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December 6, 1999

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COMMENT

Commissioner David D. Spears
U. S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st street, NW
Washington, DC 20581

Re: Response to Proposed Changes in CFTC Regulation of U.S. Futures Markets

Dear Commissioner Spears:

Enclosed is a position paper from National Farmers Organization (NFO) giving our response to the proposed changes in the regulation of the U.S. futures market by the Commodity Futures Trading Commission (CFTC), as put forth in the Final Rules relating to *Revised Procedures for Listing New Contracts* and the *Proposed Revision of the Commission's Procedure for the Review of Contract Market Rules*, published in the Federal Register on November 26, 1999 (Volume 64, Number 227).

This position paper is for distribution to the Agricultural Advisory Committee, which is scheduled to meet on December 8, 1999.

Thank you for your interest and assistance.

Sincerely,



Richard Ellinghuysen
Secretary

Enclosure

cc: Jean A. Webb

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**Response by National Farmers Organization (NFO) to Proposed Changes in the
Regulation of the US Futures Markets by the Commodity Futures Trading
Commission (CFTC)
December, 1999**

This paper is the official response of the National Farmers Organization (NFO) to the proposed changes in the regulation of the US futures markets by the Commodity Futures Trading Commission (CFTC) as put forth in the Final Rules relating to *Revised Procedures for Listing New Contracts* and the *Proposed Revision of the Commission's Procedure for the Review of Contract Market Rules*, published in the *Federal Register* on November 26, 1999 (Volume 64, Number 227).

Direct responses:

CFTC: Should the exchanges be exempt from the current fast track rules and be allowed to place new rules into effect the business day after the Commission has received submission of the rule?

NFO: NO.

CFTC: Should the exemption specifically require that contract amendments be implemented only in delivery months with no open interest at the time the rule is made effective?

NFO: YES. If the exemption is given.

NFO is opposed to the Final Rules requirement that boards of trade need only file contract certification with the Commission no later than the close of business of the business day preceding the contracts listing. NFO believes that it is in the interest of the greater public that the CFTC fast-track be utilized in all new contract implementation and any subsequent amendments thereto.

Current fast-track procedure gives the CFTC a ten-day window for contract review with the opportunity 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*). Non-cash settled contracts may be deemed approved forty-five days after receipt by the CFTC. Given the nature of the futures markets as public markets, it is of vital importance that the public and its agency, the CFTC, have the opportunity to scrutinize and as necessary, provide direction in regulating the function of these markets prior to new and amended contract implementation.

Considerations:

The fundamental question raised by the significant change in direction of the Commodity Futures Trading Commission (CFTC) that the *Revised Procedures for Listing New Contracts* -Final Rule, in combination with the request for comments on the *Proposed Revision of the Commission's Procedure for the Review of Contract Market Rules* is this: Is the assumption underlying the US futures markets the idea that these exchanges and markets are based on the public good, or private good? If the exchanges and markets are operated for the benefit of the public at large, then a regulatory system that involves a form of review prior to implementation by a publicly funded agency is an appropriate and necessary good. If the exchanges and the markets are operated for the benefit of private organizations and their members or share holders, then a regulatory system that simply polices the function of a freely trading market is the most appropriate regulatory approach.

The Final Rules and Proposed Rules in essence change the role of the CFTC from that of ensuring the broader public good, to that of controlling potential public harm. These are quite different from one another. To use a health care analogy, the one seeks to maintain health and vitality; the other seeks to avoid death. The quality of life is distinctly different.

The changes resulting from the Final and Proposed Rules create greater freedom from bureaucracy for the futures exchanges and reduce "preventative" oversight of the futures markets by the CFTC. The changes significantly remove CFTC actions based on preventing exchange rule violations and shift the CFTC's emphasis to primarily "law enforcement." Instead of requiring preventive contract evaluation and approval by the CFTC, the exchanges are allowed the freedom to create and implement new futures contracts without approval. The Proposed Rules also allow amendments to existing futures instruments to be made and implemented without prior CFTC approval and upon 24 hour notification.

In reviewing the statements of Final Rule published in the Federal Register, the CFTC indicates throughout, an understanding of many of the ramifications inherent in adopting these changes. In the Final Rules the CFTC proposes maintaining the role of enforcement of the rules, and to a great degree, abandoning the role of preventing inadequate, inappropriate or illegal contracts from being created and traded. The CFTC accepts the arguments put forward by the futures exchanges that they will self-police and that their interests are their customers' interests. The implication of these statements is that there isn't significant new risk in allowing the exchanges the latitude of trading contracts without CFTC review in advance. If a contract is found to be illegal or in violation of the Act, the illegal contracts are to be enforced anyway.

NFO has difficulty in comprehending the rule that an exchange certified contract that was later determined by the CFTC to be in violation of the Act, remains valid and enforceable. We understand the potential market confusion and potential damage that would follow from such an event if the contracts were not enforced. While that is an

important concern, it does not mitigate the legal question that must remain. If an exchange-approved contract is found by the CFTC to be illegal and in violation of the Act, on what basis must the holders of that instrument be bound to the illegal terms? This question may not readily be answered outside of Court. This is a considerably different context than we have been experiencing when all contracts have been required to be reviewed by the CFTC before trading can commence.

The National Farmers Organization sees the creation of new risk as a result of these Rules. We are reluctant to rely solely on the enforcement role of the CFTC in lieu of the preventative role that the CFTC has been playing. Will the US futures industry remain stable with the CFTC acting only in a policing role? We question the enforceability of illegal contracts that have never received CFTC approval, and believe that a test of that system is certain to occur at some point in time. Can the US avoid some of the market shattering incidents that have occurred at foreign exchanges? One could argue that the ability of the US futures markets to avoid such events is due to the preventative stance that exists as a result of the current CFTC system. NFO is reluctant to support dismantling a system whose effectiveness has become the envy of many foreign nations.

Regarding the question of whether exchanges should be able to make amendments to contracts without an initial review by the CFTC, NFO believes that the stability of our markets and the need for regulatory oversight of the futures contract markets are such that contract amendments are best proposed through CFTC's existing fast-track system. This style of approach allows review of the potential impact of the changes and gives the CFTC the opportunity to commence review for a 45-day period (or 75-day period in the case of rules published for comment in the Federal Register). Given the nature of the futures markets as public markets, it is of vital importance that the public has the opportunity to scrutinize and provide opinion and direction toward the regulation and function of these markets.

A practical question that the exchanges are grappling with is how to maintain a competitive edge with foreign exchanges that are less subject to forms of pre-approval or a review process. The adoption of much of the Final Rules would greatly impact this. It is important however, that we don't "throw the baby out with the bath water."

Since these markets do impact the broader public and not only those organizations and individuals engaged in the trading of the futures markets, we believe that it is imperative that the public and the agency of the public, the CFTC, have an opportunity to become informed, and to respond to the creation of or changes in futures contract instruments. NFO proposes that the current fast-track process be utilized on new and amended contracts. This system provides a valuable "security check as the product moves out through the door."

With regard to the question of whether contract amendments should be implemented only in delivery months with no open interest at the time the rule is made effective: Yes, most definitely. It is not acceptable to change a contract and its terms in the midst of trading it. That is like changing the rules of the game while it's being played.

Conclusion:

It is NFO's belief that the US futures markets exist for the benefit of both the public and the private sector. NFO is sensitive to the needs of the exchanges to act more rapidly in the ever changing global marketplace. NFO is also sensitive to the needs of the broader public who do not trade these markets themselves, but whose lives are impacted by the markets and those who trade them. The design of a federal regulatory agency has never been to add value to a business process, but rather to do what individual citizens cannot do for themselves: to assure opportunity by requiring fairness and openness. The cursory review that the fast-track system provides is the least we can do to insure our public a sound and secure futures industry. This is an industry with broad and far reaching impacts into the financial lives of this nations citizenry.

We believe it is imperative that the public and its agency the CFTC, have the opportunity to consider the potential ramifications of new or amended contracts prior to their implementation.

We oppose the Final Rules as they are currently published. We wish to have the fast-track rules established as the formal process for new and amended contracts. The Final and Proposed Rules in their current form removes the broader public interest too far from the process. We are concerned that the potential harm stemming from a contract determined to be illegal, and the possible market quakes and loss of public trust, places the US financial system and the public at unnecessary risk. In this light the cursory review that the fast-track system provides seems a small investment in both time and money.