 are not void or voidable in the event the Commission initiates a proceeding to disapprove, to alter, to amend, or to require a contract market to adopt a specific trading rule or procedure or to refrain from taking a specific action. The Commission is including a similar provision in proposed Regulation 1.41(z)(2) to ensure

⁹ See Standard to be Applied by the Commission in Disapproving Contract Market Rules. 45 FR 34873 (May 23, 1980).

legal certainty for transactions effected subject to rules implemented pursuant to Regulation 1.41(z). Although the Commission would not approve, affirmatively allow into effect, or deem approved any contract market rules that were implemented pursuant to this proposed rulemaking, Regulation 1.41(z)(3) would expressly state that the submitting contract market would not be exempt from any provision of the Act or the Commission's regulations other than the rule review requirements of Section 5a(a)(12) of the Act and related Commission regulations. Therefore, for example, contract markets implementing rules pursuant to Regulation 1.41(z) would continue to be subject to the rule enforcement obligations of Section 5a(a)(8) of the Act.

III. Request for Comments

The Commission is requesting comment on any aspect of the proposed procedure, including, but not limited to, the following.

A. Exclusivity of Regulation 1.41(z) Process

Under the current rule review process of Regulation 1.41(b), rules relating to terms and conditions must be submitted for Commission approval. Rules that do not relate to terms and conditions must be submitted for Commission review pursuant to other provisions of Regulation 1.41. Unless the Commission determines otherwise, such rules may be deemed approved or placed into effect, as appropriate.

Contract markets on occasion specifically request that the Commission approve a rule that otherwise did not require Commission approval under any provision of the Act or the Commission Regulations. Contract markets rules processed under Regulation 1.41(z) would simply be placed into effect and would not be considered to have been "approved" by the Commission. The Commission is proposing the Regulation 1.41(z) procedure as an alternative to the existing Regulation 1.41 process. Under this proposal, contract markets could still submit

a rule pursuant to Regulation 1.41(b) or 1.41(c), even if that rule qualified for the Regulation 1.41(z) process. However, the existence of these various rule review procedures may create confusion for market participants with respect to the regulatory history of rules and may lead to the inaccurate impression that rules adopted pursuant to Regulation 1.41(z) or 5.3 have been reviewed by the Commission.¹⁰

As a means of avoiding this possible confusion, the Commission requests comment on whether it should preserve the current approval process for rules that would qualify for the Regulation 1.41(z) process or whether the proposed Regulation 1.41(z) process should be the only process available. Similarly, should the Commission make the Regulation 5.3 procedure adopted today the sole means of listing new contracts and of amending their terms and conditions?

B. Suspension of Effectiveness of a Rule

The Act requires notice and opportunity for hearing before a rule may be disapproved or altered. This process can be lengthy. Market participants and others adversely affected by a rule change could incur harm during this period. The Commission requests comment on whether it should reserve the authority, under Regulation 1.41(z), to stay or to suspend the operation of an exchange rule once it has initiated a proceeding under Section 5a(a)(10), 5a(a)(12), 8a(7) or 8a(9) of the Act.

C. Contracts with Open Interest

The Commission is requesting comment on whether the Regulation 1.41(z) process should be available for rule amendments relating to contracts that have open interest at the time

¹⁰ So, for example, rules that were adopted pursuant to Regulation 1.41(z) or 5.3 would not have been reviewed by the Commission for possible antitrust implications.

the rule is implemented. Could the rights of such position holders be impacted by a rule change affecting their contracts? How could the Commission and/or a contract market ensure that traders are not harmed by the adoption of a rule amendment for a contract with open positions?

D. Emergency Rules

In Section 5a(a)(12)(B) of the Act, Congress mandated that the Commission create a special process for the implementation of contract market rules on an emergency basis without Commission approval. Section 5a(a)(12)(B) was adopted in the Futures Trading Practices Act of 1992. The legislative history for this provision indicates that “the Committee [on Agriculture] was concerned that the Commission might not be actively engaged in decisions by exchanges to invoke their emergency powers.”¹¹ The Commission notes that proposed Regulation 1.41(z) may obviate the need for a contract market to follow Section 5a(a)(12)(B), and its implementing regulatory provision, Regulation 1.41(f), when adopting emergency rules. The Commission requests comment on how to differentiate an emergency rule provision from any other rule that could be adopted pursuant to proposed Regulation 1.41(z).

E. New Electronic Trading Systems

As noted, the Regulation 1.41(z) process would not be available to a board of trade that is not designated as a contract market in at least one non-dormant contract. The implementation of a new electronic trading system and adoption of related rules could be viewed as being analogous to the organization of a new exchange in many respects. The Commission requests comment on whether proposed rules implementing a new electronic trading system at an existing contract market should be processed under for Regulation 1.41(z).

¹¹ See Report No. 101-236 to accompany H.R. 2869, 101st Cong., 1st Sess. at 20.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (“RFA”), 5 U.S.C. 601 et seq., requires that agencies, in promulgating rules, consider the impact of these rules on small entities. The Commission has previously determined that contract markets are not “small entities” for purposes of the RFA, 5 U.S.C. 601 et seq. 47 FR 18618 (April 30, 1982). This rulemaking establishes streamlined procedures for the review of contract market rules and rule amendments. Accordingly, the Chairman, on behalf of the Commission, hereby certifies, pursuant to section 3(a) of the RFA, 5 U.S.C. 605(b), that the action taken herein will not have a significant economic impact on a substantial number of small entities.

B. Agency Information Activities: Proposed Collection; Comment Request

Proposed Regulation 1.41(z) contains information collection requirements. As required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), the Commission has submitted a copy of this section to the Office of Management and Budget (“OMB”) for its review.

Collection of Information: Rules Pertaining to Contract Markets and Their Members, OMB Control Number 3038-0022.

The effect of the proposed Regulation 1.41(z) will be to reduce the burden previously approved by OMB for Regulations 1.41(b) and (c) by 4290 hours because the predominant number of rule submissions will be made pursuant to new proposed Regulation 1.41(z) instead of either Regulation 1.41(b) or (c). The burden associated with the proposed new Regulation 1.41(z) is estimated to be 858 hours which will result from compliance with the requirements for information required for Regulation 1.41(z) submissions.

The estimated burden of new Regulation 1.41(z) was calculated as follows:

Number of respondents: 11
Annual responses by each respondent: 26
Total annual responses: 286
Estimated average hours per response: 3
Annual Reporting Burden: 858 hours

The revised estimated burden of Regulations 1.41(b) and (c) (which was 4,125 hours and 825 hours, respectively) is:

Regulation 1.41(b)
Number of respondents: 11
Annual responses by each respondent: 2
Total annual responses: 22
Estimated average hours per response: 25
Annual Reporting burden: 550 hours

Regulation 1.41(c)
Number of respondents: 11
Annual responses by each respondent: 2
Total annual responses: 22
Estimated average hours per response: 5
Annual Reporting burden: 110

The burden associated with the entire collection (3038-0022) including this proposed rule is as follows:

Number of respondents: 15,893
Number of responses per year: 434,052
Estimated average hours per response: 1.8095

Annual Reporting Burden: 785,443 hours

This annual reporting burden of 785,443 hours represents a reduction of 3,432 hours as a result of proposed new Regulation 1.41(z).

Organizations and individuals desiring to submit comments on the information collection requirements should direct them to the Office of Information and Regulatory Affairs, OMB, Room 10235, New Executive Office Building, Washington, DC 20503; Attention: Desk Officer for the Commodity Futures Trading Commission.

The Commission considers comments by the public on this proposed collection of information in –

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- Evaluating the accuracy of the Commission's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of collection of information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques or other forms of information technology; e.g., permitting electronic submission of responses.

OMB is required to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the Federal Register. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the Commission on the proposed regulations.

Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street, NW, Washington DC 20581, (202) 418-5160.

List of Subjects in 17 CFR Part 1

Commodity Exchanges, Contract markets, Rule review procedures.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act and, in particular, sections 4, 4c, 5, 5a, 6 and 8a thereof, 7 U.S.C. 6, 6c, 7, 7a, 8, and 12a, the Commission proposes to amend Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 8, 9, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24, unless stated otherwise.

2. Section 1.41 is revised to read as follows:

§ 1.41 Contract market rules; submission of rules to the Commission; exemption of certain rules.

* * * * *

(z) Exemption from the rule review procedure requirements of Section 5a(a)(12) of the Act and related regulations.

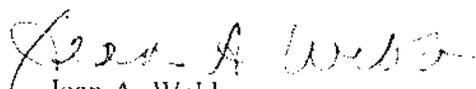
(1) Notwithstanding the rule filing requirements of Section 5a(a)(12) of the Act and related Commission regulations, a contract market may place a rule into effect without prior Commission review or approval provided that:

(i) the contract market has filed a submission for the rule, and the Commission has received the submission at its Washington, D.C. headquarters and at the regional

office having jurisdiction over the contract market by close of business on the business day preceding implementation of the rule;

- (ii) the contract market is designated in, or clears, at least one commodity contract, under Sections 4c, 5, 5a(a) and 6 of the Act, which is not dormant within the meaning of Section 5.2 of Part 5 of the Commission's regulations; and
 - (iii) the rule submission includes:
 - (A) the text of the rule (in the case of a rule amendment, brackets must indicate words deleted and underscoring must indicate words added);
 - (B) a brief explanation of the rule;
 - (C) a description of any substantive opposing views expressed by members of the contract market or others with respect to the rule; and
 - (D) a certification by the contract market that the rule neither violates nor is inconsistent with any provision of the Act or of the regulations thereunder.
- (2) A transaction effected subject to a rule implemented under this regulation shall not be void or voidable as a result of:
- (i) a violation by the contract market of the provisions of this section; or
 - (ii) the initiation, conduct or disposition of any Commission proceeding to disapprove the rule or require the contract market to revise the rule.
- (3) This regulation does not exempt contract markets from any provision of the Act or the Commission's regulations, except for the rule review requirements of Section 5a(a)(12) of the Act and related Commission regulations.

Issued in Washington, DC on November 17, 1999, by the Commission.


Jean A. Webb
Secretary of the Commission.