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COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 16, and 38

RIN 3038-AD09

Core Principles and Other Requirements for Designated Contract Markets

AGENCY: Commodity Futures Trading Commission.

ACTION: Final Rules.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is adopting new and amended rules, guidance, and acceptable practices to implement certain statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The final rules, guidance and acceptable practices, which apply to the designation and operation of contract markets, implement the Dodd-Frank Act's new statutory framework that, among other things, amends section 5 of the Commodity Exchange Act ("the Act" or "CEA") concerning designation and operation of contract markets, and adds a new CEA section 2(h)(8) to mandate the listing, trading and execution of certain swaps on designated contract markets ("DCMs").

DATES: **Effective Date**: The rules will become effective [60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. **Compliance Date for contract markets that have obtained designation on, or prior to, the date of publication of this release**: Designated contract markets must comply with the rules adopted in this

release (except § 38.151(a)) by [60 DAYS AFTER THE *EFFECTIVE DATE*]; and must comply with § 38.151(a) in accordance with the timeline described therein.

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I. Background

A. Title VII of the Dodd-Frank Act.

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act.[1] Title VII of the Dodd-Frank Act[2] amended the CEA[3] to

[1] See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act").
[2] Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010."

establish a comprehensive, new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight.

B. The Dodd-Frank Act Amendments Applicable to Designated Contract Markets.

In this final rulemaking, the Commission is establishing the regulatory obligations that each DCM must meet in order to comply with section 5 of the CEA, as amended by the Dodd-Frank Act, initially upon designation and thereafter on an ongoing basis.

Section 735 of the Dodd-Frank Act amended section 5 of the CEA pertaining to the designation and operation of contract markets, by: (i) eliminating the eight criteria that must be met for designation as a contract market, contained in former section 5(b) of the CEA; (ii) amending most of the core principles, including incorporating most of the substantive elements of the former designation criteria, and requiring that all DCMs demonstrate compliance with each of the core principles as a condition of obtaining and maintaining designation as a contract market; and (iii) adding five new core principles, including Core Principle 13 (Disciplinary Procedures), Core Principle 20 (System

[3] 7 U.S.C. 1 et seq. (amended 2010).

Safeguards), Core Principle 21 (Financial Resources), Core Principle 22 (Diversity of Boards of Directors), and Core Principle 23 (Securities and Exchange Commission).[4]

In addition, section 723(a)(3) of the Dodd-Frank Act added section 2(h)(8) of the CEA to require, among other things, that swaps that are required to be cleared must be executed either on a DCM or on a Swap Execution Facility ("SEF"),[5] unless no DCM or SEF makes the swap "available to trade."[6] Section 5h(a)(1) of the CEA, as amended by the Dodd-Frank Act, also prohibits any person from operating a facility for the trading and processing of swaps unless the facility is registered as a SEF or a DCM. Accordingly, unless otherwise specified in this release, each of the 23 core principles and the final implementing regulations, guidance and acceptable practices, apply to all "contracts" listed on a DCM, which will include swaps, futures and options contracts. The rules adopted in this release also implement relevant provisions related to the trading and execution of swaps on DCMs.

On December 22, 2010, the Commission published proposed regulations to implement the statutory provisions of the Dodd-Frank Act relevant to the designation and operation of DCMs ("DCM NPRM"), under part 38 of the Commission's regulations.[7]

The proposed rulemaking was subject to an initial 60-day comment period, which closed on February 22, 2011. The comment period was subsequently reopened on two

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[4] New Core Principle 13 is verbatim of former Designation Criterion 6.

[5] The Commission proposed rules governing the registration and operation of SEFs in a separate, rulemaking titled "Core Principles and Other Requirements for Swap Execution Facilities." 76 FR 1214, Jan. 7, 2011. The core principles applicable to DCMs pursuant to section 5 of the Act and the core principles applicable to swap execution facilities pursuant to section 5h of the Act include, in a number of instances, similar or identical language. Although the Commission's interpretation of specific language in section 5 of the Act may inform its interpretation of similar or identical language in section 5h of the Act, and vice versa, the Commission may interpret the core principles applicable to each category of registered entity in light of that category's unique market characteristics and regulatory functions and responsibilities.

[6] See section 723(a) of the Dodd-Frank Act. The Commission separately proposed rules implementing the "made available to trade" mandate. See 76 FR 77728, Dec. 14, 2011.

[7] 75 FR 80572, Dec. 22, 2010 ("DCM NPRM"). The DCM NPRM also proposed revisions to related regulations under parts 1 and 16.

separate occasions, each time for an additional 30 days.[8] The Commission received numerous written comments from members of the public, and Commission staff participated in several meetings with market participants, including representatives of both currently-designated and prospective contract markets.[9]

In this notice of final rulemaking, the Commission is adopting many of the proposed rules, guidance, and acceptable practices. However, as a result of the written comments received and dialogue with market participants, the Commission has revised and/or eliminated a number of regulations that were proposed in the DCM NPRM, and in a number of instances, has codified guidance and/or acceptable practices in lieu of the proposed rules.

The Commission also received a number of comments pertaining to the costs and/or benefits of certain proposed regulations. The Commission has undertaken an extensive review of the costs and benefits of the regulations being adopted in this release

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[8] See 76 FR 14825, Mar. 18, 2011; see also 76 FR 25274, May 4, 2011.

[9] The Commission received comment letters from numerous parties, including the following: ACM Capital Management; Alice Corporation; Alternative Investment Management Association; American Bankers Association and ABA Securities Association; American Gas Association; Argus Media, Inc. ("Argus"); Better Markets, Inc. ("Better Markets"); BJ D'Milli; BlackRock, Inc. ("BlackRock"); Bloomberg; CBOE Futures Exchanges ("CFE"); CME Group Inc. ("CME") (CME's comments were submitted on behalf of its four DCMs: the Chicago Mercantile Exchange, Inc., the Board of Trade of the City of Chicago, Inc., the New York Mercantile Exchange, Inc., and the Commodity Exchange, Inc.); Citadel; Committee on Capital Markets Regulation; Committee on Futures and Derivatives Regulation of the New York City Bar Association; DC Energy; The Depository Trust & Clearing Corporation; East Coast Petroleum; ELX Futures, L.P. ("ELX"); Eris Exchange, LLC ("Eris"); Electric Trade Association; FIA/FSR/IIB/IRI/ISDA/SIFMA/US Chamber of Commercial (jointly); Green Exchange LLC ("GreenX"); ICAP; IntercontinentalExchange, Inc. ("ICE") (ICE's comments were submitted on behalf of its four regulated futures exchanges: ICE Future US, Chicago Climate Futures Exchange, ICE Futures Europe, and ICE Futures Canada); International Swaps and Derivatives Association ("ISDA"); Kansas City Board of Trade ("KCBT"); Markit; MarkitSERV; Minneapolis Grain Exchange, Inc. ("MGEX"); Noble Energy; NYSE Liffe US LLC ("NYSE Liffe"); Nodal Exchange, LLC ("Nodal"); Todd Petzel; OneChicago LLC Futures Exchange ("OCX"); Swaps and Derivatives Market Association; Tradeweb; Trading Technologies International, Inc. ("Trading Technologies"); Wholesale Markets Brokers' Association; Working Group of Commercial Energy Firms (Hunton and Williams); and joint letter from CME, NYSE Liffe, GreenX, Eris Exchange, CBOE Futures Exchange, KCBT and MGEX ("CME Joint Comment Letter"). A number of comment letters solely addressed the implementation phasing for Dodd-Frank rulemakings. Those comments are outside the scope of this rulemaking and are more appropriate to the recent rulemaking pertaining to "Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under section 2(h) of the CEA." See 76 FR 58186, Sep. 20, 2011.

pursuant to section 15(a) of the CEA,[10] as is further discussed in the cost benefit consideration section of this final rulemaking. As discussed in that section, the Commission has determined that the final rules appropriately balance the costs and benefits associated with oversight of DCMs pursuant to the CEA, as amended by the Dodd-Frank Act.

The Commission is hereby adopting final regulations to implement section 5 of the CEA, as well as the requirements of sections 2(h)(8) and 5h(a)(1) of the CEA, as amended by the Dodd-Frank Act, as applicable to DCMs. The final regulations will eliminate the guidance on compliance with the designation criteria for DCMs, implement new and revised regulations for the core principles, and codify certain requirements and practices that have evolved over the years and are commonly accepted in the industry.

The final regulations adopted herein will become effective 60 days after publication in the Federal Register. Contract markets that have obtained designation prior to or at the time of the publication of this release must comply with the new and revised rules adopted in this release, except § 38.151(a), within 60 days of the effective date of this release; and must comply with § 38.151(a) in accordance with the timeline described in the discussion of that rule below.

II. Final Rules

A. Repeal of Designation Criteria.

Section 735 of the Dodd-Frank Act eliminated the eight DCM designation criteria in former CEA section 5(b), and largely incorporated the substance of those criteria into

[10] 7 U.S.C. 19.

the core principles. Accordingly, the Commission is eliminating the guidance on compliance with the designation criteria for DCMs contained in appendix A to part 38.[11]

B. Adoption of Rules and Revised Guidance and Acceptable Practices.

To implement section 735 of the Dodd-Frank Act, the Commission proposed a number of new and revised rules, guidance, and acceptable practices to implement the new and revised core principles. As described in the DCM NPRM, the Commission evaluated the preexisting regulatory framework for overseeing DCMs, which consisted largely of guidance and acceptable practices, in order to update those provisions and to determine which core principles would benefit from having new or revised derivative regulations. Based on that review, and in view of the Dodd-Frank Act's amendments to section 5(d)(1) of the CEA,[12] which specifically provides the Commission with discretion to determine, by rule or regulation, the manner in which boards of trade comply with the core principles, the Commission proposed revised guidance and acceptable practices for some core principles and, for several core principles, proposed to codify rules in lieu of guidance and acceptable practices.[13]

Summary of Comments

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[11] As proposed in the DCM NPRM, appendix A to part 38 will contain the application form for contract market designation.

[12] Former Core Principle 1 stated, among other things, that boards of trade "shall have reasonable discretion in establishing the manner in which they comply with the core principles." This "reasonable discretion" provision underpinned the Commission's use of core principle guidance and acceptable practices. Section 735 of the Dodd-Frank Act amended this provision to include the proviso that "[u]nless otherwise determined by the Commission by rule or regulation . . .," boards of trade shall have reasonable discretion in establishing the manner in which they comply with the core principles. See 7 U.S.C. 7(d)(1)(amended 2010).

[13] Guidance provides DCMs and DCM applicants with contextual information regarding the core principles, including important concerns which the Commission believes should be taken into account in complying with specific core principles. In contrast, the acceptable practices are more specific than guidance and provide examples of how DCMs may satisfy particular requirements of the core principles; they do not, however, establish mandatory means of compliance. Acceptable practices are intended to assist DCMs by establishing non-exclusive safe harbors. The safe harbors apply only to compliance with specific aspects of the core principle, and do not protect the contract market with respect to charges of violations of other sections of the CEA or other aspects of the core principle.

The Commission received a number of comments generally pertaining to the proposed codification of rules in lieu of guidance and/or acceptable practices. Several commenters contended that the principles-based regime has permitted the U.S. futures markets to prosper and keep pace with rapidly changing technology and market needs, and that a rules-based regime will stifle growth, innovation, and competition.[14] Others noted that the futures markets' resilience throughout the financial crisis is evidence in support of the effectiveness of a principles-based regime.[15] Commenters also argued that the prescriptive nature of the rules will result in increased costs for DCMs and for the Commission[16] and that current industry best practices are subject to change and are only able to evolve through continuous improvement and innovation, which is only possible under a flexible regime.[17] Several commenters provided comments on the codification of specific rules in lieu of guidance and/or acceptable practices, which are addressed below, in the discussion of the respective rules.

Discussion

This final rulemaking largely adopts the framework of rules, guidance and acceptable practices that was proposed in the DCM NPRM, with certain substantive revisions to the regulations, as described in this release. For several core principles, the Commission is maintaining the rules, guidance and acceptable practices, as proposed, with appropriate revisions arising from the Commission's consideration of comments. In

[14] CME Comment Letter at 3-4 (Feb. 22, 2011); Eris Comment Letter at 1-2 (Feb. 22, 2011); GreenX Comment Letter at 1 (Feb. 22, 2011); ICE Comment Letter at 3 (Feb. 22, 2011); KCBT Comment Letter at 1, 9 (Feb. 22, 2011).
[15] CME Comment Letter at 3 (Feb. 22, 2011); ICE Comment Letter at 2 (Feb. 22, 2011); KCBT Comment Letter at 9 (Feb. 22, 2011); Eris Comment Letter at 3 (June 3, 2011).
[16] CME Comment Letter at 3 (Feb. 22, 2011); GreenX Comment Letter at 2 (Feb. 2, 2011); MGEX Comment Letter at 2 (Feb. 22, 2011).
[17] CME Comment Letter at 3 (Feb. 22, 2011); GreenX Comment Letter at 2, 11 (Feb. 22, 2011).

several instances, this final rulemaking converts proposed rules to guidance and/or acceptable practices for various DCM compliance practices.

In determining whether to codify a compliance practice in the form of a rule or guidance/acceptable practice, the Commission was guided by whether the practice consisted of a commonly-accepted industry practice. Where there is a standard industry practice that the Commission has determined to be an acceptable compliance practice, the Commission believes that the promulgation of clear-cut regulations will provide greater legal certainty and transparency to DCMs in determining their compliance obligations, and to market participants in determining their obligations as DCM members, and will facilitate the enforcement of such provisions. Several of the rules adopted in this notice of final rulemaking largely codify practices that are commonly accepted in the industry and are currently being undertaken by most, if not all, DCMs.

In the context of each individual rule, the Commission also was guided by comments that provided a basis for greater flexibility or, in some instances, for greater specificity, in respect to the stated compliance obligation.

In addition, the Commission's determination to codify certain compliance practices as rules, rather than as guidance/acceptable practices, is based on its long experience in regulating DCMs. In numerous instances, the rules codify practices that have evolved from the Division of Market Oversight's ("DMO") recommendations in the context of Rule Enforcement Reviews ("RERs").[18]

[18]As noted in the DCM NPRM, the RERs are the cornerstone of the Commission's oversight program, serving as a key tool for monitoring a DCM's compliance with the core principles, and also as a primary means for identifying industry trends and DCM best practices for self-regulation. See DCM NPRM at 80574-75 for a more detailed discussion of RERs.

Some commenters claimed that the Commission's approach was overly prescriptive and inconsistent with the core principle framework.[19] While maintaining the core principle framework as part of the Dodd-Frank Act, Congress revised DCM Core Principle 1 to specifically provide the Commission with discretion to determine, by rule or regulation, the manner in which boards of trade are to comply with the core principles.[20] Accordingly, in circumstances where a standard industry practice has developed, the Commission is adopting rules in order to provide greater legal certainty and transparency to DCMs and market participants. In other circumstances, the Commission is maintaining the guidance and acceptable practices framework, particularly where the Commission experienced that a standard compliance approach has not evolved within the industry over the years. In those instances, the final regulations maintain the flexibility for DCMs to determine the specific manner in which they choose to satisfy their compliance obligations.

Several commenters claimed that the codification of additional rules will increase the Commission's costs of regulating DCMs. The Commission believes that a regulatory framework consisting of a higher proportion of rules, in addition to guidance and acceptable practices, may in fact be less costly to administer, as DCMs will have a clear understanding of what is required in order to demonstrate compliance with the core principles. The costs and benefits of this final rulemaking are described further in the Cost Benefit Consideration discussion of this release.

C. General Regulations (Subpart A).

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[19] See e.g., CME Comment Letters (Feb. 22, 2011, Apr. 18, 2011, Jun. 3, 2011 and Aug. 3, 2011); MGEX Comment Letter (Jun. 3, 2011); GreenX Comment Letter (Feb. 22, 2011).
[20] 7 U.S.C. 7(d)(1)(amended 2010).

The regulations in this final rulemaking are codified in a series of subparts under part 38. The general regulations consisting of §§ 38.1 through 38.10[21] are codified in subpart A, and the regulations applicable to each of the 23 core principles are codified in subparts B through X, respectively.[22]

1. § 38.1 – Scope

The Commission proposed non-substantive revisions to § 38.1 that corrected cross-references to other sections of the Commission's regulations. Section 38.1 is adopted as proposed.

2. § 38.2 – Applicable Provisions

Proposed § 38.2 specified the Commission regulations that are applicable to DCMs. In addition to revising the heading, the proposed revisions to § 38.2 updated the list of Commission regulations that are applicable to DCMs, including the relevant regulations that have been codified, or are proposed to be codified, upon the Commission's finalization of the relevant rulemakings that culminated upon enactment of the Dodd-Frank Act. These included regulations relating to real-time reporting of swaps and the determination of appropriate block size for swaps under part 43, requirements for swap data recordkeeping and reporting under part 45, designation requirements for swap data repositories under part 49, and position limits under part 150 and/or part 151, as applicable.

Discussion

The Commission is revising § 38.2 to specify the Commission regulations from which DCMs will be exempt. The original intent of § 38.2 was to exempt DCMs from

[21] The DCM NPRM did not propose any revisions to § 38.6 of the Commission's regulations.
[22] Each of these subparts begins with a regulation containing the language of the core principle.

various Commission regulations under Title 17 that were codified prior to the CFMA. Proposed § 38.2 listed the specific regulations with which DCMs were required to comply, with the understanding that the DCM was exempt from those not listed. In this final rulemaking, to add clarity, the Commission is revising the title of the rule to "Exempt Provisions" and is modifying § 38.2 to reflect the list of regulations from which DCMs are exempt. Those regulations include: § 1.35(e)-(j), § 1.39(b), § 1.44, § 1.53, § 1.54, § 1.59(b)-(c), § 1.62, § 1.63(a)-(b) and (d)-(f), § 1.64, § 1.69, part 8, § 100.1, § 155.2, and part 156. While § 38.2 likely will be amended if and when the referenced rules are eliminated from the regulations or modified, this revised approach will eliminate the need for the Commission to continually update § 38.2 when new regulations with which DCMs must comply are codified.

3. § 38.3 - Procedures for Designation

<u>§ 38.3(a) - Application procedures</u>

Among the proposed revisions to § 38.3, which contains the application and designation procedures for DCM applicants, the Commission proposed to eliminate the 90-day expedited review procedures for DCM applications, which currently are codified in § 38.3(a)(2). The proposed modification would result in all DCM applications being subject to the statutory 180-day review procedures provided under section 6(a) of the CEA and § 38.3(a)(1) of the Commission's regulations.[23]

As noted above, the Dodd-Frank Act eliminated the standalone DCM designation criteria. Accordingly, the Commission proposed re-designating appendix A to include a new DCM application form ("Form DCM") that contains comprehensive instructions and a list of necessary information and documentation required to initiate a DCM designation

[23] 7 U.S.C. 8(a).

proceeding. All new applicants seeking designation would submit to the Commission a completed form, including the information required in each exhibit.[24]

The DCM NPRM also proposed certain revisions to § 38.3 that would require DCM applications and certain related DCM filings to be filed with the Secretary of the Commission in an electronic format, via the internet, e-mail, or other means of direct electronic submission as approved by the Commission.[25]

Summary of Comments

Two commenters discussed the proposed elimination of the 90-day expedited review process for DCM applications in § 38.3(a)(1). Nodal expressed support for the proposed elimination of the 90-day review procedures.[26] Eris opposed the proposed elimination and commented, among other things, that Form DCM should result in a streamlined and standardized review process and that eliminating the 90-day accelerated review process would place new entities at a competitive disadvantage because it would delay their time to market, which is critical for new entrants.[27]

Discussion

The Commission is adopting proposed § 38.3(a) with one modification.

As described in the DCM NPRM, the Commission proposed eliminating the 90-day accelerated review process based on its experience in processing DCM applications.

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[24] Form DCM would also be used by applicants amending a pending application and existing DCMs applying for an amendment to their order of designation.

[25] The proposed electronic filing requirements would specifically apply to DCM applications, reinstatements, requests for transfer of designations, requests for withdrawal of application for designation, and vacation of designations. As explained in the DCM NPRM, the proposed revisions would make the DCM application filing process consistent with the electronic process used for filing rule and product submissions under parts 39 and 40 of the Commission's regulations. See 17 CFR parts 39 and 40. In addition to these substantive revisions, many of the proposed revisions to § 38.3 were non-substantive and were intended to clarify the rule.

[26] Nodal Comment Letter at 5 (Feb. 22, 2011).

[27] Eris Comment Letter at 4 (Feb. 22, 2011).

Specifically, the Commission has found that in the interest of meeting the expedited approval timeline, applicants seeking expedited review often filed incomplete or draft applications without adequate supporting materials. Accordingly, the 90-day review process required the expenditure of significant Commission resources as well as the applicant's resources, and often resulted in placing the DCM designation requests on the 180-day review track. It is the Commission's view that the 180-day review period is a more reasonable timeframe for the review of designation requests and will result in more efficient use of the applicant's and the Commission's resources.

In regards to Eris' specific claim that elimination of the 90-day accelerated review process would place new entities at a competitive disadvantage by delaying their time to market, the Commission notes that eliminating the 90-day review process will not prevent Commission staff from reviewing and/or rendering a determination on a DCM application before the 180-day period ends, particularly in instances where a DCM application is substantially complete, does not raise novel issues, and/or where a DCM applicant timely provides supplemental or follow-up responses or documentation necessary for a designation determination.[28] Similarly, while the Commission recognizes that Form DCM will provide the added benefit of a more streamlined and standardized procedure for submitting and reviewing DCM applications, such benefits will not necessarily result in an expedited Commission determination. Rather, the completeness of the application and timely response to Commission staff's requests will determine the timeframe within which the Commission reviews a DCM application.

[28]Section 6(a) of the Act provides that "the Commission shall approve or deny an application for designation or registration as a contract market . . . within 180 days of the filing of the application." 7 U.S.C. § 8(a).

To account for potential changes in the Commission's prospective technological capabilities, the Commission is slightly modifying the proposed text of § 38.3(a) to clarify that a board of trade must file Form DCM electronically "in a format and manner specified by the Secretary of the Commission."

The Commission is also making several minor non-substantive and organizational revisions to Form DCM. Additionally, the Commission is clarifying that the exhibits submitted in connection with Form DCM should include a description of how the applicant meets the definition of "board of trade" (as defined in section 1a(2) of the CEA). Applicants must submit all applicable exhibits simultaneous with the submission of completed Form DCM. Form DCM and all exhibits must be substantially complete prior to submission.

§ 38.3(b)-Reinstatement of dormant designation

Proposed § 38.3(b) required that a dormant DCM, prior to listing or relisting products for trading, must reinstate its designation under the procedures of paragraphs (a)(1) and (a)(2) of § 38.3. The proposed rule provided that applications for reinstatement of designation may rely upon previously-submitted materials that pertain to, and accurately describe, current conditions. The Commission did not receive any comments on § 38.3(b) and is adopting this provision as proposed.

§ 38.3(c)-Delegation of authority

Proposed § 38.3(c) delegated authority to the Director of the Division of Market Oversight (or such other employees as the Director may designate) to notify an applicant seeking designation in the event that the application is materially incomplete and that the

180-day review period is stayed. The Commission did not receive any comments on § 38.3(c) and is adopting this provision as proposed.

§ 38.3(d)-Request for transfer of designation

The Commission proposed new § 38.3(d) to formalize the procedures that a DCM must follow when requesting the transfer of its DCM designation and positions comprising open interest, in anticipation of a corporate event (e.g., a merger, corporate reorganization, or change in corporate domicile) which results in the transfer of all or substantially all of the DCM's assets to another legal entity. Proposed § 38.3(d)(2) required a DCM to submit to the Commission a request for transfer of designation no later than three months prior to the anticipated corporate change. If a DCM did not know or could not reasonably have known of the anticipated change three months prior to the change, it was required to immediately file the request as soon as it did know of such change. The proposed rule required, that in either case, the request must include a series of submissions, including, among other things, the underlying agreement that governs the corporate change, a narrative description of the corporate change that includes the reason for the change and its impact on the DCM, a discussion of the transferee's ability to comply with the CEA and the Commission's regulations, the governing documents of the transferee, and a list of contracts, agreements, transactions or swaps for which the DCM requests transfer of open interest.

Proposed § 38.3(d) also required, as a condition of approval, that the DCM submit a representation that it is in compliance with the CEA, including the DCM core principles, and the Commission's regulations. In addition, the proposed rule required a DCM to submit various representations by the transferee, including, but not limited to, a

representation that the transferee will assume responsibility for complying with all applicable provisions of the CEA and the Commission's regulations and that none of the proposed rule changes will affect the rights and obligations of any participant to which open positions are transferred.

Summary of Comments

CME contended that the proposed rule is overly prescriptive because it applies a "one-size-fits-all approach" even though the circumstances of each transfer are likely to be unique.[29] While CME did not oppose the three-month advance notification requirement, it did oppose what it believed to be the broad scope of the additional documentation required to be submitted simultaneously with such notification.[30] CME stated that the required information is unnecessary and is likely to result in later notification to the Commission.[31] As an alternative, CME recommended that the Commission tailor the information it requires based on the nature of the requested transfer.[32]

CME also contended that if a DCM could not have reasonably known of an anticipated change three months in advance, then it cannot "immediately" file both the request and all of the required submissions once it does know, because preparing the submissions takes time. CME suggested that the rule be amended to require that the documentation be filed "promptly" as soon as the DCM knows of the change, rather than "immediately."[33]

Discussion

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[29] CME Comment Letter at 11 (Feb. 22, 2011).
[30] Id.
[31] Id.
[32] Id.
[33] Id.

In response to CME's contention that each transfer is likely to be unique, and its opposition to some of the documentation required by the rule, the Commission notes that the specific information requirements contained in the proposed rule are necessary to enable the Commission to determine that the transfer is in compliance with the CEA. The required documents, such as the transfer agreement, governing documents, list of contracts to be transferred, and compliance representations, are relevant to the Commission's determination of the DCM's ongoing compliance with the CEA. Such documentation is also relatively standard in transfer transactions. The Commission recognizes, however, that there may be some variations in the form of governance documents or underlying agreements for each transfer. Accordingly, DCMs may provide the substance of the required information in the form available to them.

In response to CME's suggestion that the rule be amended to require that the documentation be filed "promptly" as soon as the DCM knows of the change, rather than "immediately," the Commission notes that the proposed rule specifically stated that in situations where a DCM could not have reasonably known of an anticipated change three months in advance, the DCM must immediately file the request as soon as it knows of such change, with an explanation as to the timing of the request. The Commission believes that in the context of this rule, use of the term "promptly" rather than "immediately" would not provide a meaningful distinction, as the rule simply requires DCMs to provide the documentation as soon as they know of the change.

As described in connection with § 38.3(a), the Commission is slightly modifying the proposed text to clarify that a DCM must file a request for transfer of designation

electronically "in a format and manner specified by the Secretary of the Commission." The Commission is adopting the remainder of the rule as proposed.

§ 38.3(e)-Request for withdrawal of application for designation

Proposed § 38.3(e) specified the procedures that a DCM must follow for withdrawing an application for designation. The Commission did not receive any comments on this provision. The Commission is slightly modifying the proposed text to clarify that an applicant must file a request for withdrawal of application for designation electronically "in a format and manner specified by the Secretary of the Commission." The Commission is adopting the remainder of the rule as proposed.

§ 38.3(f)-Request for vacation of designation

Proposed § 38.3(f) specified the procedures that a DCM must follow for vacating its designation. The Commission did not receive any comments on this provision. The Commission is adopting it as proposed, with a slight modification to the proposed text to clarify that a DCM must file a request for vacation of designation electronically "in a format and manner specified by the Secretary of the Commission."

§ 38.3(g)-Requirements for existing designated contract markets

Proposed § 38.3(g) required that each existing DCM provide the Commission with a signed certification of its compliance with each of the 23 core principles and the Commission's regulations under part 38, within 60 days of the effective date of the publication of the final rules proposed in the DCM NPRM. The failure of any existing DCM to provide such certification would be grounds for revocation of the DCM's designation status. The Commission requested comments on whether the 60 day period is sufficient, and if not, what period of time may be more appropriate, and why.

Summary of Comments

Multiple commenters opposed the proposed 60-day timeframe for existing DCMs to certify compliance with the core principles and associated regulations. Commenters suggested several alternative timeframes, including 90 days,[34] 120 days,[35] 180 days,[36] 12 months,[37] and 18 months.[38] KCBT argued that the proposed effective date is unreasonable and would be burdensome for DCMs, and suggested that the Commission work with each DCM to create a reasonable compliance timeframe.[39]

Commenters stated that a 60-day timeframe would be unreasonable given the expenditure of resources and detailed analysis required as a result of significant changes to existing core principles and the addition of new core principles. GreenX stated that Core Principle 21 (Financial Resources) may require DCMs to obtain new investment or financing arrangements.[40] KCBT stated that it will take DCMs time to convert programs and processes from current acceptable practices to adherence to what it sees as prescriptive objectives and deadlines.[41] Nodal, which is currently operating as an exempt commercial market ("ECM"), stated that 60 days is an unnecessarily harsh timeframe for an existing business to transform its operations and demand changes from its support providers.[42] Finally, NYSE Liffe claimed that even 90 or 120 days would be insufficient because certain proposals, such as Core Principles 2 (Compliance with Rules), 4 (Prevention of Market Disruption), and 20 (System Safeguards), will require the

[34] Nodal Comment Letter at 4 (Feb. 22, 2011).
[35] CFE Comment Letter at 6-7 (Feb. 22, 2011).
[36] GreenX Comment Letter at 21 (Feb. 22, 2011).
[37] MGEX Comment Letter at 2 (Feb. 22, 2011), and at 1 (June 3, 2011).
[38] NYSE Liffe Comment Letter at 14 (Feb. 22, 2011).
[39] KCBT Comment Letter at 2 (Feb. 22, 2011).
[40] GreenX Comment Letter at 21 (Feb. 22, 2011).
[41] KCBT Comment Letter at 2 (Feb. 22, 2011).
[42] Nodal Comment Letter at 4 (Feb. 22, 2011).

implementation of automated systems that require significant time to implement coding and conduct testing.[43] NYSE Liffe further claimed that the DCM's management and boards will have to review and approve rule changes before they can be implemented, and that the DCM will also have to negotiate and execute changes to contracts with third-party service providers.[44] CME disagreed with the assertion that the proposed new regulations simply codify practices that are commonly accepted in the industry, and argued that the rules will necessitate strategic, operational, system, and rule changes.[45] CME claimed that it would need a minimum of 180 days just to assess the impact of the new regulations and to identify, design, and plan the projects necessary to implement them.[46]

MGEX stated that a "catch all" certification is of limited value given that DCMs spend "countless hours and dollars" demonstrating that they are in compliance with core principles through RERs and responding to other Commission inquiries.[47] MGEX also questioned whether it can conclude with any certainty that it is in compliance with the new and revised core principles and regulations.[48] MGEX requested that the certification requirement be stricken, or if the requirement is deemed necessary, that the process be limited to providing a signed letter attesting to compliance (and that all application forms and documentation that are required with a formal application should be waived for

[43] NYSE Liffe Comment Letter at 14 (Feb. 22, 2011).
[44] Id.
[45] CME Comment Letter at 12 (Feb. 22, 2011).
[46] Id.
[47] MGEX Comment Letter at 2 (Feb. 22, 2011).
[48] Id.

existing DCMs).[49] MGEX also requested that current DCMs that are already compliant with the existing core principles should be grandfathered.[50]

Nodal stated that the proposed rules do not address how a DCM applicant that is operating as an ECM pursuant to a grandfathering order can comply with the DCM requirements, and suggested that the Commission stagger certain compliance timeframes to accommodate entities that are operating pursuant to grandfather relief and that may potentially seek to operate as a DCM.[51]

Discussion

The Commission acknowledges commenters' concerns regarding the 60-day time frame for existing DCMs to certify compliance with the core principles and is eliminating this requirement from the final rules. In addition, the Commission has determined that existing DCMs may need additional time to comply with the rules being adopted in this release, and is therefore allowing DCMs an additional 60 days after the effective date of this release to comply with all of the new and revised final rules, except for § 38.151(a), as described in this release. All DCMs are expected to be in compliance with the final rules by that date. Albeit, the new and revised core principles, as amended by the Dodd-Frank Act, took effect on July 16, 2011, and all DCMs were required to be in compliance with each of the new and revised core principles as of that date. The Commission further notes that all DCMs will continue to be subject to compliance reviews by the Commission, including RERs.

With respect to Nodal's comments regarding the impact of the effective date of the DCM and SEF rules on ECMs, the Commission issued orders whereby entities

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[49] Id.
[50] MGEX Comment Letter at 1 (June 3, 2011).
[51] Nodal Comment Letter at 4 (Feb. 22, 2011).

operating as exempt commercial markets pursuant to section 2(h)(3)-(7) of the CEA, or as exempt boards of trade pursuant to section 5d of the CEA, could receive grandfather relief to continue to operate in accordance with those provisions notwithstanding their deletion from the CEA effective July 15, 2011, by the Dodd-Frank Act.[52] The continued operation and compliance timeframes for exempt boards of trade and exempt commercial markets are addressed by those orders, and accordingly, are outside the scope of this rulemaking.

4. § 38.4 - Procedures for Listing Products and Implementing Designated Contract Market Rules

The proposed amendments to § 38.4 were largely intended to conform the rule to §§ 40.3 (Voluntary submission of new products for Commission review and approval) and 40.5(b) (Voluntary submission of rules for Commission review and approval).[53] Those rules were recently revised in the separate release pertaining to "Provisions Common to Registered Entities."[54]

Summary of Comments

In comments submitted both in connection with this rulemaking and with the proposed rulemaking for "Provisions Common to Registered Entities,"[55] CME stated that the proposed procedures for listing products would increase the burdens associated with new product submissions and rule changes and would create new and costly bureaucratic inefficiencies, competitive disadvantages in the global marketplace, and impediments to

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[52] See 75 FR 56513, Sept. 16, 2010; see also 76 FR 42508, Jul. 14, 2011.
[53] Section 40.3 was amended to require additional information to be provided by registered entities submitting new products for the Commission's review and approval. Section 40.5(b) codified a new standard for the review of new rules or rule amendments as established under the Dodd-Frank Act. 75 FR 44776, Jul. 27, 2011.
[54] Id.
[55] Id.

innovation.[56] CME stated that there has been no showing that the current streamlined process undermines market integrity, and that the process in fact has facilitated growth and innovation.[57]

CFE stated that a number of the regulations proposed in the DCM NPRM require DCMs to provide notification and reports to the Commission, but that the proposed regulations do not specify the manner in which the required notifications and reports should be submitted to the Commission.[58] CFE requested that the Commission designate a single e-mail address for the submission of all DCM notifications and reports.[59]

Discussion

The Commission is adopting the rule as proposed. The rule conforms to revisions to part 40 that were made in a separate rulemaking for "Provisions Common to Registered Entities."[60] In that rulemaking, the Commission, among other things, revised and eliminated several proposed documentation provisions in order to respond to comments that the submission of documentation in connection with new rules and rule amendments would be burdensome. The Commission also noted that the final rules will conserve both Commission and registered entity resources and will be less burdensome than existing practice. CME's comments on these provisions were addressed in the part 40 rulemaking, and are outside the scope of this rulemaking."[61]

In response to CFE's comment, the Commission notes that all filings submitted pursuant to part 38 should be filed electronically with the Secretary of the Commission,

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[56] CME Comment Letter at 10, 13 (Feb. 22, 2011).
[57] Id.
[58] CFE Comment Letter at 7 (Feb. 22, 2011).
[59] Id.
[60] 75 FR 44776, July 27, 2011.
[61] Id.

in a format and manner determined by the Secretary, at submissions@cftc.gov and the Division of Market Oversight at DMOSubmissions@cftc.gov.

5. § 38.5 – Information Relating to Contract Market Compliance

§ 38.5(a)-Requests for information; § 38.5(b)-Demonstration of compliance; and, § 38.5(d)-Delegation of authority

The provisions in § 38.5 address requirements for DCMs to provide information relating to contract market compliance. Proposed § 38.5(a) required that a DCM must file with the Commission information related to its business as a DCM, including information relating to data entry and trade details, upon Commission request. Proposed § 38.5(b) required that a DCM must file with the Commission a written demonstration that the DCM is in compliance the core principles, upon Commission request. Proposed § 38.5(d) delegates the Commission's authority to seek information as set forth in paragraph § 38.5(b) to the Director of the Division of Market Oversight, or such other employees as the Director may designate. As noted in the DCM NPRM, except for technical revisions, the aforementioned proposed rules were not substantively modified from their current versions. The Commission did not receive any comments on these rules and adopts them as proposed.

§ 38.5(c)-Equity interest transfers

Proposed § 38.5(c) required DCMs to file with the Commission a notice of the transfer of ten percent or more of its equity, no later than the business day following the date on which the DCM enters into a firm obligation to transfer the equity interest.[62] The proposed rule required that the notification include several submissions, including any relevant agreements (including preliminary agreements), changes to relevant corporate

[62] See generally, DCM NPRM for an explanation of the proposed 10 percent threshold.

documents, a chart outlining any new ownership or corporate or organizational structure, a brief description of the purpose and any impact of the equity interest transfer, and a representation from the DCM that it meets all of the requirements of section 5(d) of the Act and Commission regulations thereunder. The proposed rule also required that DCMs notify the Commission of the consummation of the transaction on the day in which it occurs. Proposed § 38.5(c)(3)[63] required that when there is a change in ownership, the DCM must certify, no later than two business days following the date on which the change in ownership occurs, that the DCM meets all of the requirements of section 5(d) of the CEA, as amended by the Dodd-Frank Act, and the provisions of part 38 of the Commission's regulations. The proposed rule also required that the DCM include, as part of its certification, an explanation of whether any aspects of the DCM's operations will change as a result of the change in ownership and, if so, that the DCM must provide a description of the changes.

Summary of Comments

Two commenters stated that they do not object to the general notification requirement, but contended that the submissions required to be simultaneously filed with the initial notification do not lend themselves to preparation within the 24-hour time frame proposed in the rules.[64] NYSE Liffe proposed that a period of ten business days to provide the additional information would allow more time for the DCM to provide accurate and meaningful information.[65] NYSE Liffe also requested clarification that the requirement to provide "preliminary agreements" only pertains to agreements that have

[63] The Commission proposed redesignating § 38.5(d) as § 38.5(c).
[64] CME Comment Letter at 13 (Feb. 22, 2011) (noting that associated changes to relevant corporate documents are unlikely to be finalized until closer to the transfer date); NYSE Liffe Comment Letter at 13 (Feb. 22, 2011) (noting that the information will have to be collected and formatted).
[65] NYSE Liffe Comment Letter at 14 (Feb. 22, 2011)

been executed, and not to drafts that may have been exchanged for purposes of discussion.[66]

CME stated that a representation from a DCM that it meets all of the requirements of section 5(d) of the CEA is more appropriate as a requirement upon consummation of the equity interest transfer, rather than with the initial notification.[67]

MGEX stated that as a mutual association with a membership-based ownership structure, it frequently experiences changes in membership and ownership.[68] MGEX stated that notice to the Commission seems reasonable for single event situations where a new party obtains a ten percent or more interest at one time, but disagreed with the rationale for the requirement to recertify again as part of such event.[69] Instead, MGEX suggested that the Commission should inquire only if there is a concern over such an event.[70]

Discussion

The Commission is adopting the proposed rule with certain revisions.

The Commission is revising the rule to provide that the DCM must submit to the Commission a notification of each transaction involving the transfer of ten percent or more of the equity interest in the designated contract market, and that such notification must be provided at the earliest possible time but in no event later than ten business days following the date upon which the designated contract market enters into a legally binding obligation to transfer the equity interest.

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[66] Id.
[67] CME Comment Letter at 13 (Feb. 22, 2011).
[68] MGEX Comment Letter at 2 (Feb. 22, 2011).
[69] Id. at 3.
[70] Id.

The Commission acknowledges NYSE Liffe and CME's concerns regarding the timing of the submission filing requirement and therefore has extended the time period to up to ten business days for a DCM to file notification with the Commission upon entering into an agreement to transfer an equity interest of ten percent or more. While DCMs may take up to ten business days to submit a notification, the DCM must provide Commission staff with sufficient time, prior to consummating the equity interest transfer, to review and consider the implications of the change in ownership, including whether the change in ownership will adversely impact the operations of the DCM or the DCM's ability to comply with the core principles and the Commission's regulations thereunder. The rule further reminds DCMs that any aspect of an equity interest transfer described that necessitates the filing of a rule as defined in part 40 of the Commission regulations must comply with the rule submission requirements, including timing of filing, of section 5c(c) of the CEA and part 40, and all other applicable Commission regulations.

In response to CME's comment that the representation from a DCM that it meets all of the requirements of section 5(d) of the CEA is more appropriate as a requirement upon consummation of the equity interest transfer, and NYSE Liffe's comment that the Commission clarify that "preliminary agreements" do not include draft documents, the Commission is revising the rule to eliminate references to the specific documents that must be provided with the notification. Rather, the Commission may upon receiving a notification of the equity interest transfer, where necessary, request appropriate documentation pursuant to its authority under § 38.5 of the Commission's regulations. Such documentation may include: (i) relevant agreement(s), including any preliminary agreements (not including draft documents); (ii) associated changes to relevant corporate

documents; (iii) chart outlining any new ownership or corporate or organizational structure, if available; (iv) a brief description of the purpose and any impact of the equity interest transfer; and, (v) a certification, upon consummation of the equity interest transfer that the designated contract market continues to meet all of the requirements of section 5(d) of the Act and Commission regulations adopted thereunder.

The Commission acknowledges MGEX's comment but believes that the rule is necessary. The Commission must oversee and ensure the continued compliance of all DCMs with the core principles and the Commission's regulations. In order to fulfill its oversight obligations, and to ensure that DCMs maintain compliance with their self-regulatory obligations, the Commission must undertake an effective due diligence review of the impact of ownership transfers. Accordingly, the Commission adopts the proposed rule, with the aforementioned modifications.

6. § 38.7 - Prohibited Use of Data Collected for Regulatory Purposes

Proposed § 38.7[71] prohibited DCMs from using proprietary data or personal information submitted by any person to the DCM for regulatory purposes, for business or marketing purposes. In the DCM NPRM, the Commission noted that nothing in the proposed provision should be viewed as prohibiting a DCM from sharing such information with another DCM or SEF for regulatory purposes, where necessary.

Summary of Comments

Several commenters argued that the restriction on the use of proprietary or personal information is too broad. CME stated that the proposed rules should distinguish between proprietary and personal information that is provided to a DCM exclusively for

[71] The DCM NPRM did not propose any revisions to current § 38.6 (Enforceability), and this provision remains unchanged.

regulatory purposes and information that is provided to a DCM for both regulatory and non-regulatory purposes.[72] CME claimed that a DCM should be permitted to use the latter type of information for business or marketing purposes, provided that the DCM has transparent rules and policies which disclose what information collected by the DCM will be used exclusively for the furtherance of its self-regulatory obligations and how such confidential information will be protected.[73] CME also contended that a DCM should not be precluded from using proprietary or personal information that is provided for regulatory purposes for business or marketing purposes where the market participant has specifically agreed to such use.[74] MGEX agreed with the underlying purpose of the proposed rule but suggested allowing market participants to opt-out of having their information used for business or marketing purposes.[75]

ELX stated that the standard should rest on whether the use and manner of use of the information violates the reasonable expectation of confidentiality on the part of the disclosing firm.[76] For example, ELX stated that senior officers of the exchange should have access to such data to understand the markets they are responsible for overseeing even if they don't have a "compliance" moniker in their title.[77] ELX also stated that an exchange should be able to consolidate proprietary data in an anonymous fashion to explain its markets without running afoul of the proposed rule.[78] ELX also claimed that a DCM should be able to use its discretion to convey proprietary information for business

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[72] CME Comment Letter at 13-14 (Feb. 22, 2011).
[73] Id.
[74] Id.
[75] MGEX Comment Letter at 3 (Feb. 22, 2011).
[76] ELX Comment Letter at 3 (Feb. 22, 2011).
[77] Id.
[78] Id.

or marketing purposes back to employees of the firm that supplied the data.[79] For example, ELX stated that a DCM should be permitted to explain to a trading desk how the activities of its firm have changed or could be conducted more cost-effectively.[80]

Discussion

The Commission has considered the comments and is amending proposed § 38.7 to allow DCMs to use proprietary or personal information for business or marketing purposes if the person from whom they collect or receive such information clearly consents to the use of its information in such a manner. In response to CME and ELX's comments, the Commission notes that a DCM could use information that it receives for both regulatory and non-regulatory purposes for business or marketing purposes (or could convey proprietary information back to employees of the firm that supplied the data) if the source of the information clearly consents to the use in such a manner. The Commission is also amending the proposed rule to prohibit a DCM from conditioning access to its trading facility based upon such consent.

Finally, as stated in the preamble to the proposed rule and amplified above, the Commission notes that § 38.7 is intended to protect regulatory information provided by market participants to DCMs from unauthorized commercial use.[81] The Commission notes consistent with the requirements of the final rule, DCMs should have rules to safeguard regulatory information from misuse. The Commission would expect such rules, among other things, to restrict access to such information within the DCM to avoid improper use of such information for commercial purposes.

7. § 38.8 - Listing of Swaps on a Designated Contract Market

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[79] Id.
[80] Id.
[81] See 75 FR 80572, 80577, note 37, Dec. 22, 2010.

Proposed § 38.8(a) required a DCM to notify the Commission, prior to or upon listing its first swap contract, of the manner in which it will fulfill each of the requirements under the amended CEA and part 38 with respect to the listing, trading, execution and reporting of swap transactions.

Proposed § 38.8(b) required a DCM, before it lists swaps, to request from the Commission a unique, alphanumeric code for the purpose of identifying the DCM. The rule required a DCM to do so pursuant to the swap recordkeeping and reporting requirements under then-proposed part 45 of the Commission's regulations. Proposed § 38.8(b) also codified the obligations of DCMs to comply with the provisions of part 45, which set forth the recordkeeping and reporting requirements for DCMs with respect to swaps.[82]

Summary of Comments

CFE argued that a DCM should be allowed to offer trading in swaps in the same manner that a SEF is permitted to do so, and that it would be costly and unnecessary to require a DCM to create a separate SEF in order to offer trading in swaps instead of just permitting the DCM to adopt separate rules that permit the trading of swaps on the DCM consistent with the SEF requirements.[83] CFE argued that a DCM should not have to create a separate entity, board, board committees, membership application and approval process, and rule set in order to offer trading in swaps in the same manner that a SEF can

[82] See "Swap Data Recordkeeping and Reporting Requirements," Proposed Rule, 75 FR 76573, Dec. 8, 2010.
[83] CFE Comment Letter at 1 (Feb. 22, 2011).

do when it already has all of those components in place and can simply add any required components for SEFs.[84]

ELX stated that the DCM NPRM did not make clear what criteria will be used to distinguish between a swap contract and a futures contract, and claimed that this ambiguity will cause uncertainty and redundant costs for boards of trade that would prefer to follow a DCM model without having to adopt a parallel set of rules and procedures.[85] ELX cited compliance with section 727 of the Dodd-Frank Act and § 38.10 as one area where clarity is needed.[86]

Discussion

The Commission is adopting the rule as proposed, with one clarification. CFE's comments take issue with provisions in the Dodd-Frank Act that are not within the Commission's discretion to revise. Swaps are permitted to be traded on a SEF or a DCM, pursuant to rules promulgated for each entity.[87] Accordingly, swaps traded on a DCM must be traded pursuant to DCM rules. As noted in the Final Exemptive Order issued July 14, 2011,[88] DCMs may list and trade swaps after July 16, 2011 without further exemptive relief. In that Order, the Commission noted that if a DCM intends to trade swaps pursuant to the rules, processes, and procedures currently regulating trading on its DCM, the DCM may need to amend or otherwise update its rules, processes, and

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[84] Id. at 2.
[85] ELX Comment Letter at 4 (Feb. 22, 2011).
[86] Id. at 5.
[87] See CEA section 2(h)(8), 7 U.S.C. 2(h)(8). See also 17 CFR 38.9 ("A board of trade that operates a designated contract market and that intends to also operate a swap execution facility must separately register...and on an ongoing basis, comply with the core principles under Section 5h of the Act, and the swap execution facility rules under part 37 of this chapter").
[88] 76 FR 42508, Jul. 14, 2011.

procedures in order to address the trading of swaps.[89] In response to ELX, the determining factors in distinguishing between swaps and futures are outside of the scope of this proceeding. The CEA provided a definition for swaps under section 1a(47), and the Commission published proposed rules and interpretive guidance to further define the term on May 23, 2011.[90]

The Commission is modifying § 38.8(b), consistent with the Commission's final Swap Data Recordkeeping and Reporting Requirements Rule,[91] to require DCMs to generate and assign a unique swap identifier at, or as soon as technologically practicable following, the time of execution of the swap. The unique swap identifier ("USI") must have two alphanumeric components. The first component is the unique alphanumeric code assigned to the DCM by the Commission for the purpose of identifying the DCM with respect to USI creation. DCMs must obtain this first alphanumeric component from the Commission prior to executing any swap on its facility.[92] The second component is an alphanumeric code generated and assigned to that swap by the automated systems of the DCM, which shall be unique to that swap and different with respect to all such codes generated and assigned by that DCM to all other swaps. Each DCM must generate and assign a USI at, or as soon as technologically practicable, following the time of execution of the swap. The DCM is required to transmit the USI to the SDR, each swap

[89] Id. at 42,518, n. 131. On July 27, 2011, DMO staff sent a notification letter to all existing DCMs stating that if the DCM intends to list swaps prior to the effective date of the final rules implementing part 38, it must include with its initial submission of the terms and conditions of a swap contract (pursuant to section 5c(c) of the CEA, as amended by the Dodd-Frank Act) any amendments to its rules that are necessary to provide for the trading of swaps, including a concise explanation and analysis of any systems and oversight procedures that the DCM proposes to revise in order to accommodate the trading of swaps. The information requested in the July 27 letter is separate from the request in proposed section 38.8(a); however, information provided in response to the July 27 letter may support, in part, the requirement under section 38.8(a) to provide a written demonstration detailing how the DCM is addressing its self-regulatory obligations with respect to swap transactions.
[90] 76 FR 29818, May 23, 2011.
[91] 77 FR 2136, Jan. 13, 2012.
[92] The Commission will establish a formal process by which DCMs can obtain a USI identifier.

counterparty, and the registered derivative clearing organization ("DCO") (if the swap is cleared). The DCM, similar to all registered entities and counterparties, is required to use the USI to identify the swap in "all recordkeeping and all swap data reporting pursuant to [part 45]." This clarification is based upon the final rulemaking that implements swap data recordkeeping and reporting requirements under part 45 of the Commission's regulations.[93]

8. § 38.9 – Boards of Trade Operating Both a Designated Contract Market and a Swap Execution Facility

Proposed § 38.9(a) codified the requirement that a board of trade that operates a DCM and that intends to operate a SEF must separately register pursuant to the SEF registration requirements and, on an ongoing basis, must separately comply with the SEF core principles under section 5h of the CEA, as amended by the Dodd-Frank Act, and the applicable Commission regulations to be codified under part 37 of the Commission regulations.[94]

Proposed § 38.9(b) codified the statutory requirement that any board of trade that is a DCM and intends to operate as an independent SEF may use the same electronic trade execution system for listing and executing swaps, provided that the board of trade makes it clear to market participants whether the electronic trading of such swaps is taking place on or through the DCM or the SEF.[95]

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[93] 77 FR 2136, Jan. 13, 2012.

[94] See notice of proposed rulemaking pertaining to "Core Principles and Other Requirements for Swap Execution Facilities." 76 FR 1214, Jan. 7, 2011.

[95] Section 5h(c) of the CEA, as amended by the Dodd-Frank Act, provides:

> IDENTIFICATION OF FACILITY USED TO TRADE SWAPS BY CONTRACT MARKETS.—A board of trade that operates a contract market shall, to the extent that the board of trade also operates a swap execution facility and uses the same electronic trade execution system for listing and executing trades of swaps on or through the contract market and the swap execution facility, identify whether the electronic trading of such swaps is taking place on or through the contract market or the swap execution facility.

Summary of Comments

CME requested clarification as to whether the regulation is intended to create a more substantive obligation on the part of DCMs and SEFs given that market participants typically interface with electronic platforms through proprietary or third-party front end systems that are not controlled by the DCM.[96]

ICE noted that while the proposed rule prescribed how a DCM can list swaps, it did not describe how the core principles, written for futures contracts, apply to a DCM listing swaps. ICE requested clarification that a swap can be executed on a DCM using the same execution methods as on a SEF, such as a request for quote ("RFQ") mechanism.[97] Finally, ICE stated that, like a SEF, a DCM should be able to allow the bilateral execution of swaps where there is no clearing mandate.[98] ICE claimed that without these clarifications, there will be a bias away from the trading of swaps on DCMs in favor of SEFs, and that the rulemaking would frustrate Congress' intention of also having swaps trade on DCMs.[99]

Alice Corporation states that organizations that choose to operate both a SEF and DCM should be able to meet the requirements of both entities with a single organization.[100] Alice Corporation also stated that it offers the ability to fill a large size order with multiple contracts on an all-or-nothing basis, as customers with large orders sometimes wish to execute with a single contracts.[101] Alice stated that this design would

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[96] CME Comment Letter at 14 (Feb. 22, 2011).
[97] ICE Comment Letter at 10 (Feb. 22, 2011).
[98] Id.
[99] Id.
[100] Alice Corporation Comment Letter at 3 (May 31, 2011).
[101] Id.

enable automatic execution of block size trades, and questioned whether an impartially offered price discount for volume would be acceptable to the Commission.[102]

Discussion

The Commission is adopting the rule as proposed. In response to CME's comment, the Commission notes that it would not be sufficient for a board of trade that operates both a DCM and a SEF to simply have DCM rules that might identify whether a transaction is being executed on a DCM or a SEF. Instead, a consolidated DCM/SEF trading screen must identify whether the execution is occurring on the DCM or the SEF, irrespective of how proprietary or third-party front end systems eventually present that data to market participants. Section 5h(c) of the CEA, as amended by the Dodd-Frank Act, clearly requires that a board of trade that operates both a DCM and SEF identify to market participants whether each swap is being executed on the DCM or the SEF.

With respect to comments requesting clarification that a swap can be executed on a DCM using execution methods other than a central limit order book[103] the Commission notes that swaps executed on a DCM are subject to all rules and requirements applicable to futures and options traded on DCMs.[104] In particular, all swaps traded on a DCM must be executed through the DCM's trading facility, except as otherwise expressly permitted by Core Principle 9,[105] and are subject to the Commission's rules pertaining to DCMs.

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[102] Id.
[103] ICE Comment Letter at 2-3 (Feb. 22, 2011); Alice Corporation Comment Letter at 3 (May 31, 2011).
[104] Section 723 of the Dodd-Frank Act provides that the execution of swaps subject to the clearing requirement of section 2(h)(1) of the CEA must occur either on a DCM or on a SEF, unless no DCM or SEF makes the swap available to trade.
[105] Core Principle 9 provides, in relevant part, that "[t]he rules of the board of trade may authorize, for bona fide business purposes:
(i) transfer trades or office trades;
(ii) an exchange of—
(I) futures in connection with a cash commodity transaction;
(II) futures for cash commodities; or

Only certain Commission rules, for example, those relating to the real-time and regulatory reporting of swaps, will be different for swaps in relation to futures. In response to ICE's comment that a DCM, like a SEF, should be able to allow the bilateral execution of swaps where there is no clearing mandate, the Commission notes that ICE's position is based on the proposed SEF rules, which are not yet finalized.[106] Moreover, the Commission further notes that under the CEA, a DCM must be a board of trade, which is defined under section 1a(2) of the CEA, 7 U.S.C. 1a(2), as an organized exchange or other trading facility.[107] As defined under the CEA, both an organized exchange,[108] and other trading facility[109] require, among other things, multiple participants to execute or trade contracts or transactions, by accepting bids or offers made by other participants that are open to multiple participants in the facility or system, or through the interaction of multiple bids or offers within a system with a pre-determined nondiscretionary automated trade matching and execution algorithm.

(III) futures for swaps; or
(iii) a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization. 7 U.S.C. 5(d)(9).

[106] The Commission further notes that pursuant to Core Principle 21, all contracts traded on a DCM must be cleared through a registered DCO, irrespective of the clearing mandate.

[107] The CEA requires that DCMs must be boards of trade, as defined under the CEA. See, e.g., 7 U.S.C. 7(a) (stating the a board of trade may apply for designation as a contract market); see also 7 U.S.C. 7(d) (core principles apply to board of trade).

[108] As defined in section 1a(37) of the CEA, the term ''organized exchange'' means a trading facility that: (A) permits trading: (i) by or on behalf of a person that is not an eligible contract participant; or (ii) by persons other than on a principal-to-principal basis; or (B) has adopted (directly or through another nongovernmental entity) rules that: (i) govern the conduct of participants, other than rules that govern the submission of orders or execution of transactions on the trading facility; and (ii) include disciplinary sanctions other than the exclusion of participants from trading.

[109] As defined in section 1a(51) (A) of the CEA, the term ''trading facility'' means a person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions— (i) by accepting bids or offers made by other participants that are open to multiple participants in the facility or system; or (ii) through the interaction of multiple bids or multiple offers within a system with a pre-determined nondiscretionary automated trade matching and execution algorithm. See section 1a(51)(B) and (C) for exclusions and special rules application to trading facility.

The Commission has considered Alice Corporation's comments, and notes that while a board of trade that is a single corporate entity may operate both a DCM and a SEF , DCMs and SEFs have separate core principles and requirements, and any entity that operates both must separately meet the statutory and regulatory requirements of each facility. In response to Alice Corporation's further comment that counterparties on a DCM should be able to offer volume-based quotes, it is unclear whether Alice Corporation's comment is being offered in the context of acceptable methods of trading on a DCM's central marketplace or in the context of off-exchange transactions. If the former, the Commission reiterates that the acceptable methods of trading on a DCM's central marketplace are specifically determined under the CEA, which requires at a minimum that DCMs must be "trading facilities," though even in that context the Commission has accepted trading systems beyond pure price-and-time algorithms. If Alice Corporation's reference to volume-based quotes is some sort of off-exchange trading methodology, the Commission reiterates that its analysis of such a proposal would be conducted under Core Principle 9. The comment does not offer sufficient information to analyze the suggestion at this time.

9. § 38.10 – Reporting of Swaps Traded on a Designated Contract Market

Proposed § 38.10 codified the compliance obligations of DCMs with respect to real-time reporting of swap transactions and swap data recordkeeping and reporting obligations, as was required under then-proposed parts 43[110] and 45[111] of the Commission's regulations, respectively.

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[110] See "Real Time Public Reporting of Swap Transaction Data," Proposed Rule, 75 FR 76139, Dec. 7, 2010.

[111] See "Swap Data Recordkeeping and Reporting Requirements," Proposed Rule, 75 FR 76573, Dec. 8, 2010.

Summary of Comments and Discussion

CME referred the Commission to comments it submitted on February 7, 2011 with respect to proposed rulemakings under part 43 (real-time public reporting of swap transaction data) and part 45 (swap data recordkeeping and reporting requirements).[112]

Rule 38.10 references the reporting requirements contained under parts 43 and 45, but does not contain the substantive obligations associated with the requirements. Accordingly, CME's comments were considered in connection with the final rulemakings under parts 43 and 45.

The Commission is adopting this provision as proposed, with certain clarifications to conform the rule to the regulations under parts 43 and 45. Specifically, proposed § 38.10 required that each DCM, with respect to swaps traded on or through the DCM, report specified swap data to an SDR. The Commission is modifying § 38.10 to clarify that DCMs must maintain and report specified swap data for swaps traded "on or pursuant" to the rules of the DCM. The clarification is consistent with the rulemakings that implement real-time reporting of swap transaction data and swap data recordkeeping and reporting requirements under parts 43 and 45 of the Commission's regulations.[113]

D. <u>Core Principles</u>

As noted above, this release reorganizes part 38 to include subparts A through X. Each of subparts B through X includes relevant regulations applicable to the 23 core

[112] CME Comment Letter at 14 (Feb. 22, 2011).
[113] 75 FR 76140, Dec. 7, 2010; 75 FR 76574, Dec. 8, 2010.

principles. This final rulemaking codifies within each subpart the statutory language of the respective core principle.[114]

1. Subpart B - Designation as Contract Market

In the DCM NPRM, the Commission proposed to codify the statutory text of Core Principle 1 in § 38.100.[115] The Commission is adopting § 38.100 as proposed.

2. Subpart C - Compliance with Rules

Section 5(d)(2) of the CEA, as amended by the Dodd-Frank Act, requires that a DCM establish, monitor, and enforce compliance with its rules, including rules regarding access requirements and the terms and conditions of any contract to be traded on the contract market, and rules prohibiting abusive trade practices.[116] A DCM must also have the capacity to detect and investigate potential rule violations and to sanction any person that violates its rules. In addition, a DCM's rules must provide it with the ability and authority to perform the obligations and responsibilities required under Core Principle 2, including the capacity to carry out such international information sharing agreements that the Commission may require.

The Commission proposed several rules implementing amended Core Principle 2, as further described below.

i. § 38.150—Core Principle 2

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[114] As noted in the DCM NPRM, in two instances the language of the core principle, as codified, was slightly revised to add references to the CEA where the statutory language simply cited to the CEA section without citing to the statute. These non-substantive edits were made to sections 38.100 and 38.1200.

[115] Section 735 of the Dodd-Frank Act amended Core Principle 1 by adding that compliance with the core principles, and any other rule or regulation that the Commission may impose under section 8a(5) of the CEA, is a necessary condition to obtain and maintain designation as a contract market, and by adding the condition that "unless otherwise determined by the Commission by rule or regulation," DCMs have reasonable discretion in establishing the manner in which they comply with the core principles. 7 U.S.C. 7(d)(1).

[116] Section 735 of the Dodd-Frank Act amended section 5 of the CEA to eliminate DCM designation criteria and amends several core principles, including Core Principle 2. Core Principle 2 was amended to include language formerly found in Designation Criterion 8—Ability to Obtain Information, and to specifically require that a DCM have the ability to detect, investigate, and sanction rule violations.

Proposed § 38.150 codified the text of section 5(d)(2) of the CEA.

CME commented that a DCM cannot be expected to carry out international or other informational sharing agreements to which it is not a party, and should not be compelled by regulation to enter into such agreements.[117] KCBT opposed the requirement that a DCM establish rules and enter into informational-sharing agreements, particularly when such agreements contain specific requirements that are unsuitable to a DCM or conditions with which the DCM is unable to comply.[118]

Discussion

The Commission is adopting § 38.150 as proposed. Section 38.150 simply codifies the statutory language of the core principle. The Commission, therefore, does not have discretion to amend the requirements or obligations imposed by the statute.[119]

ii. § 38.151 – Access Requirements

<u>§ 38.151(a)-Jurisdiction</u>

Proposed § 38.151(a) required that prior to granting a member or market participant access to its markets, the DCM must require the member or market participant to consent to its jurisdiction.

Summary of Comments

CFE stated that the term "market participant" used in the proposed rule should be limited to non-members of a DCM that have the ability to enter orders directly into a DCM's trade matching system for execution, and that the term should not include non-

[117] CME Comment Letter at 15 (Feb. 22, 2011).
[118] KCBT Comment Letter at 3 (Feb. 22, 2011).
[119] Section 5(d)(2)(C) of the CEA, as amended by the Dodd-Frank Act, states that "[t]he rules of the contract market shall provide the board of trade with the ability and authority to obtain any necessary information to perform any function described in this subsection, including the capacity to carry out such international information sharing agreements as the Commission may require." 7 U.S.C. 7(d)(2).

members that do not have this ability.[120] CFE further commented that the proposed rule should not apply to customers whose orders pass through a member's system before receipt by a DCM because, according to CFE, in that instance the customer order is being received by the DCM from the member.[121] CFE also asserted that customers that submit orders through a member do not have the privilege of trading on a DCM and thus the proposed rule should not apply to them.[122]

CME recommended that the Commission withdraw the proposed rule.[123] It contended that requiring clearing firms to obtain every customer's consent to the regulatory jurisdiction of each DCM would be costly.[124] Moreover, CME commented that even if such consent were obtained, the proposed rule would be entirely ineffective in achieving the Commission's desired outcome.[125] CME explained that if a non-member who had consented to the exchange's jurisdiction under the proposed rule committed a rule violation and subsequently elected not to cooperate in the investigation or disciplinary process, the exchange's only recourse would be to deny the non-member access and, if appropriate, refer the matter to the Commission.[126] CME further explained that a DCM's enforcement options, and the regulatory outcomes, do not change based on whether or not there is a record of the non-member consenting to jurisdiction, but rather depend on whether the non-member chooses to participate in the DCM's investigative and disciplinary processes.[127]

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[120] CFE Comment Letter at 2 (Feb. 22, 2011).
[121] Id.
[122] Id.
[123] CME Comment Letter at 17 (Feb. 22, 2011).
[124] Id. at 16.
[125] Id.
[126] Id.
[127] Id.

ICE contended that the proposed rule should distinguish between direct-access and intermediated market participants.[128] Furthermore, ICE stated that a trader should be specifically subject to the jurisdiction and the disciplinary process of the DCM only when the privilege of trading on a DCM is specifically granted by the DCM.[129] Likewise, KCBT explained that even if a non-member consents to KCBT jurisdiction, but later fails to abide by such consent, KCBT's only recourse would be to revoke such participant's market access.[130] Therefore, KCBT questioned the benefit of implementing the proposed rule.[131]

NYSE Liffe sought clarification regarding the type of market participant covered by the proposed rule.[132] NYSE Liffe requested that the Commission confirm that, unless NYSE Liffe permits market participants direct access to its trading platform, it would not consider a DCM to be "granting" market participants access to its markets, thus necessitating that it require market participants to consent to the DCM's jurisdiction.[133]

Discussion

The Commission is adopting § 38.151(a) as proposed. While acknowledging the comments described above, the Commission believes that § 38.151(a) codifies jurisdictional requirements necessary to effectuate the statutory mandate of Core Principle 2 that a board of trade "shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market." In the Commission's view, settled jurisdiction—established by a DCM prior to granting

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[128] ICE Comment Letter at 12-13 (Feb. 22, 2011).
[129] Id. at 15.
[130] KCBT Comment Letter at 2 (Feb. 22, 2011).
[131] Id.
[132] NYSE Liffe Comment Letter at 11 (Feb. 22, 2011).
[133] Id.

members and market participants access to its markets—is necessary to effectively investigate and sanction persons that violate DCM rules. In particular, a DCM should not be in the position of asking market participants to voluntarily submit to jurisdiction and cooperate in investigatory proceedings after a potential rule violation has been found. Similarly, market participants should be clear that their trading practices are subject to the rules of a DCM, including rules that require cooperation in investigatory and disciplinary processes. For the avoidance of doubt, the Commission notes that the scope of § 38.151(a) is not limited to market participants with direct market access, or limited as otherwise suggested by CFE, ICE and NYSE Liffe. To the contrary, persons whose trades are intermediated, persons who are customers of member firms, and persons whose access to the exchange is granted by or through member firms are within the scope of § 38.151(a).

The Commission notes commenters' suggestion that a DCM's ultimate recourse against non-members who fail to cooperate in investigations or disciplinary proceedings is to deny such non-members access to the exchange and, if appropriate, refer them to the Commission. The Commission confirms that denial of access and referral to the Commission are the appropriate steps for a DCM to take when a market participant fails to cooperate in an investigation or disciplinary proceedings. The Commission expects that DCMs will in fact follow these steps. However, the Commission does not agree that this absolves DCMs from their responsibility to establish jurisdiction over members and market participants as an initial condition of trading. Finally, the Commission recognizes that DCMs may need additional time to secure existing market participants' agreements to jurisdiction. Accordingly, the Commission is granting DCMs up to 180 days

following the applicable effective date of the rules being adopted in this release to comply with the requirements of § 38.151(a) with respect to existing members and market participants. Each DCM may determine for itself how it will secure such agreements. For example, a DCM could utilize its clearing firms to secure the agreement. With respect to new members and market participants, DCMs will be subject to § 38.151(a) on the effective date of the rules being adopted in this release.

§ 38.151(b)-Impartial access by members, market participants and independent software vendors

Proposed § 38.151(b) required that a DCM provide its members, market participants and independent software vendors ("ISVs") with impartial access to its markets and services, including: (1) access criteria that are impartial, transparent, and applied in a non-discriminatory manner, and (2) comparable fee structures for members, market participants and ISVs, receiving equal access to, or services from, the DCM. In regards to the proposed rule's comparable fee structure requirement, the DCM NPRM preamble discussion of proposed § 38.151(b) stated that "[f]ee structures may differ among categories if such fee structures are reasonably related to the cost of providing access or services to a particular category."[134]

Summary of Comments

Chris Barnard supported this requirement, stating that the only reason for charging different fee structure would relate to differing costs of providing access or service to a particular category.[135] CFE commented that the Commission's application of

[134] See DCM NPRM at 80579. As an example, the preamble further stated that "if a certain category required greater information technology or administrative expenses on the part of the DCM, then a DCM may recoup those costs in establishing fees for that category or member or market participant." Id.
[135] Barnard Comment Letter at 2 (Feb. 22, 2011).

the requirement to have comparable fee structures is too narrow.[136] CFE stated that it is in a DCM's best interest to set fees at levels that encourage participation on the DCM (rather than to exclude participants) because having greater participation leads to greater contract volume and thus more transaction revenue for the DCM.[137] CFE agreed that a DCM should be able to have fee structures that differ among categories and did not believe that the only permitted differentiation should be based on cost.[138]

CME stated that the fee restrictions imposed by the proposed rule exceed the Commission's authority under the Dodd-Frank Act, and questioned the basis for the proposed rule.[139] In particular, CME argued that the agency lacks authority to set or limit fees charged by DCMs.[140]

ELX stated that exchanges must have some flexibility in implementing fees in order to allow new markets to effectively build a customer base.[141] According to ELX, not all customers "receive the same commission" from their FCM, IB or executing broker, and it is artificial to require exchanges to forego their flexibility in pricing to build a marketplace.[142] ELX further stated that competition should not be rigidly regulated at the exchange level while other regulated entities doing business with customers are permitted to use competitive pricing.[143]

ICE noted that the discriminatory conduct prohibited by the proposed rule would be subject to review by the Commission as an "access denial" issue under part 9 of the

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[136] CFE Comment Letter at 3 (Feb. 22, 2011).
[137] Id.
[138] Id.
[139] CME Comment Letter at 8-9 (Feb. 22, 2011).
[140] Id.
[141] ELX Comment Letter at 3 (Feb. 22, 2011).
[142] Id. at 4.
[143] Id.

Commission's regulations.[144] Moreover, ICE asserted that in its view, there has been no pattern of DCMs denying access to their markets that warrants the proposed rule.[145] ICE added that the proposed rule should not require access requirements for traders who do not apply for, and are not granted access to, the trading platform by the DCM.[146]

KCBT objected to the Commission's mandate of access and fee equality, stating that the mandate may not take into consideration all aspects of an exchange's varying fee or access structures, including beneficial rate structures for high-volume traders or market maker programs.[147] Consequently, KCBT urged the Commission to withdraw from its attempt to impose fee restrictions on DCMs.[148]

MGEX stated that in general, it is in the best interest of the DCM to have open and available markets and services.[149] Therefore, MGEX argued that the proposed rule is unnecessary and infringes on the business judgment of the DCM. [150]

Trading Technologies stated that the Commission should modify its proposed impartial access rules to require that DCM co-location service fees be reasonably related to the cost of providing such services.[151]

Discussion

The Commission is adopting the rule as proposed, with the modifications and clarifications described below.

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[144] ICE Comment Letter at 15 (Feb. 22, 2011).
[145] Id. at 15.
[146] Id.
[147] KCBT Comment Letter at 3 (Feb. 22, 2011).
[148] Id.
[149] MGEX Comment Letter at 3 (Feb. 22, 2011).
[150] Id.
[151] Trading Technologies Comment Letter at 4 (Jun. 3, 2011). The Commission recently addressed co-location fees in a separate proposed rulemaking for "Co-location/Proximity Hosting Services." See notice of proposed rulemaking, 75 FR 33198, Jun. 11, 2010.

The Commission believes that the proposed rule falls within the Commission's authority under the Dodd-Frank Act. As an initial matter, Congress, under the Dodd-Frank Act, expressly authorized the Commission to promulgate rules implementing requirements for DCMs, including access requirements.[152] Moreover, the statutory language of Core Principle 2 expressly requires that DCMs "establish, monitor and enforce compliance with the rules of the contract market, including: (1) Access requirements[.]"[153] Though the CEA does not specify that DCMs provide "impartial" access, the Commission believes that a reasonable reading of the CEA is that it permits rules that would promote impartial access.

The Commission has considered comments that claimed that the rule is unnecessary, and believes that impartial access rules are necessary in order to prevent the use of discriminatory access requirements as a competitive tool against certain participants. In particular, access to a DCM should be based on the financial and operational soundness of a participant, not on factors that could bar access and result in discriminatory access or act as a barrier to entry. Any participant should be able to demonstrate financial soundness by showing either that it is a clearing member of a DCO that clears products traded on that DCM, or that it has clearing arrangements in place with such a clearing member. Furthermore, granting impartial access to participants that satisfy a DCM's access requirements will likely enhance the DCM's liquidity and the overall transparency of the swaps and futures markets.

In regards to comments pertaining to the proposed rule's treatment of fees, the Commission believes that commenters have misinterpreted the proposed requirement for

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[152] See CEA section 5(d)(1)(A)(ii) (Core Principle 1), 7 U.S.C. 7(d)(1).
[153] CEA section 5(d)(2)(A)(i) (Core Principle 2), 7 U.S.C. 7(d)(2).

comparable fee structures for categories of market participants receiving equal access to the DCM. The requirement in proposed § 38.151(b) neither sets nor limits fees charged by DCMs. Rather, it states only that the DCM set non-discriminatory fee classes for those receiving access to the DCM as a way to implement the requirement of impartial access to DCMs. DCMs may establish different categories of market participants, but may not discriminate within a particular category. Accordingly, contrary to CME's comment claiming that the fee restrictions imposed by the proposed rule exceed the Commission's authority under the Dodd-Frank Act, the rule does not set or impose fees on DCMs.

To clarify the DCM NPRM preamble discussion of the proposed rule's fee requirement, and in response to CFE and KCBT's comment that a DCM should be able to differentiate among categories by using factors other than cost, the Commission notes that when a DCM determines its fee structure, it may consider other factors in addition to the cost of providing a member, market participant or ISV with access. The proposed requirement that DCMs have a comparable fee structure for categories of market participants was not designed to be a rigid requirement that fails to take into account legitimate business justifications for offering different fees to different categories of entities seeking access. The Commission recognizes that DCMs may also consider services they receive from members, market participants or ISVs (in addition to costs) when determining their fee structure. Market making is an example of one type of service that could merit a fee discount.

To address comments submitted in connection with proposed § 38.151(a) pertaining to the uncertainty of the term "market participant," the Commission is

replacing the term "market participant" in proposed § 38.151(b) with the phrase "persons with trading privileges."

The Commission is adopting the remainder of the rule as proposed.

§ 38.151(c)-Limitations on access

Proposed § 38.151(c) required a DCM to establish and impartially enforce rules governing any decision by the DCM to deny, suspend, or permanently bar a member's or market participant's access to the contract market. Any decision by a DCM to deny, suspend, or permanently bar a member's or market participant's access to the DCM must be impartial and applied in a non-discriminatory manner.

Summary of Comments

CFE, ICE, and NYSE Liffe commented on the uncertainty of the term "market participant" as used in paragraphs (a), (b), and (c) of proposed § 38.151.[154]

Discussion

To address comments pertaining to the uncertainty of the term "market participant," the Commission is replacing the term "market participant" in proposed § 38.151(c) with the phrase "persons with trading privileges."

iii. § 38.152 – Abusive Trading Practices Prohibited

As proposed, § 38.152 required a DCM to prohibit the following abusive trading practices: front-running, wash trading, pre-arranged trading, fraudulent trading, money passes, and any other trading practices that the DCM deems to be abusive. Additionally, a DCM permitting intermediation would be required to prohibit additional trading practices, including trading ahead of customer orders, trading against customer orders,

[154] CFE Comment Letter at 2 (Feb. 22, 2011); ICE Comment Letter at 14 (Feb. 22, 2011); NYSE Liffe Comment Letter at 11 (Feb. 22, 2011).

accommodation trading, and improper cross-trading. The proposal also required a DCM to prohibit any other manipulative or disruptive trading practices prohibited by the Act or by the Commission pursuant to regulation.[155]

Summary of Comments

CME and MGEX stated that the proposed rule is too vague because it does not specifically define the enumerated prohibited trade practices.[156] CME also stated that DCMs should have reasonable discretion to establish rules appropriate to their markets that are consistent with the CEA and that satisfy the core principles.[157] CME additionally commented that prearranged trading, which is identified in the proposed rule as a prohibited trade practice, may be permissible at DCMs that allow for block trading, exchange for related position transactions, and pre-execution communications, subject to specified conditions.[158]

Chris Barnard commented that the proposed rule refers to the prohibition of "any other manipulative or disruptive trading practices prohibited by the Act or by the Commission," which is important in order to cover new disruptive practices as they emerge, including spoofing.[159] Better Markets commented that it is unclear whether any of the practices associated with high frequency trading will be prohibited by the

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[155] Section 747 of the Dodd-Frank Act amended section 4c(a) of the CEA, 7 U.S.C. 6c(a), by adding three disruptive practices which make it: unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that–

(A) Violate bids or offers;
(B) Demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
(C) Is, is of the character of, or is commonly known as the trade as 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution).

[156] CME Comment Letter at 17 (Feb. 22, 2011) (CME also argued that the proposed regulation was superfluous given that Core Principle 12 already requires a DCM to establish and enforce rules to protect markets and market participants from abusive practices); MGEX Comment Letter at 3 (Feb. 22, 2011).
[157] CME Comment Letter at 17 (Feb. 22, 2011).
[158] Id. at 17-18.
[159] Barnard Comment Letter at 3 (May 20, 2011).

Commission.[160] Better Markets recommended that the Commission expand its list of prohibited trade practices to include exploiting a large quantity or block trade, price spraying, rebate harvesting, and layering the market, as all four of those practices involve fraudulent trading.[161]

Discussion

The Commission is adopting § 38.152 as proposed, subject to the modification described below.

In response to CME and MGEX's concerns regarding the perceived vagueness of the enumerated trading practices, the Commission notes that the definitions of the respective abusive trading practices are commonly known within the industry. Moreover, the enumerated practices in the proposed rule are commonly prohibited within the industry and are typically already prohibited in DCM rulebooks.[162] Although the Commission believes, as noted by CME, that a DCM should have reasonable discretion to establish rules for their markets, the Commission believes that, at a minimum, a DCM must prohibit the abusive trading practices identified in the rule. Indeed, in the RERs conducted by Commission staff to examine DCMs' core principle compliance, Commission staff has found that it is essential for a DCM to be able to demonstrate the capacity to detect, investigate, and enforce the trading violations prohibited under the rule. Consistent with CME's comments on this issue, the Commission clarifies that in certain limited circumstances, as provided under the CEA and the Commission regulations, pre-arranged trading, including block trading and exchange for related

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[160] Better Markets Comment Letter at 5 (Feb. 22, 2011).
[161] Id. at 5-8.
[162] See e.g., CME Rule 534 (Wash Trades Prohibited), and MGEX Rule 743.00 (Accommodation or Wash Trades Forbidden).

position transactions, are permissible at DCMs. Accordingly, the Commission is amending proposed § 38.152 to clarify that a DCM must prohibit pre-arranged trading except as otherwise permitted in part 38 of this chapter. The Commission confirms that pre-execution communications are permissible if allowed by a DCM's rules that have been certified to or approved by the Commission.

In response to Chris Barnard's comment about the inclusion of "spoofing" as a prohibited trade practice, the Commission notes that section 747 of the Dodd-Frank Act amended section 4c(a) of the CEA and includes spoofing as a disruptive trading practice. In the final rule, DCMs are required to prohibit any other manipulative or disruptive trading practices prohibited by the Act. Additionally, the Commission notes that Better Markets' comments regarding Core Principle 2 and high frequency trading are addressed in the context of Core Principle 4.

iv. § 38.153 - Capacity to Detect and Investigate Rule Violations

Proposed § 38.153 required that a DCM have arrangements and resources for effective rule enforcement.[163] This included the authority to collect information and examine books and records of members and market participants. Additionally, the proposed rule required a DCM to have, in addition to appropriate resources for trade practice surveillance programs, appropriate resources to enforce all of its rules.

Summary of Comments

CFE requested that the Commission clarify the term "market participant."[164] CFE claimed that if the term "market participant" were to be interpreted to apply to all customers and not just those customers with direct electronic access to the DCM, then the

[163] As noted in the DCM NPRM, proposed regulation 38.153 was based on the former application guidance for Core Principle 2.
[164] CFE Comment Letter at 2 (Feb. 2, 2011).

rule would greatly expand a DCM's regulatory responsibilities over participants with whom it has no direct relationship or connection.[165] CFE further asserted that the rule would greatly increase costs for the DCM and that it would be very difficult for a DCM to undertake the same examination responsibilities for customers that do not have a direct relationship with the DCM that are applicable to a DCM member.

CME stated that the proposed rule appears to imply that the entire class of non-member, non-registered market participants will be subject to the panoply of recordkeeping requirements currently applicable only to members, registrants, and direct access clients of CME.[166] Additionally, CME commented that the proposed rule does not detail which books, records and information the DCM must be able to obtain from non-member market participants.[167]

Discussion

The Commission is adopting this provision as proposed, subject to the modification described below.

The Commission is cognizant that a broad interpretation of the term "market participant" could significantly increase the regulatory responsibilities for DCMs. As noted above, the use of "market participant" may be interpreted to capture a wider range of persons than the Commission intended. Therefore, in response to the commenters' concerns, the Commission is replacing the term "market participant" with "persons under investigation" in the final rule. Thus, a DCM must have the authority to collect books and records from its members, and from any persons under investigation, for effective

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[165] Id.
[166] CME Comment Letter at 18 (Feb. 22, 2011).
[167] Id.

enforcement of its rules. The books and records collected by the DCM should encompass all information and documents that are necessary to detect and prosecute rule violations.

v. § 38.154 – Regulatory Services Provided by a Third Party

As the Commission stated in the DCM NPRM, the CEA "provides that a DCM may comply with applicable core principles by delegating relevant functions to a registered futures association or another registered entity" (collectively, a "regulatory service provider").[168] Proposed § 38.154(a) required that a DCM that contracts with a regulatory service provider ensure that its regulatory service provider has sufficient capacity and resources to provide timely and effective regulatory services. The proposed rule also made clear that a DCM "will at all times remain responsible for the performance of any regulatory services received, for compliance with the [DCM's] obligations under the CEA and Commission regulations, and for the regulatory service provider's performance on its behalf."[169]

Proposed § 38.154(b) required that a DCM maintain adequate compliance staff to supervise any services performed by a regulatory service provider. The proposed rule also required that the DCM hold regular meetings with its regulatory service provider to discuss current work and other matters of regulatory concern. The DCM must also conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf.

Proposed § 38.154(c) required a DCM that utilizes a regulatory service provider to retain exclusive authority over certain areas, including the cancellation of trades, issuance of disciplinary charges against members or market participants, and denials of

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[168] Id. at 80580.
[169] 75 FR 80572, 80612, Dec. 22, 2010.

access to the trading platform for disciplinary reasons. While the proposed rule permitted a DCM to retain exclusive authority in other areas of its choosing, it required that the decision to open an investigation into a possible rule violation reside with the regulatory service provider.

Summary of Comments

MGEX, KCBT and CME asserted that the proposed rule was overly burdensome or unnecessary.[170] MGEX expressed general opposition to proposed § 38.154, stating that if a service has been delegated to another registered entity pursuant to a Commission-approved agreement, then this "should be sufficient and no other formal agreement is necessary."[171] KCBT contended that proposed § 38.154 is overly burdensome and duplicative, particularly when a DCM contracts with a regulatory service provider that is also a DCM required to comply with the same core principles.[172] KCBT noted that it currently is a party to a services agreement with another DCM and that it will be costly and unnecessary to perform periodic reviews and hold regular meetings with this regulatory service provider.[173]

Similarly, CME contended that the proposed rule was overly prescriptive and suggested that the rules would better serve as guidance and acceptable practices.[174] In particular, CME pointed to the requirements that a DCM conduct periodic reviews of the services provided and hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other

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[170] MGEX Comment Letter at 3 (Feb. 22, 2011); KCBT Comment Letter at 3 (Feb. 22, 2011); CME Comment Letter at 19 (Feb. 22, 2011).
[171] MGEX Comment Letter at 3 (Feb. 22, 2011).
[172] KCBT Comment Letter at 3 (Feb. 22, 2011).
[173] Id.
[174] CME Comment Letter at 18-19 (Feb. 22, 2011).

matters of regulatory concern.[175] CME stated that "[w]hile it may well be that it is constructive for the DCM to hold regular meetings with its service provider and 'discuss market participants,' the core principle should stand on its own and the DCM should have the flexibility to determine how best to demonstrate compliance with the core principle."[176]

CME further objected to the requirement that exclusive authority to open investigations remain with the regulatory service provider.[177] While it argued that the regulatory service provider "should have the independence to open an investigation at its discretion, [CME] sees no reason why the DCM cannot also direct the regulatory service provider to open an investigation."[178] Additionally, CME and KCBT both objected to the requirement in proposed § 38.154(c) that all decisions concerning the cancellation of trades remain within the exclusive authority of the DCM.[179] CME and KCBT argued that a DCM may be better served by granting such authority to a regulatory service provider.[180]

NYSE Liffe expressed support for the idea that a DCM will remain ultimately responsible for meeting its regulatory obligations even when it contracts with a regulatory service provider.[181] However, NYSE Liffe requested clarification regarding what authority must be maintained by a DCM when it uses a third-party regulatory service provider.[182] NYSE Liffe pointed to the requirement in proposed § 38.154(c) that a DCM must retain "exclusive authority" in certain areas and requested further clarification as to

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[175] Id.
[176] CME Comment Letter at 19 (Feb. 22, 2011) .
[177] Id.
[178] Id.
[179] CME Comment Letter at 19 (Feb. 22, 2011); KCBT Comment Letter at 3 (Feb. 22, 2011).
[180] Id.
[181] NYSE Liffe Comment Letter at 9 (Feb. 22, 2011).
[182] Id.

the definition of "exclusive authority."[183] In particular, NYSE Liffe requested guidance as to whether a DCM retains "exclusive authority" if its regulatory service provider prepares and presents an investigation report to a DCM's review panel, or assists DCM staff in presenting the matter, as long as the ultimate decision to bring a disciplinary action remains with the DCM's review panel.[184] Additionally, NYSE Liffe sought guidance as to whether a regulatory service provider would be permitted to "prosecute a disciplinary proceeding...so long as the ultimate decision to impose a penalty on a respondent, including a possible denial of access to the trading platform, resides with a hearing panel formed pursuant to the DCM's rules?"[185]

Discussion

The Commission is adopting § 38.154 (a) and (b), as proposed, and is adopting § 38.154(c) with certain modifications.

In the past, the Commission has described acceptable "contracting" and "delegating" arrangements for the performance of core principle functions by third-parties.[186] The Commission proposed § 38.154 to clarify its previous guidance on such arrangements. In particular, the Commission does not draw substantive distinctions between "contracting" and "delegating" arrangements as they pertain to core principle compliance functions. Regardless of the term by which a DCM may refer to its utilization of a third-party, the Commission believes that the same regulatory requirements are applicable for purposes of part 38. For purposes of part 38, the Commission refers to such arrangements as "delegation." The Commission also notes

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[183] Id.
[184] Id.
[185] Id. at 10.
[186] See 66 FR 42256, 42266, Aug. 10, 2001.

that DCMs must remain responsible for carrying out any function delegated to a third party, and that DCMs must ensure that the services received will enable the DCM to remain in compliance with the CEA's requirements. The Commission believes that proposed § 38.154 effectively establishes a system for administering regulatory services provided to DCMs by third party regulatory service providers. The Commission is of the view that the rule generally provides an appropriate balance between flexibility and ensuring that a DCM properly oversees the actions of its regulatory service provider to ensure accountability and effective performance.

The Commission acknowledges comments asserting that the rule is overly burdensome or unnecessary but believes that a DCM that elects to use a regulatory service provider must properly supervise the quality and effectiveness of the regulatory services provided on its behalf. The Commission believes that proper supervision will require that a DCM have complete and timely knowledge of relevant work performed by the DCM's regulatory service provider on its behalf. The Commission also believes that such knowledge can only be acquired through the periodic reviews and regular meetings required under proposed § 38.154.

Additionally, the Commission acknowledges CME and KCBT's comments regarding the cancellation of trades but believes that the potential economic consequences of trade cancellations on a DCM's members and market participants are such that a DCM should retain exclusive authority over the cancellation of trades.

The Commission has considered CME's comment regarding the importance of allowing a DCM to open investigations into possible rule violations. The Commission believes that a DCM should have the ability to request that its regulatory service provider

conduct an investigation on a market participant or to conduct such an investigation on its own. Consequently, the Commission is modifying § 38.154(c) by removing the requirement that the decision to open an investigation into possible rule violations reside exclusively with the regulatory service provider.

Lastly, in response to the request by NYSE Liffe for additional guidance regarding whether certain regulatory decisions must be retained by a DCM, the Commission believes that a DCM would retain "exclusive authority" under § 38.154(c) if it permits a regulatory service provider to present, or assist DCM staff to present, an investigation report or evidence to a disciplinary panel as long as the decisions to bring a disciplinary action and impose a disciplinary penalty on a respondent, including the decision to deny access, remains with the DCM or the DCM's disciplinary bodies.

vi. § 38.155 – Compliance Staff and Resources

In proposed § 38.155(a), the Commission required that a DCM establish and maintain sufficient compliance staff and resources to conduct a number of enumerated tasks, such as audit trail reviews, trade practice surveillance, market surveillance, and real time market monitoring. The proposed rule also required that the DCM have sufficient compliance staff to address unusual market or trading events and to conduct and complete any investigations in a timely manner.

In proposed § 38.155(b), the Commission required a DCM to monitor the size and workload of its compliance staff annually to ensure that staff and resources are adequate. In the preamble to the proposed rule, the Commission clarified that it was not proposing that compliance staff size be determined based on a specific formula. Rather, the Commission intended "to leave to the discretion of each individual DCM to determine

the size of the staff it needs to effectively perform its self-regulatory responsibilities."[187] In making this determination, the proposed rule also set forth certain factors that should be considered in determining the appropriate level of compliance resources and staff.

Summary of Comments

NYSE Liffe noted that in proposed § 38.154(b), "a DCM that contracts with a regulatory service provider must still maintain sufficient compliance staff."[188] NYSE Liffe suggested that § 38.155 take into consideration whether a DCM has contracted with a regulatory service provider in determining the appropriate level of compliance staff and resources.[189] NYSE Liffe also requested that the Commission "make clear that a DCM meets its requirement to have sufficient compliance staff to address unusual market or trading events where its regulatory services provider has sufficient resources for addressing these unusual events."[190]

Chris Barnard requested that the Commission amend § 38.155 to require DCMs to have a chief compliance officer "working within a job description, structures, rules and procedures that act to maintain its independence."[191]

Discussion

The Commission believes that proposed § 38.155 effectively sets forth the requirement that DCMs must establish and maintain sufficient compliance staff to enforce compliance with its rules as required under Core Principle 2, and accordingly, the Commission is adopting § 38.155 as proposed.

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[187] DCM NPRM at 80580.
[188] NYSE Liffe Comment Letter at 10 (Feb. 22, 2011). See also DCM NPRM at 80612.
[189] NYSE Comment Letter at 10 (Feb. 22, 2011).
[190] Id.
[191] Barnard Comment Letter at 3 (May 20, 2011).

The Commission is of the view that having adequate staff to perform a DCM's compliance and enforcement responsibilities is essential to the effectiveness of its self-regulatory programs, including market surveillance, audit trail, trade practice surveillance, and disciplinary programs. The Commission believes (as noted by NYSE Liffe) that the staff of a regulatory service provider may be taken into consideration when determining whether a DCM has sufficient compliance staff. However, the Commission notes that pursuant to § 38.154(b), each DCM must still retain sufficient compliance staff to supervise the quality and effectiveness of any services provided by a regulatory service provider on its behalf.

The Commission acknowledges Chris Barnard's comment that a DCM should be required to designate a chief compliance officer but notes that the Dodd-Frank Act mandates that certain regulated entities, such as SEFs, swap data repositories, and derivatives clearing organizations, designate chief compliance officers. There is no explicit statutory requirement for DCMs. Therefore, the Commission does not believe it is appropriate to require DCMs to appoint a chief compliance officer. However, it is current industry practice for DCMs to designate an individual as chief regulatory officer, and it will be difficult for a DCM to meet the requirements of § 38.155 without a chief regulatory officer or similar individual to supervise its regulatory program, including any services rendered to the DCM by a regulatory service provider.

vii. § 38.156 - Automated Trade Surveillance System

Proposed § 38.156 required a DCM to maintain an automated trade surveillance system capable of detecting and investigating potential trade practice violations. The automated trade surveillance would be required to maintain all data reflecting the details

of each order entered into the trading system, including order modifications and cancellations, and data reflecting transactions executed on the DCM. The proposed rule required the automated surveillance system to process this data on a trade date plus one day basis ("T + 1 basis"). Additionally, according to the rule, the automated trade surveillance system would be required to provide users with the ability to compute, retain and compare trading statistics; compute profit and loss; and reconstruct the sequence of trading activity.

Summary of Comments

CME commented that an exchange does not capture order details, modifications or cancellations for open-outcry orders in an automated manner unless such orders are transmitted to the floor via the exchange's order routing system, or with respect to privately negotiated transactions.[192] CME asserted that it has been unable to design a system that automates the actual investigation of potential trade practice violations, and that it would not be able to do so within 60 days of the final rules taking effect.[193] CME further argued that it is unclear whether the regulation applies to electronic trading or open outcry trading.[194] CME challenged the use of what it deems as "broad and ambiguous" terms to describe capabilities that a DCM's automated trade surveillance system is required to have, including the capability to detect and flag specific trade execution patterns and anomalies; compute, retain and compare trading statistics; and compute trade gains, losses, and futures-equivalent positions.[195] CME recommended that

[192] CME Comment Letter at 20 (Feb. 22, 2011).
[193] Id.
[194] Id.
[195] Id.

the Commission reconsider the requirements of this regulation and consider a more flexible, core principles-based approach.[196]

MGEX agreed with the proposed requirement that a DCM's automated surveillance system must maintain all trade data and order data on a T + 1 basis, but opposed the proposed requirement that a DCM compute, retain and compare trading statistics.[197] MGEX contended that this information is not a trade data item and requested that this requirement be removed from the final rule.[198]

NYSE Liffe commented that it would take significant time to determine the types of changes to existing automated systems required to implement the proposed rules, including § 38.156, and recommended that the Commission provide existing DCMs with at least 18 months from the effective date of the rule to certify compliance with the final regulations.[199]

Better Markets commented that an automated trade surveillance system, which records orders, modifications of orders, and cancellations, must allow for such data to be time-stamped at intervals consistent with the capabilities of high frequency traders that use the DCM's systems to transact.[200]

Discussion

The Commission is adopting proposed § 38.156, with one modification.

The requirement that an automated trade surveillance system maintain all data reflecting the details of each order entered into the trading system is being moved to § 38.552 (Elements of an acceptable audit trail program). Specifically, the Commission

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[196] Id.
[197] MGEX Comment Letter at 4 (Feb. 22, 2011).
[198] Id.
[199] NYSE Liffe Comment Letter at 14 (Feb. 22, 2011).
[200] Better Markets Comment Letter at 9 (Feb. 22, 2011).

believes that § 38.552(b) is the more logical place in the Commission's rules to address this aspect of a DCM's automated surveillance system because paragraph (b) specifies the requirements for a DCM's audit trail program, including a history of all orders and trades.

In response to CME's comment regarding a system that automates the actual investigation, the Commission notes that CME has misinterpreted the proposed rule, as § 38.156 applies to a DCM's automated surveillance system and not to the actual investigation which the Commission expects would be carried out by a DCM's compliance staff with the assistance of automated surveillance tools. The Commission confirms that the speed and timing of capturing information through an automated trade surveillance system is different for open-outcry than for electronic trading, as CME stated in its comments; this is addressed in the discussion concerning § 38.552.

In regards to CME's comment pertaining to the breadth of the rule, while the Commission acknowledges that computing, retaining, and comparing trading statistics may not specifically be a trade data item, the Commission believes that these analytical tools are a necessary component of an effective trade surveillance system. The Commission notes that timing concerns raised by NYSE Liffe regarding compliance with the final rules are addressed above in the § 38.3 discussion. Additionally, the Commission notes that Better Markets' comments regarding Core Principle 2 and high frequency trading are addressed in the context of Core Principle 4.

viii. § 38.157 – Real-time Market Monitoring

Proposed § 38.157 codified existing practices at DCMs for real-time monitoring of electronic trading, and reflected the growth of electronic trading in the U.S. futures

markets, as well as the Commission's experience in designating new contract markets since passage of the CFMA.[201] Proposed § 38.157 required a DCM to conduct real-time market monitoring of all trading activity on its electronic trading platform to ensure orderly trading and identify market or system anomalies. The proposed rule further required a DCM to have the authority to cancel trades and adjust trade prices when necessary, and that any price adjustments or trade cancellations must be transparent to the market and subject to clear, fair and publicly-available standards.

Summary of Comments

In its comments, CME reiterated its belief that the proposed rules are overly prescriptive.[202] CME argued that the standards set in the proposed rule are unreasonably high.[203] CME pointed to the requirement that a DCM "conduct real-time market monitoring of all trading activity on its electronic trading platform(s) to ensure orderly trading and identify any market or system anomalies" and argued that it is not clear whether any DCM could comply with these standards.[204]

Better Markets stated that when conducting real-time market monitoring, DCMs should have the capability to monitor high frequency trading.[205] Better Markets argued that this process should include "monitoring of orders and cancellations, each time-stamped at intervals consistent with the capabilities of [high frequency traders]."[206]

Discussion

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[201] See DCM NPRM at 80581.
[202] CME Comment Letter at 20-21 (Feb. 22, 2011).
[203] Id.
[204] CME Comment Letter at 20-21 (Feb. 22, 2011) (citing DCM NPRM at 80613, with emphasis added by CME).
[205] Better Markets Comment Letter at 9 (Feb. 22, 2011).
[206] Id.

The Commission is adopting § 38.157, as proposed, subject to the modification described below.

In regard to the CME's comment, the Commission believes that § 38.157, as proposed, enables a DCM to effectively monitor its electronic markets and grants a DCM the flexibility to determine the best way to conduct real-time market monitoring. The Commission also believes that the proposed rule correctly mandates that a DCM conduct real-time market monitoring of all trading activity that occurs on its electronic trading platform(s) in order to detect disorderly trading and market or system anomalies, and take appropriate regulatory action.

The Commission recognizes that real-time market monitoring cannot ensure orderly trading at all times, but it should be able to identify disorderly trading when it occurs. Therefore, the Commission is modifying the first sentence of proposed § 38.157 to remove the requirement to "ensure orderly trading" and instead state that "a designated contract market must conduct real-time market monitoring of all trading activity on its electronic trading platform(s) to identify disorderly trading and any market or system anomalies." In response to Better Markets' comments, the Commission believes that § 38.157 is sufficient to establish a DCM's obligations with respect to real-time market monitoring of all trading on a DCM's electronic trading platform, including high frequency trading. The Commission will continue to assess the impact of high frequency trading on the markets regulated by the Commission.

The Commission believes that § 38.157 effectively establishes a DCM's obligations with respect to real-time market monitoring of trading activity on its

electronic trading platforms. Accordingly, the Commission is adopting § 38.157 as modified above.

ix. § 38.158 - Investigations and Investigation Reports

§ 38.158(a)-Procedures

Proposed paragraph (a) of § 38.158 required that a DCM have procedures to conduct investigations of possible rule violations. The proposed rule required that an investigation must be commenced upon Commission staff's request or upon discovery of information by the DCM indicating a possible basis for finding that a violation has occurred or will occur.

Summary of Comments

CME argued that the proposed rule diminishes any discretion on behalf of DCMs to determine the matters that warrant a formal investigation, because at the time of discovery or upon receipt of information, and before a review occurs, there always may be a possible basis that a violation has occurred or will occur.[207] CME agreed that written referrals from the Commission, law enforcement authorities, other regulatory agencies, or other SROs should result in a formal investigation in every instance.[208] However, CME contended that the DCM should have reasonable discretion to determine how it responds to complaints and other referrals, including the discretion to follow-up with a less formal inquiry in certain situations.[209]

Discussion

The Commission is adopting § 38.158(a) as proposed, subject to a minor modification. The Commission confirms that in certain circumstances a DCM should

[207] CME Comment Letter at 21 (Feb. 22, 2011).
[208] Id.
[209] Id.

have reasonable discretion regarding whether or not to open an investigation, as noted by CME. Consequently, the Commission is revising paragraph (a) of § 38.158 to reflect that an investigation must be commenced upon receipt of a request from Commission staff or upon the discovery or receipt of information by the DCM that indicates a "reasonable basis" for finding that a violation "may have" occurred or will occur.

§ 38.158(b)-Timeliness

Proposed § 38.158(b) required that an investigation be completed in a timely manner, which is defined in the proposed rule as 12 months after an investigation is opened, absent mitigating factors. The mitigating factors identified in the proposed rule included the complexity of the investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined by compliance staff.

Summary of Comments

CME expressed general support for the proposed rule, but recommended that the list of possible mitigating circumstances also include the domicile of the subjects and cooperative enforcement matters with the Commission, since the DCM may not have independent control over the pace of the investigation.[210] CME also requested that the Commission make clear that the time period necessary to prosecute an investigation once it is referred for enforcement action is independent of the 12-month period referenced in the regulation.[211]

Discussion

The Commission is adopting the rule as proposed.

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[210] Id.
[211] Id. at 22.

The Commission believes that a 12-month period to complete an investigation is appropriate and timely. Although the Commission believes, as noted by CME, that additional mitigating factors could justifiably contribute to a delay in completing an investigation within a 12-month period the Commission notes that the factors included in the proposed rule were not intended to be an exhaustive list of mitigating circumstances. In the Commission's view, the factors listed in the proposed rule represent some of the more common examples that could delay completing an investigation within the 12-month period. The Commission also confirms that § 38.158 only applies to the investigation phase of a matter.

§ 38.158(c)-Investigation reports when a reasonable basis exists for finding a violation

Proposed § 38.158(c) sets forth the elements and information that must be included in an investigation report when there is a reasonable basis for finding a rule violation, including: (i) the reason for the investigation; (ii) a summary of the complaint, if any; (iii) the relevant facts; (iv) compliance staff's analysis and conclusions; (v) a recommendation as to whether disciplinary action should be pursued; and (vi) the member or market participant's disciplinary history.

Summary of Comments

CME commented that rule violations can range from very minor to egregious and not every rule violation merits formal disciplinary action.[212] CME argued that minor transgressions can effectively be addressed by the issuance of a warning letter by CME compliance staff, and that the Commission should amend the rule accordingly to account for this possibility.[213]

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[212] Id.
[213] Id.

CME and ICE opposed the requirement that a DCM include a respondent's disciplinary history in the investigative report that is submitted to a review panel.[214] CME commented that a respondent's disciplinary history is not relevant to the consideration of whether that respondent has committed a further violation of the DCM's rules.[215] However, CME noted that an exception would be where the prior disciplinary offense is an element of proof for the rule violations for which compliance staff is asking the review panel to issue charges, such as a violation of a previously issued "cease and desist" order.[216] ICE stated that unless the rule violations that are the subject of the investigative report involve pervasive recordkeeping violations, only substantive violations in the respondent's history would be relevant to the review panel's deliberations.[217]

Discussion

The Commission is adopting the rule as proposed, subject to one modification to address the comments from CME and ICE.

The Commission confirms, as CME noted, that "minor transgressions" can be addressed by a DCM's compliance staff with the issuance of warning letters and this is discussed below in § 38.158(e). However, as further discussed below in §§ 38.158(d) and (e), no more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling 12-month period.

The Commission also agrees with CME and ICE that a respondent's disciplinary history is not always relevant to the consideration of whether a respondent has committed

[214] CME Comment Letter at 21-22 (Feb. 22, 2011); ICE Comment Letter at 15 (Feb. 22, 2011).
[215] CME Comment Letter at 35 (Feb. 22, 2011).
[216] Id.
[217] ICE Comment Letter at 15 (Feb. 22, 2011).

a further violation of a DCM's rules. As a result, this requirement is being eliminated from the final rule. The Commission notes, however, that all disciplinary sanctions, including sanctions imposed pursuant to an accepted settlement offer, must take into account the respondent's disciplinary history.

§ 38.158(d)-Investigation reports when no reasonable basis exists for finding a violation

Proposed § 38.158(d) sets forth the elements and information that must be included in an investigation report when it has been determined that no reasonable basis exists for finding a rule violation, including: (i) the reason the investigation was initiated; (ii) a summary of the complaint, if any; (iii) the relevant facts; and (iv) compliance staff's analysis and conclusions. The proposed rule also required that if a DCM's compliance staff recommends that a warning letter be issued, the investigation report must also include the potential wrongdoer's disciplinary history.

Summary of Comments

CME recommended that the Commission amend the proposed rule to account for a DCM's ability to close a case administratively and still issue a warning letter without disciplinary committee approval, as the CME Market Regulation Department currently has such authority.[218]

Discussion

The Commission is adopting § 38.158(d) as proposed, subject to one modification.

The Commission is eliminating the provision in paragraph (d) that discussed the concept of warning letters because the Commission does not believe that a DCM would need to limit the number of warning letters that can be issued when a rule violation has

[218] CME Comment Letter at 22 (Feb. 22, 2011).

not been found. For example, Commission staff has found in its RERs that some DCMs issue warning letters as reminders or for educational purposes. The Commission notes, however, that this modification does not impact the limitation on the number of warning letters that may be issued—by a disciplinary panel or by compliance staff—to the same person for the same violation in a rolling 12-month period when a rule violation is found to have been committed.

§ 38.158(e)-Warning letters

Proposed § 38.158(e) provided that a DCM may authorize its compliance staff to issue a warning letter or to recommend that a disciplinary committee issue a warning letter. The proposed rule also provided that no more than one warning letter for the same potential violation may be issued to the same person or entity during a rolling 12-month period.

Summary of Comments

CME and MGEX opposed the requirement that a DCM may only issue one warning letter to the same person for the same rule violation in a rolling 12-month period.[219] CME stated that the rule is unduly prescriptive and fails to take into consideration important factors that are relevant to a DCM when evaluating potential sanctions in a disciplinary matter.[220] CME stated that the DCM should have discretion to determine the appropriate sanctions in all cases.[221] MGEX contended that the requirement will effectively prohibit a DCM from using warning letters as an educational tool or reminder.[222] According to MGEX, the proposed rule forces DCMs to adopt

[219] CME Comment Letter at 22-23 (Feb. 22, 2011); MGEX Comment Letter at 4 (Feb. 22, 2011).
[220] CME Comment Letter at 22 (Feb. 22, 2011).
[221] Id.
[222] MGEX Comment Letter at 4 (Feb. 22, 2011).

summary fines and prevents them from pursuing minor infractions, which may lead to additional unintended consequences outside of the purpose of the Dodd-Frank Act.[223] MGEX recommended that the Commission remove this requirement and provide the DCM more flexibility in determining the proper methodology for enforcing rules, regulations, and procedures.[224]

Discussion

The Commission is adopting §38.158(e) with certain modifications, including to convert a portion of the rule to guidance.

The Commission acknowledges the comments from CME and MGEX concerning the issuance of warning letters but believes that in order to ensure that warning letters serve as effective deterrents, and to preserve the value of disciplinary sanctions, the Commission believes that no more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling 12-month period.[225] As discussed in the DCM NPRM, while a warning letter may be appropriate for a first-time violation, the Commission does not believe that more than one warning letter in a rolling 12-month period for the same violation is ever appropriate.[226] This provision will remain as a rule. A policy of issuing repeated warning letters, rather than issuing meaningful sanctions, to members and market participants who repeatedly violate the same or similar rules denigrates the effectiveness of a DCM's rule enforcement program.[227] Furthermore, the section of the proposed rule governing

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[223] Id.
[224] Id.
[225] For purposes of this rule, the Commission does not consider a "reminder letter" or such other similar letter to be any different than a warning letter.
[226] See DCM NPRM at 80581.
[227] See id. at 80581.

warning letters is consistent with what Commission staff has advised DCM applicants in the past and with recommendations made in prior RERs.[228]

The Commission notes that the final rule does not include the reference that a warning letter issued in accordance with this section is not a penalty or an indication that a finding of a violation has been made because paragraph (e) only addresses warning letters that are issued for a finding of a violation. Also, the provision requiring a copy of a warning letter issued by compliance staff to be included in the investigation report is being eliminated from the final rule because the Commission has determined that such a requirement is unnecessary.

As noted above, the Commission believes that minor transgressions can be addressed by the issuance of a warning letter by a DCM's compliance staff. Accordingly, in order to provide a DCM with flexibility in this regard, the Commission is moving this provision of the rule to the guidance section of Core Principle 2. The text of the guidance provides that the rules of a DCM may authorize compliance staff to issue a warning letter to a person or entity under investigation or to recommend that a disciplinary panel take such action.

x. § 38.159 – Ability to Obtain Information

Proposed § 38.159 required a DCM to have the ability and authority to obtain any necessary information to perform any function required under proposed subpart C (Compliance with rules) of the Commission's regulations. This would include the capacity to carry out any international information sharing agreements required by the Commission. Proposed § 38.159 also provided "that information sharing agreements can

[228] See 1998 Rule Enforcement Review of Kansas City Board of Trade; and Rule Enforcement Review of the Minneapolis Grain Exchange (Aug. 27, 2009).

be established with other designated contract markets and swap execution facilities, or the Commission can act in conjunction with a DCM to carry out such information sharing."[229]

Summary of Comments

CME and KCBT stated that a DCM should not be mandated to carry out international or other informational sharing agreements to which it is not a party and should not be compelled by Commission regulation to enter into agreements, particularly when such agreements contain terms determined by other parties, which conceivably could include terms or conditions unsuitable to a DCM or conditions that a DCM is unable to comply with.[230]

Discussion

The Commission is adopting § 38.159 as proposed. In response to CME and KCBT's comments, § 38.159 clarifies and codifies the Core Principle 2 requirement that a DCM have the ability and authority to obtain necessary information to perform its rule enforcement obligations. The core principle specifically requires that the rules of the DCM provide it with the ability and authority to perform any function described in the core principle, including capacity to carry out such international information sharing agreements, as the Commission may require. The rule provides that information sharing agreements can be established with other DCMs or SEFs, or that the Commission can act in conjunction with a DCM to carry out such information sharing.[231] The Commission notes that the language of § 38.159, including the language to which CME objects, is

[229] DCM NPRM at 80614.
[230] CME Comment Letter at 15 (Feb. 22, 2011); KCBT Comment Letter at 3 (Feb. 22, 2012).
[231] As noted in the DCM NPRM, this proposed language is virtually identical to the language found in the guidance for former Designation Criterion 8.

substantially similar to the language of Core Principle 2. The Commission also notes that while the rule requires DCMs to have the capacity to carry out such information sharing agreements, as is required by the statute, the rule does not mandate or prescribe the specific terms of such agreements, and thus, DCMs would have the ability to collaborate on the terms of such agreements. The Commission believes that § 38.159 appropriately implements the requirements of section 5(d)(2)(C) of the CEA and is adopting § 38.159 as proposed.

xi. § 38.160 - Additional Rules Required

Proposed § 38.160 required a DCM to adopt and enforce any additional rules that it believes are necessary to comply with the requirements of this subpart C.

The Commission has determined to codify proposed § 38.160 as guidance for Core Principle 2 in appendix B, rather than a rule, in order to provide DCMs with added flexibility in adopting rules that they believe are necessary to comply with this core principle. Consistent with this determination, the Commission is replacing proposed § 38.160 with new § 38.160 (titled "Additional sources for compliance") that simply permits DCMs to rely upon the guidance in appendix B of this part to demonstrate to the Commission compliance with § 38.150 of this part.

3. Subpart D - Contracts Not Readily Subject to Manipulation

The Dodd-Frank Act did not revise the statutory text of Core Principle 3 (Contracts Not Readily Subject to Manipulation). DCMs historically have complied with the requirements of Core Principle 3 through the guidance provided in Guideline No. 1, which was codified in former appendix A to part 40, which is now superseded by appendix C under part 38 of this final rulemaking. In the DCM NPRM, the Commission

proposed to maintain the guidance under former Guideline No. 1 in new appendix C, but with certain proposed revisions, as the central mode of compliance for DCMs under Core Principle 3. In addition to the guidance, the DCM NPRM proposed two rules under Core Principle 3. Proposed § 38.200 codified the statutory language of Core Principle 3, and proposed § 38.201 referred applicants and DCMs to the guidance in appendix C to part 38 for purposes of demonstrating to the Commission their compliance with the requirements of § 38.200.

In the DCM NPRM, the Commission proposed certain revisions to former Guideline No. 1, including: (1) codifying the provision in appendix C of part 38, and eliminating it from part 40; (2) re-titling the guidance as "Demonstration of Compliance That a Contract is not Readily Susceptible to Manipulation;" and (3) amending and updating the guidance to expand the provision to include swap transactions.

Proposed appendix C to part 38 was intended to act as a source for new and existing DCMs to reference for best practices when developing products to list for trading. The amended guidance provided greater detail to DCMs regarding the relevant considerations in demonstrating compliance with Core Principle 3 when designing a contract and submitting supporting documentation and data to the Commission at the time the DCM submits: (1) the terms and conditions of a new contract under §§ 40.2 or 40.3, or (2) amendments to terms and conditions under §§ 40.5 or 40.6. Specifically, proposed appendix C to part 38 provided guidance regarding: (1) the forms of supporting information a new contract submission should include; (2) how to estimate deliverable supplies; (3) the contract terms and conditions that should be specified for physically delivered contracts; (4) how to demonstrate that a cash-settled contract is reflective of the

underlying cash market, is not readily subject to manipulation or distortion, and is based on a cash price series that is reliable, acceptable, publicly available and timely; (5) the contract terms and conditions that should be specified for cash-settled contracts; (6) the requirements for options on futures contracts; (7) the terms and conditions for non-price based futures contracts; and (8) the terms and conditions for swap contracts.

Estimating Deliverable Supply

Summary of Comments

CME commented on the proposed guidance pertaining to estimating deliverable supply in paragraph (b)(1)(i)(A) of proposed appendix C.[232] CME contended that the proposed definition of deliverable supply is restrictive and inconsistent with long-standing industry practice.[233] Specifically, CME objected to the proposed provision that states that "an appropriate estimate of deliverable supply excludes supplies that are committed to some commercial use."[234] CME stated that DCMs have historically estimated deliverable supplies by including in their calculations all supplies that are stored in the delivery territory or that move through the delivery territory, including a determination of amounts committed to commercial use.[235] CME asserted that the proposed rulemaking does not identify any problems with continuing to use the current methodology in these markets, and claimed that if the proposed standard is adopted, it

[232] CME Comment Letter at 38 (Feb. 22, 2011). Proposed paragraph (b)(1)(i)(A) of appendix C provided guidance on how to estimate the deliverable supply of a commodity that underlies a futures contract. The estimated deliverable supply should reflect the amount of that commodity that can reasonably be expected to be readily available to long traders to take delivery and short traders to make delivery at the expiration of a futures contract. This information is used by Commission staff when considering a contract's terms and conditions in determining whether a contract is readily susceptible to manipulation. DCM NPRM at 80631.
[233] CME Comment Letter at 38 (Feb. 22, 2011).
[234] See proposed paragraph (b)(1)(i)(A), appendix C. DCM NPRM at 80631.
[235] CME Comment Letter at 38 (Feb. 22, 2011).

will impose additional costs on exchanges and market participants, including requiring exchanges to survey market participants annually with no defined benefit.[236]

Moreover, CME argued that the requirement that DCMs submit monthly deliverable supply estimates "for at least the most recent five years for which data sources permit" to be used by the Commission to review a DCM's certification or approval request for a new contract or related rule amendment is onerous for DCMs.[237] Instead, CME suggested that the Commission require monthly estimates of deliverable supply for the most recent three years.[238]

Discussion

The Commission acknowledges CME's comments regarding the proposed guidance for estimating deliverable supply but notes that a DCM has historically been required to estimate deliverable supplies, which has required that a DCM consult with market participants on a regular basis. In that regard, contrary to CME's claim, the proposed guidance stating that exchanges should survey market participants should not impose additional costs on exchanges. As noted above, Commission staff will continue to work with exchange staff to determine how the deliverable supply for a certain commodity should be estimated. Moreover, the Commission confirms, as noted by CME, that the term "commercial use" may not be appropriate and could cause confusion. Accordingly, the Commission is eliminating the sentence in proposed paragraph (b)(1)(i)(A) that references the term "commercial use," and is replacing it with the term "long-term agreement." Specifically, the Commission will clarify in paragraph (b)(1)(i)(A) that an estimate of deliverable supply would not include supply that is

[236] Id.
[237] Id.
[238] Id.

committed for long-term agreements (i.e., the amount of supply that would not be available to fulfill the delivery obligations arising from current trading).

The Commission is further clarifying in paragraph (b)(1)(i)(A) of the guidance that an exchange may include all or a portion of the supply that is committed for long-term agreements if it can demonstrate that those supplies are consistently and regularly made available to the spot market for traders to acquire at prevailing economic values. Specifically, the Commission is adding language to paragraph (b)(1)(i)(A) to provide that if the estimated deliverable supply that is committed for long-term agreements, or a significant portion thereof, can be demonstrated by the exchange to be consistently and regularly made available to the spot market for short traders to acquire at prevailing economic values, then those "available" supplies committed for long-term contracts may be included in the exchange's estimate of deliverable supply for that commodity.[239]

Similarly, in paragraph (b)(1)(i)(C) of the guidance, the Commission is eliminating the term "commercial use" and replacing it with the term "committed for long-term agreements."

The Commission further agrees with CME that three years of monthly estimates of deliverable supply is sufficient for the Commission to use to determine whether or not a contract is readily susceptible to manipulation or distortion. In this regard, the Commission is amending paragraphs (a)(2), (b)(1)(i)(A), (b)(1)(i)(B), and (b)(1)(i)(C) to reflect a three year obligation.

Calculation of Price Indices

[239] In adding this language, the Commission is responding to CME's March 28, 2011 comment letter which stated that the Commission should define what it understands as "long-term agreement," stating that requiring DCMs to consult with market participants to estimate deliverable supply on a monthly basis would be a substantial burden.

Summary of Comments

CME commented on the proposed guidance for calculating price indices in paragraphs (c)(3)(ii) and (g)(ii) of appendix C.[240] CME stated that the guidance may not be applicable for some markets where there may not be eight independent entities in the entire industry, and that in those situations, the cash settlement survey should include transactions representing at least 51 percent of the total production of the commodity in question.[241]

Argus stated that it is important that the examination of a referenced index price should recognize the differences in markets and instrument types, and that the methodologies used to determine an index price may vary depending on the characteristics of the market in question.[242] Accordingly, Argus recommended that any review of the integrity of a price index should be flexible enough to account for differences in markets and instrument types.[243] Argus also requested that the Commission clarify that the proposed guidance for calculation of prices is applicable only to DCMs or SEFs, and does not apply to independent price data providers of price

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[240] CME Comment Letter at 38-39 (Feb. 22, 2011). Proposed paragraphs (c)(3)(ii) and (g)(ii) of appendix C addressed calculation procedures for safeguarding against potential attempts to artificially influence a cash settlement price for futures contracts settled by cash settlement. The guidance provided that if the cash price is determined by a survey of cash market sources, the survey should include either: (1) at least four independent entities (if such sources do not take a position); or (2) eight entities (if such sources trade for their own accounts).

[241] CME Comment Letter at 38 (Feb. 22, 2011). Proposed c(3)(ii) and (g)(ii) of appendix C provided that: "Where a designated contract market itself generates the cash settlement price series, the designated contract market should establish calculation procedures that safeguard against potential attempts to artificially influence the price. For example, if the cash settlement price is derived by the designated contract market based on a survey of cash market sources, the designated contract market should maintain a list of such entities which all should be reputable sources with knowledge of the cash market. In addition, the sample of sources polled should be representative of the cash market, and the poll should be conducted at a time when trading in the cash market is active. The cash-settlement survey should include a minimum of four independent entities if such sources do not take positions in the commodity (e.g., if the survey list is comprised exclusively of brokers) or at least eight independent entities if such sources trade for their own accounts (e.g., if the survey list is comprised of dealers or merchants)."

[242] Argus Comment Letter at 4 (Feb. 22, 2011).

[243] Id.

indices.[244] Argus stated that as a market data price provider it obtains price data that is voluntarily provided to it by market participants, and that it has no means of requiring participants to provide that data.[245] In that regard, Argus contended that for less liquid markets, there may only be a few market participants willing to provide data to Argus to use to determine a price series for a commodity.[246] Argus noted that, in contrast, a DCM or SEF has the ability to use market transactions traded on its platform, or to survey market participants that trade on its platform, to determine a cash settlement price.[247] Thus, Argus stated that the guidance in paragraph (c)(3)(ii) should not apply to market data price providers.[248]

Discussion

In light of the concerns raised in the comments above, the Commission is eliminating the last sentence of paragraphs (c)(3)(ii) and (g)(ii), which provides that "[t]he cash-settlement survey should include a minimum of four independent entities if such sources do not take positions in the commodity (e.g., if the survey list is comprised exclusively of brokers) or at least eight independent entities if such sources trade for their own accounts (e.g., if the survey list is comprised of dealers or merchants)." The Commission notes that the guidance in appendix C to part 38 is not a restrictive list of acceptable methodologies. The Commission will continue to review a contract's susceptibility to manipulation on a contract-by-contract basis, including taking into account the characteristics of the underlying market with respect to the price methodology used by independent price data providers.

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[244] Id. at 4-6.
[245] Id.
[246] Id.
[247] Id.
[248] Id.

The Commission is also making several clarifying amendments to appendix C to part 38. The Commission is amending the guidance in paragraph (c)(2) pertaining to a DCM's evaluation of the susceptibility of a cash-settled contract to manipulation. Specifically, the Commission is adding the phrase "[i]n a manner that follows the determination of deliverable supply as noted above in b(1)" to the first sentence in paragraph (c)(2). This will clarify that for cash-settled contracts based on physical commodities, an exchange should analyze the size and liquidity of the cash market that underlies the listed contract as it would if the contract were settled through physical delivery.

The Commission also is amending paragraph (c)(4)(i)(E) regarding Maximum Price Fluctuations Limits for cash-settled contracts, to clarify that for broad-based stock index futures contracts, rules should be adopted to coordinate with New York Stock Exchange ("NYSE") declared Circuit Breaker Trading Halts.[249] However, because there are proposals for alternative market coordination currently being considered (other than the Circuit Breaker Trading Halt), the guidance will be amended to add the proviso "or other market coordinated Circuit Breaker mechanism."[250]

Finally, the Commission is amending paragraph (e)(1), regarding Security Futures Contracts, to eliminate the sentence that states "[a] designated contract market should follow the appropriate guidance regarding physically delivered security futures products that are settled through physical delivery or cash settlement." The sentence was included in the guidance and is being eliminated because part 41 Security Futures Products governs trading in those contracts including the minimum requirements that an

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[249] See discussion of NYSE circuit breakers, available at: http://usequities.nyx.com/markets/nyse-equities/circuit-breakers.
[250] See supra discussion of section 38.255.

underlying security or security index must have and maintain to be listed for trading on a DCM.

4. Subpart E - Prevention of Market Disruption

The Dodd-Frank Act amended current Core Principle 4 by: (i) changing the title of the core principle from "Monitoring of Trading" to "Prevention of Market Disruption;" and (ii) specifying the methods and procedures DCMs must employ in discharging their obligations under Core Principle 4. The amendments to Core Principle 4 emphasize that DCMs must take an active role not only in monitoring trading activities within their markets, but in preventing market disruptions. The rules proposed for this core principle largely codified the relevant provisions of the existing Application Guidance and Acceptable Practices for Core Principle 4, as contained in appendix B to part 38, and included new requirements that clarified and strengthened certain DCM obligations arising under the amended core principle.

i. § 38.251 - General Requirements

Core Principle 4 requires DCMs to conduct real-time monitoring of trading and have the ability to comprehensively and accurately reconstruct trading.[251] Accordingly, these requirements are set forth in proposed § 38.251. Further, the proposed rule required that intraday trade monitoring must include the capacity to detect abnormal price movements, unusual trading volumes, impairments to market liquidity, and position-limit violations. Proposed § 38.251 also required that, where the DCM cannot reasonably demonstrate that its manual processes are effective in detecting and preventing abuses, the DCM must implement automated trading alerts to detect potential problems.

[251] 7 U.S.C. 7(d)(4).

The Commission invited comment on whether DCMs should be required to monitor the extent of high frequency trading, and whether automated trading systems should include the ability to detect and flag high frequency trading anomalies.

Summary of Comments

Several commenters asserted that their current regulatory systems do not allow for effective real-time monitoring of position limits. CME opined that requiring real-time monitoring capabilities across every instrument for vague terms such as "abnormal price movements," "unusual trading volumes," and "impairments to market liquidity" does not provide DCMs with sufficient clarity with respect to what specific capabilities satisfy the standard.[252] CME specifically stated that the Commission should clarify and appreciate the unique aspects of different types of trading venues and distinguish where requirements are different.[253] CME also stated that the regulations should distinguish between trading conducted on an electronic venue and trading conducted in an open-outcry venue.[254] MGEX stated that the automated trading alert requirement of proposed § 38.251 "seems to add more burden and cost than potentially providing any real value."[255] KCBT requested that the Commission remove this requirement and stated that customer reportable positions are received once daily on a T+1 basis and that it is impractical to require DCMs to monitor for intraday compliance with position limits.[256]

ICE stated that it has previously made the Commission aware of the difficulties inherent in trying to monitor positions on a real-time basis, and that the only way to

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[252] CME Comment Letter at 24 (Feb. 22, 2011).
[253] Id.
[254] Id.
[255] MGEX Comment Letter at 4 (Feb. 22, 2011). MGEX also stated that the Commission should adopt a more flexible core principle approach. See MGEX Comment Letter at 2 (June 3, 2011).
[256] KCBT Comment Letter at 4 (Feb. 22, 2011).

accurately determine whether an intraday position limit violation has occurred is on the basis of information available on a T+1 basis.[257] ICE also requested that the Commission delete the phrase "impairments to market liquidity" from the rule, arguing that the wording is vague and has "no foundation" in the core principle.[258]

With respect to the monitoring of high frequency trading, several commenters stated that such monitoring would be problematic.[259] MGEX and CME raised concerns over the absence of a definition for high frequency trading, which CME claimed can include many different trading strategies.[260] CME questioned whether the Commission had unique concerns about high frequency traders, and further remarked that the Commission has not articulated what purpose would be served by singling out high frequency trading for special monitoring.[261] CME further stated that empirical studies have consistently demonstrated that high frequency trading fosters tighter markets, greater liquidity and enhanced market efficiency.[262]

CME stated that "[a]s a practical matter, however, CME Group, and we imagine other DCMs, certainly have the capability to monitor the messaging frequency of participants in their markets and can quickly and easily identify which participants generate high messaging traffic."[263] CME also stated that it requires registered users who predominantly enter orders via an automated trading system to be identified as automated traders and that their orders are identified in the audit trail as originating from automated

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[257] ICE Comment Letter at 11 (Feb. 22, 2011).
[258] Id.
[259] KCBT Comment Letter at 4 (Feb. 22, 2011); MGEX Comment Letter at 4 (Feb. 22, 2011); CME Comment Letter at 24-25 (Feb. 22, 2011).
[260] MGEX Comment Letter at 4 (Feb. 22, 2011); CME Comment Letter at 24-25 (Feb. 22, 2011).
[261] CME Comment Letter at 25 (Feb. 22, 2011).
[262] Id.
[263] Id.

systems.[264] Finally, CME noted that its systems were designed to identify anomalies or transaction patterns that violate their rules or might otherwise be indicative of some other risk to the orderly functioning of the markets.[265]

Better Markets opined that the Dodd-Frank Act provides the Commission with an opportunity to get ahead of high frequency and algorithmic trading and that, while hedgers undoubtedly need market liquidity, high frequency traders generate volume that does not reliably generate liquidity for market participants.[266] In addition, Better Markets commented that many widely used tactics of high frequency traders are specifically designed to influence pricing decisions by providing false signals of market price levels and depth, and, as a result, the Commission must take an expressly restrictive approach to high frequency trading.[267]

Discussion

The Commission is adopting proposed § 38.251, with certain modifications, including converting portions of the rule to guidance.

The Commission is modifying § 38.251 to eliminate the obligation to monitor, on an intraday basis, for "impairments to market liquidity." The Commission is also revising the rule to clarify what must be included in real-time monitoring as compared to monitoring of intraday trading that may not need to be done in real time. Monitoring of market conditions, price movements and trading volumes in order to detect and attempt to resolve abnormalities must be accomplished in real time in order to achieve, as much as is possible, the statute's new emphasis on preventive actions. It is acceptable, however,

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[264] Id.
[265] Id.
[266] Better Markets Comment Letter at 7 (Jun. 3, 2011).
[267] Id.

to have a program that detects, on a T+1 basis, trading abuses and position-limit violations that occur intraday.

In addition, the rule is now being supplemented with guidance and acceptable practices in appendix B to part 38. The Commission believes that monitoring for market anomalies is a key part of a DCM's ability to demonstrate its "capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process," as required by the statute. Moreover, given the number of listed contracts and the volumes of trading on any particular DCM, the Commission believes that automated trading alerts, preferably in real time, are the most effective means of detecting market anomalies. While having an effective automated alerts regime will be set forth as a method of monitoring in guidance, a DCM will maintain flexibility in meeting the requirement of the rule by, for example, demonstrating the effectiveness of an alternate method of monitoring.

With respect to position-limit monitoring, the DCM NPRM did not require that such limits necessarily be monitored in real time. However, DCMs must have the ability to monitor such limits, including for intraday violations, at a minimum on a T+1 basis. Therefore, the requirement to monitor for position-limit violations is clarified in the rule and further described in the guidance and acceptable practices in appendix B, giving the DCM some flexibility in meeting the requirement.

As for the Commission's inquiry about requiring additional monitoring of high-frequency trading, the Commission recognizes that DCMs should be capable of monitoring for the types of trading that may be characterized as "high frequency," but has decided not to implement, in this rulemaking, further rules pertaining to the monitoring of

high frequency trading. The Commission is encouraged that there are efforts underway, both within and outside the Commission, to define and develop approaches for better monitoring of high-frequency and algorithmic trading. This is particularly evident from recent work done at the behest of the Commission's Technology Advisory Committee (TAC).[268] Further, the United Kingdom government's Foresight Project also commissioned a recently released report on the future of computer trading in financial markets, which aims to assess the risks and benefits of automated buying and selling. This project may assist the Commission's further development of a regulatory framework for high frequency trading activities.[269]

ii. § 38.252 - Additional Requirements for Physical-Delivery Contracts

Proposed § 38.252 required, among other things, that for physical-delivery contracts, DCMs must monitor each contract's terms and conditions as to whether there is convergence of the futures price to the cash price of the underlying commodity and must take meaningful corrective action, including addressing conditions that interfere with convergence, or if appropriate, change contract terms and conditions, when lack of convergence impacts the ability to use the markets for making hedging decisions and for price discovery.

The Commission requested comments on what other factors, in addition to the delivery mechanism, a DCM should be required to consider in determining whether convergence is occurring.

Summary of Comments

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[268] See, e.g., reports associated with the TAC available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_ptfs2.pdf

[269] See "The Future of Computer Trading in Financial Markets" available at http://www.bis.gov.uk/foresight/our-work/projects/current-projects/computer-trading.

CME, MGEX and KCBT all opposed what they deemed to be a prescriptive rule, and noted that most of the requirements in proposed § 38.252 are currently acceptable practices under appendix B for the monitoring of trading.[270] These commenters contended that the requirements in proposed §38.252 should remain as acceptable practices.[271]

ICE also noted that for certain products it is inherently more difficult to statistically determine convergence of futures to cash market prices.[272]

Discussion

The Commission is adopting § 38.252, with certain modifications, including converting a portion of the rule to acceptable practices.

The Commission is retaining as a rule the general obligation that DCMs monitor physical-delivery contracts with respect to their terms and conditions as they relate to the underlying market and monitor the adequacy of deliverable supplies to meet futures delivery requirements. The DCM must also make a good-faith effort to resolve conditions that threaten reasonable convergence or the adequacy of deliverable supplies. While the Commission acknowledges ICE's comment that for certain products it may be more difficult to ascertain convergence because of the absence of reliable cash prices, the Commission is of the view that a DCM must monitor the performance of its contracts to ensure they continue to perform their economic functions.

In order to provide DCMs with additional flexibility in meeting their monitoring obligations associated with physical-delivery contracts, the specific elements of such

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[270] CME Comment Letter at 25 (Feb. 22, 2011); MGEX Comment Letter at 5 (Feb. 22, 2011); KCBT Comment Letter at 4-5 (Feb. 22, 2011).
[271] Id.
[272] ICE Comment Letter at 12 (Feb. 22, 2011).

monitoring that were initially included in the proposed rule are now included in acceptable practices under appendix B of part 38, rather than in the rule.

iii. § 38.253 - Additional Requirements for Cash-Settled Contracts

In addition to requirements that DCMs monitor the pricing and methodologies for settling cash-settled contracts, proposed § 38.253 required that, where a DCM contract is settled by reference to the price of a contract or instrument traded in another venue, including a price or index derived from prices on another exchange, the DCM must have rules that require the traders on the DCM's market to provide the DCM with their positions in the reference market as the traders' contracts approach settlement. In the alternative, § 38.253 provided that the DCM may have an information sharing agreement with the other venue or designated contract market.

Summary of Comments

Argus commented that it is inappropriate to require DCMs to monitor the "availability and pricing of the commodity making up the index to which the contract will be settled" where the index price is generated based upon transactions that are executed off the DCM's market.[273]

CME disagreed with what it contended was the prescriptive nature of the proposed rule, and noted that many of the requirements in proposed § 38.253 are currently acceptable practices for trade monitoring.[274] CME suggested that the requirements in § 38.253 remain as acceptable practices.[275] CME further stated that the Commission is uniquely situated to add regulatory value to the industry by reviewing for potential cross-venue rule violations, and noted that the Commission is the central

[273] Argus Comment Letter at 6 (Feb. 22, 2011).
[274] CME Comment Letter at 26 (Feb. 22, 2011).
[275] Id.

repository for position information delivered to it on a daily basis and in a common format, across all venues.[276] CME also asserted that the Commission would be imposing an onerous burden on DCMs and their customers by requiring the reporting of information that the Commission already receives or will be receiving.[277] CME also stated that the alternative proposal, that the DCM enter into an information-sharing agreement with the other venue, also will result in additional costs to both entities, and that it may not be practical or prudent for a DCM to enter into such an agreement with the other venue.[278] CME noted that its rules already allow it to request such information from market participants on an as-needed basis.[279]

Nodal stated that DCMs that are a party to an industry agreement (such as the International Information Sharing Memorandum of Understanding & Agreement) should satisfy the information sharing requirement in this rule by virtue of such agreement.[280]

Discussion

The Commission is codifying proposed § 38.253, with certain modifications, including to convert a portion of the rule to acceptable practices. The Commission removed from the rule the requirement that DCMs monitor the availability and pricing of the commodity making up the index to which the contract will be settled. Section 38.253(a) requires that DCMs monitor the pricing of the index to which the contract is settled, and that DCMs monitor the continued appropriateness of the index to which the contract is settled and take steps to resolve conditions, including amending contract terms where necessary, where there is a threat of manipulation, disruptions, or distortions. For

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[276] Id.
[277] Id.
[278] Id.
[279] Id.
[280] Nodal Comment Letter at 5 (Feb. 22, 2011).

cash-settled contracts, the Commission believes that a DCM must have the ability to determine whether a trader in its market is manipulating the instrument or index to which the DCM contract settles.

In regards to § 38.253(b), as the CME noted, the Commission does obtain certain position information in the large-trader reporting systems for futures and swaps. However, the Commission may not routinely obtain such position information, including where a DCM contract settles to the price of a non-U.S. futures contract or a cash index. Notwithstanding the continued importance of a DCM's obligation to monitor across other venues in such circumstances, the Commission believes that the rule need not set forth the specific methods to accomplish such monitoring. Accordingly, the Commission sets forth the specific methods of accomplishing the cross-venue monitoring under acceptable practices. Specifically, the rule requires that the monitoring of cash-settled contracts must include access to information on the activities of its traders' in the reference market. The acceptable practices for this rule provides that a DCM, at a minimum, gather such information, either directly or through information sharing agreements, to traders' position and transactions in the reference market for traders of a significant size in the DCM contract, near the settlement of the contract.

iv. § 38.254 - Ability to Obtain Information

To ensure that DCMs have the ability to properly assess the potential for price manipulation, price distortions, and the disruption of the delivery or cash-settlement process, proposed § 38.254 provided that each DCM require that traders in their market keep records, including records of their activity in the underlying commodity and related derivative markets and contracts, and make such records available, upon request, to the

designated contract market.[281] The proposed rule further required that DCMs with participants trading through intermediaries must either use a comprehensive large-trader reporting system or be able to demonstrate that it can obtain position data from other sources in order to conduct an effective surveillance program.

Summary of Comments

CME opposed the proposed rule and recommended that the types of records that the DCM should require traders to keep should be covered in acceptable practices.[282] KCBT contended that it is unnecessary and burdensome for a DCM to require traders to keep such records.[283] Similarly, MGEX raised concerns about the burden that will be placed on its traders as a result of the proposed record-keeping obligation, and noted that, for contracts not traded on the DCM, it is unclear what records a DCM must tell its trader to keep.[284]

Discussion

The Commission is adopting § 38.254 as proposed, but is allowing, as an acceptable practice in appendix B, that DCMs limit the requirement of § 38.254(b) to those transactions or positions that are reportable under the DCM's large-trader reporting system or where the market participant otherwise holds substantial positions.

The Commission has considered the comments, but does not believe that this rule is unnecessary or that the requirements should instead be codified as acceptable practices. The Commission notes that a trader's burden to keep such records is sound commercial practice, and that a trader of a reportable size is already required, under Commission's

[281] The pre-existing acceptable practice for Core Principle 4 provides that DCMs, at a minimum, should have routine access to the positions and trading of their market participants.
[282] CME Comment Letter at 26 (Feb. 22, 2011).
[283] KCBT Comment Letter at 5 (Feb. 22, 2011).
[284] MGEX Comment Letter at 5 (Feb. 22, 2011).

regulations § 18.05 for futures and options and § 20.6 for swaps, to keep records of such activity and to make them available to the Commission upon request. In addition, the Commission has found trader records to be an invaluable tool in its surveillance efforts, and believes that the DCM, as a self-regulatory organization, should have direct access to such information in order to discharge its obligations under the DCM core principles, and in particular Core Principle 4.

v. § 38.255 - Risk Controls for Trading

Proposed § 38.255 required DCMs to have in place effective risk controls including, but not limited to, pauses and/or halts to trading in the event of extraordinary price movements that may result in distorted prices or trigger market disruptions. Additionally, the rule provided that where a DCM's contract is linked to, or a substitute for, other contracts on the DCM or on other trading venues, including where a contract is based on the price of an equity security or the level of an equity index, risk controls should, to the extent possible, be coordinated with those other contracts or trading venues. In the preamble of the DCM NPRM, the Commission requested comments on what types of pauses and halts are necessary and appropriate for particular market conditions. The preamble of the DCM NPRM also recognized that pauses and halts comprise only one category of risk controls, and that additional controls may be necessary to reduce the potential for market disruptions. The preamble specifically listed several risk controls that the Commission had in mind, including price collars or bands, maximum order size limits, stop-loss order protections, kill buttons, and any others that may be suggested by commenters. The Commission invited comments on the appropriateness of the listed risk controls, and posed the following questions: What other

DCM risk controls are appropriate or necessary to reduce the risk of market disruptions? Which risk controls should be mandated, and how?

Summary of Comments

Several commenters asserted that DCMs should have discretion to determine the specific risk controls that should be implemented within their markets.[285] CME commented that the marketplace would benefit from some standardization of the types of pre-trade risk controls employed by DCMs and other trading venues, and expressed support for an acceptable practice framework that includes pre-trade quantity limits, price banding, and messaging throttles, but argued that the specific parameters of such controls should be determined by the DCMs.[286]

Various commenters also stated that there are effective ways to prevent market disruptions other than pauses and halts, and that the appropriate controls may depend on a number of factors, such as the product, number of market participants, and the market's liquidity. CME contended that the Commission should not impose rules that mandate coordination of such risk controls.[287] NYSE Liffe argued that a DCM should be able to take into account other controls, but should not be required to adopt identical controls.[288] MGEX stated that forcing market coordination of trading pauses and halts is unnecessary, and that if market instability moves from one contract market to another, the next market should be able to pause or halt trading as it determines necessary.[289] ICE stated that a

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[285] CME Comment Letter at 26 (Feb. 22, 2011); KCBT Comment Letter at 5 (Feb. 22, 2011); ICE Comment Letter at 11-12 (Feb. 22, 2011); CFE Comment Letter at 4 (Feb. 22, 2011); NYSE Liffe Comment Letter at 11 (Feb. 22, 2011); ELX Comment Letter at 4 (Feb. 22, 2011); MGEX Comment Letter at 5 (Feb. 22, 2011); ICE Comment Letter at 12 (Feb. 22, 2011); Barnard Comment Letter at 3 (Feb. 22, 2011).
[286] CME Comment Letter at 27 (Feb. 22, 2011).
[287] Id.
[288] NYSE Liffe Comment Letter at 11 (Feb. 22, 2011).
[289] MGEX Comment Letter at 5 (Feb. 22, 2011).

temporary price floor or ceiling can work better than a pause or halt since trading can continue uninterrupted, thereby offering the earliest opportunity for price reversal should the market deem a sudden large move to be an overreaction or error.[290] ICE also stated that pauses and halts are not the only effective way to prevent market disruption, and that by being prescriptive, the Commission is freezing innovation in preventing market disruptions.[291]

Finally, Better Markets asserted that the proposed rules are extremely useful, but incomplete.[292] Better Markets stated that there should be a "speed limit" to serve as a buffer against the potential for an uncontrolled spiral of disruption fueled by HFTs, and that the rule should require that bids be kept open for minimum durations and that positions be held for minimum durations.[293]

Discussion

The Commission is adopting proposed § 38.255, with certain modifications, including converting a portion of the rule to acceptable practices. As stated in the DCM NPRM, the Commission believes that pauses and halts are effective risk management tools that must be implemented by DCMs to facilitate orderly markets. As the Commission noted in the DCM NPRM, risk controls such as trading pauses and halts, among other things, can allow time for participants to analyze the market impact of new information that may have caused a sudden market move, allow new orders to come into a market that has moved dramatically, and allow traders to assess and secure their capital needs in the face of potential margin calls. Automated risk control mechanisms,

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[290] ICE Comment Letter at 12 (Feb. 22, 2011).
[291] Id.
[292] Better Markets Comment Letter at 9 (Feb. 22, 2011).
[293] Id.

including pauses and halts, have proven to be effective and necessary in preventing market disruptions and, therefore, will remain as part of the rule.

The Commission notes that the pauses and halts are intended to apply in the event of extraordinary price movements that may trigger or propagate systemic disruptions. Accordingly, in response to ICE and other commenters that question the necessity of pauses and halts over other forms of risk controls, the Commission notes that a DCM's ability to pause or halt trading in extraordinary circumstances and, importantly, to re-start trading through the appropriate re-opening procedures, will allow DCMs to mitigate the propagation of shocks that are of a systemic nature and to facilitate orderly markets. Furthermore, DCMs must ensure that such pauses and halts are effective for their specific order-routing and trading environment and are adapted to the specific types of products traded.

Following the DCM NPRM's publication, the Pre-Trade Functionality Subcommittee of the CFTC Technology Advisory Committee ("TAC") issued a report that recommended the implementation of several trade risk controls at the exchange level.[294] The controls recommended in the Subcommittee report were consistent, in large part, with the trade controls referenced in the preamble to the DCM NPRM, and which are being adopted in this final rulemaking.[295] The TAC accepted the Subcommittee report, which specifically recommended that exchanges implement pre-trade limits on order size, price collars around the current price, intraday position limits (of a type that

[294] "Recommendations on Pre-Trade practices for Trading Firms, Clearing Firms and Exchanges involved in Direct Market Access," March 1, 2011, available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_ptfs2.pdf

[295] The DCM NPRM specifically mentioned position limits that must be monitored for intraday violations, daily price limits, trading pauses, reasonability tests for order price and size, stop logic functionality, and trade-cancellation policies in the form of "no-bust" ranges.

represent financial risk to the clearing member), message throttles, and clear error-trade and order-cancellation policies.[296] The Subcommittee report noted that "[s]ome measure of standardization of pre-trade risk controls at the exchange level is the cheapest, most effective and most robust path to addressing the Commission's concern [for preserving market integrity]."[297]

The Commission believes that the implementation of the specific automated trade risk controls listed in the DCM NPRM is generally desirable, but also recognizes that such controls should be adapted to the unique characteristics of the markets to which they apply. Indeed, any controls should consider the delicate balance between avoiding a market disruption while not impeding a market's price discovery function. Controls that unduly restrict a market's ability to respond to legitimate market events will interfere with price discovery.

Accordingly, consistent with many of the comments on this subject, the Commission is enumerating specific types of automated risk controls, in addition to pauses and halts, that may be implemented by DCMs in the acceptable practices rather than in the rule, in order to give DCMs greater discretion to select among the enumerated risk controls, or to create new risk controls that may be more appropriate or necessary for their markets. DCMs also will have discretion in determining the parameters for the selected controls. Specifically, the acceptable practices for Core Principle 4 provide that DCMs should have appropriate trade risk controls adapted to the unique characteristics of

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[296] See "Pre-Trade Functionality Subcommittee of the CFTC Technology Advisory Committee report, "Recommendations on Pre-Trade Practices for Trading Firms, Clearing Firms, and Exchanges Involved in Direct Market Access," at 4-5 (March 1, 2011), accepted by the TAC and available at: http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_ptfs2.pdf

[297] Id. at 4.

the markets to which they apply that are designed to prevent market disruptions without unduly interfering with that market's price discovery function. The acceptable practices also enumerate several of the pre-trade controls cited by the Joint CFTC/Securities and Exchange Commission ("SEC") Advisory Committee, specifically: pre-trade limits on order size, price collars or bands around the current price, message throttles, and daily price limits.[298]

Additionally, in response to commenters' concerns, the Commission is moving the language in the proposed rule concerning the coordination of risk controls among other markets or exchanges to the acceptable practices. Specifically, a DCM with a contract that is linked to, or is a substitute for, other contracts, either on its market or on other trading venues, must, to the extent practicable, coordinate its risk controls with any similar controls placed on those other contracts. If a contract is based on the price of an equity security or the level of an equity index, such risk controls must, to the extent practicable, be coordinated with any similar controls placed on national security exchanges.

Independent of this rulemaking, the Joint CFTC/SEC Advisory Committee recommended that the SEC and CFTC require that the pause rules of the exchanges and FINRA be expanded to cover all but the most inactively traded and listed equity securities, ETFs, and options and single stock futures on those securities.[299]

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[298] The DCM NPRM did not specifically address whether DCMs should require market participants to certify that their electronic systems were adequately tested before trading on a DCM, nor did it specifically address pre-trade, post trade or emergency controls and supervision of electronic systems. The Commission may address electronic system testing, controls, and supervision-related issues in a subsequent proceeding.
[299] The Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues was established a few days after the dramatic securities market events of May 6, 2010, called by some the "Flash Crash." The Committee is charged with addressing regulatory issues of mutual concern to the CFTC and SEC. See "Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010," (Feb. 18, 2011) available at http://www.cftc.gov/MarketReports/StaffReportonMay6MarketEvents/index.htm.

vi. § 38.256 - Trade Reconstruction

The Dodd-Frank Act added language to Core Principle 4 providing that a DCM must have the ability to comprehensively and accurately reconstruct all trading on its trading facility. These audit-trail data and reconstructions must also be made available to the Commission in a form, manner, and time as determined by the Commission. Proposed § 38.256 codified these requirements.

Summary of Comments

CME argued that audit trial data is extremely detailed and voluminous and that the DCMs should be given adequate time to prepare the trading data before it is supplied to the Commission.[300] CME suggested that the wording "in a form, manner, and time as determined by the Commission" be replaced with "such reasonable time as determined by the Commission.[301]

Chris Barnard expressed support for the trade reconstruction requirement but requested that the rule be clarified to ensure that the trade reconstruction requirement includes all trading events, including the entry of bids and offers in the order of their occurrence, as well as executed trades in order.[302]

Discussion

The Commission is clarifying the rule slightly so that the audit trail data must be available to the Commission "in a form, manner, and time that is acceptable to the Commission." The revised wording is consistent with § 38.950(a), which requires that DCMs maintain records in a form and manner that is acceptable to the Commission.

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[300] CME Comment Letter at 27 (Feb. 22, 2011).
[301] Id.
[302] Barnard Comment Letter at 2 (May 20, 2011).

The Commission believes that the DCM audit-trail requirements contained in § 38.551 and § 38.552 clarify the DCM's obligation for reconstruction of trading and are sufficient to meet Mr. Barnard's concerns.

vii. § 38.257 - Regulatory service provider

Proposed § 38.257 provided that a DCM must comply with the regulations in subpart E through a dedicated regulatory department, or by delegation of that function to a regulatory service provider over which the DCM has supervisory authority.

Discussion

The Commission did not receive any comments on the proposed rule, and is adopting the rule as proposed.

viii. § 38.258 - Additional Rules Required

Proposed § 38.258 required a DCM to adopt and enforce any additional rules that it believed were necessary to comply with the requirements of subpart E.

Discussion

Though the Commission did not receive any comments on the proposed rule, the Commission is of the view that the obligations in the proposed rule are more appropriate in the guidance. Accordingly, the proposed rule is moved to guidance. Consistent with this determination, the Commission is replacing proposed § 38.258 with new § 38.258 (titled "Additional sources for compliance") that simply permits DCMs to rely upon the guidance and acceptable practices in appendix B of this part to demonstrate to the Commission compliance with Core Principle 4.

5. Subpart F - Position Limitations or Accountability

Core Principle 5 under section 5(d)(5) of the CEA requires that DCMs adopt for each contract, as is necessary and appropriate, position limitations or position accountability. The Dodd-Frank Act amended Core Principle 5 by adding that for any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a) of the CEA, the DCM shall set the position limitation of the board of trade at a level not higher than the position limitation established by the Commission. At the time of the publication of the DCM NPRM, the federal position limits established by the Commission were codified in part 150 of the Commission's regulations, and the Commission had proposed rules to replace part 150 with new requirements in part 151, consistent with the requirements of the Dodd-Frank Act. The Commission published the final rules for "Position Limits for Futures and Swaps" on November 18, 2011.[303] That final rulemaking requires DCMs to comply with part 150 (Limits on Positions) until such time that the Commission replaces part 150 with the new part 151 (Limits on Positions).[304] In that final release, the Commission requires that exchanges adopt their own position limits for 28 physical commodity contracts subject to federal limits, and provides acceptable practices for establishing position limits in other commodity contracts. The Commission also established alternative acceptable practices of adopting position accountability rules in lieu of position limits for non-spot months in those other commodity contracts. Proposed § 38.301 required that each DCM must comply with the requirements of part 151 as a condition of its compliance with Core Principle 5.

Summary of Comments

[303] See "Position Limits for Futures and Swaps," 76 FR 71626, Nov. 18, 2011.
[304] Id. at 71632.

CME stated that the proposed position limits in the part 151 rulemaking may affect the price discovery mechanism of the U.S. futures markets and asked that the Commission give careful consideration to the comments it submitted in the part 151 rulemaking.[305]

Discussion

The Commission is adopting the rule, with one modification. The rule is being revised to add an additional clause that requires DCMs to continue to meet the requirements of part 150 of the Commission's regulations – the current position limit regulations – until such time that compliance is required under part 151. This clarification will ensure that DCMs are in compliance with the Commission's regulations under part 150 in the interim period - until the compliance date for the new position limits regulations takes effect. CME's comments were more appropriate to the Position Limit rulemaking proceeding, and they were addressed in that rulemaking.[306]

6. Subpart G - Emergency Authority

The Dodd-Frank Act made minor, non-substantive changes to Core Principle 6 under section 5(d)(6) of the CEA. In implementing the core principles, the Commission proposed to retain most of the former Application Guidance associated with Core Principle 6 (found in appendix B to part 38 of the Commission's regulations) with some revisions and additions.

Proposed § 38.350 codified the statutory text of the core principle. Proposed § 38.351 referred applicants and DCMs to the guidance and acceptable practices in appendix B to part 38 for purposes of demonstrating to the Commission their compliance

[305] CME Comment Letter at 27 (Feb. 22, 2011).
[306] 76 FR 71626, Nov. 18, 2011.

with the requirements of subpart G. The proposed guidance provided that a DCM should have the authority to intervene as necessary to maintain fair and orderly trading and to prevent or address manipulation or disruptive trading practices, whether the need for intervention arises exclusively from the DCM's own market or as part of a coordinated, cross-market intervention. The proposed guidance also provided that the DCM rules should include procedures and guidelines to avoid conflicts of interest in accordance with new provisions proposed in § 40.9 and to include alternate lines of communication and approval procedures in order to be able to address, in real time, emergencies that may arise. The proposed guidance also clarified that the DCM must have rules that allow it to take such market actions as may be directed by the Commission.

The proposed rulemaking also proposed certain acceptable practices, including that the DCM have: (i) procedures and guidelines for decision-making and implementation of emergency intervention in the market, and (ii) the authority to: liquidate or transfer open positions in the market,[307] suspend or curtail trading in any contract, require market participants in any contract to meet special margin requirements, and allow it to take such market actions as the Commission may direct.

Summary of Comments

KCBT contended that liquidation of positions and special margin requirements are more appropriately addressed in the rules and procedures relevant to Derivatives Clearing Organizations.[308] CME commented that the Commission should revise the

[307] In situations where a swap is traded on more than one platform, emergency action to liquidate or transfer open interest must be directed, or agreed to, by the Commission or Commission staff.
[308] KCBT Comment Letter at 6 (Feb. 22, 2011); see also 76 FR 69334, Nov. 8, 2011.

proposed guidance to make clear that DCMs have the flexibility and independence necessary to address market emergencies.[309]

Discussion

The Commission adopts proposed §§ 38.350 and 38.351, without modification.

In response to the comments pertaining to the proposed guidance, the Commission is making slight revisions to the guidance to clarify that DCMs retain the authority to independently respond to emergencies in an effective and timely manner consistent with the nature of the emergency, as long as all such actions taken by the DCM are made in good faith to protect the integrity of the markets.

In response to KCBT's comments, the Commission notes that the statute requires DCMs, in consultation and cooperation with the Commission, to adopt rules permitting them to liquidate open positions and impose special margin requirements under their emergency authority.

7. Subpart H - Availability of General Information

Core Principle 7 requires that DCMs make available to the public accurate information concerning the contract market's rules and regulations, contracts and operations. The Dodd-Frank Act amended Core Principle 7 by adding a provision requiring the board of trade to make public the rules and specifications describing the operation of the DCM's electronic matching platform or trade execution facility.[310] Since passage of the CFMA, the types of information and the various practices for providing information have become standardized across the industry as DCMs have adopted practices that comply with the current guidance and acceptable practices for Core

[309] CME Comment Letter at 28 (Feb. 22, 2011).
[310] This requirement, while new to the text of Core Principle 7, was previously required as part of former Designation Criteria 4.

Principle 7. Accordingly, proposed § 38.401 in subpart H codified these practices. In addition, the Commission proposed several additional provisions to ensure that pertinent information is available to the Commission, market participants and the public, as described below.

The Commission also proposed to codify the statutory text of the core principle in § 38.400, and is adopting the rule, as proposed.

i. § 38.401(a) – General

Proposed § 38.401(a) required DCMs to have in place procedures, arrangements and resources for disclosing to market authorities, market participants, and the public accurate and relevant information pertaining to: (i) contract terms and conditions, (ii) rules and regulations applicable to the trading mechanism; and (iii) rules and specifications pertaining to the operation of the electronic matching platform or trade execution facility. Under the proposed rule, DCMs are required to ensure that market authorities, market participants, and the public have available all material information pertaining to new product listings, new or amended governance, trading and product rules, or other changes to information previously disclosed by the DCM, within the time period prescribed in proposed § 38.401(c). Section 38.401(a) of the proposed regulation required that DCMs provide the required information to market participants and the public by posting such information on their website, as set forth in proposed § 38.401(c).

Discussion

The Commission did not receive comments on the proposed rule, and is adopting the proposed rule with minor, non-substantive modifications.[311]

ii. § 38.401(b) - Accuracy Requirement

[311] The Commission is revising § 38.401(a) to clarify several internal references.

Proposed § 38.401(b) required that each DCM have procedures in place to ensure that any information or communication with the Commission is accurate and complete, and further that no false or misleading information is submitted and that no material information is omitted. Similarly, the proposed rule required that each DCM have procedures in place to ensure the accuracy and completeness of any information made available to market participants and the public, including information that is made available on its website.

Summary of Comments

NYSE Liffe expressed concern that the requirement to provide "accurate and complete" information in "any communication" with the Commission would chill dialogue between DCMs and Commission staff.[312] NYSE Liffe argued that in addition to submitting formal filings with the Commission, DCM staff frequently interact with Commission staff on a more informal basis, and in some cases DCM staff may speak without complete information.[313] NYSE Liffe asserted that a DCM may feel constrained from directly responding to Commission inquiries or from reaching out to Commission staff if it is concerned that the information it provides to the Commission may later prove to be inaccurate or incomplete.[314] Accordingly, NYSE Liffe requested clarification that the proposed rule will only apply to formal filings made with the Commission.[315] NYSE Liffe also noted that while it makes every effort to accurately post information required to be made public, for several data elements, it must rely on data sent to it by clearing

[312] NYSE Liffe Comment Letter at 12 (Feb. 22, 2011).
[313] Id.
[314] Id.
[315] Id.

service providers and member firms.[316] NYSE Liffe argued that it would be inappropriate to set a strict liability standard over aggregated data that part 16 of the Commission's rules requires the DCM to make public when it does not entirely control the generation of component parts of that data.[317]

Discussion

The Commission is adopting proposed § 38.401(b), with certain revisions. While DCMs must provide the Commission with accurate and complete information, the Commission recognizes that the proposed rule text may raise concerns with DCMs in freely communicating with Commission staff in certain instances. Accordingly, the Commission is revising the rule to clarify that a DCM must "provide information that it believes, to the best of its knowledge, is accurate and complete, and must not omit material information" with respect to any communication with the Commission, and any information required to be transmitted or made available to market participants and the public, including on its website or otherwise. The requirements of § 38.401(b) are intended to be, and should be interpreted as being, consistent with the false reporting provision under section 9(a)(3) of the CEA, 7 U.S.C. 13. The amended rule accommodates the possibility that DCMs may not exercise complete control over all of the information that they receive from third-parties and later make public.

iii. § 38.401(c) - Notice of Regulatory Submissions

The Commission historically has required DCMs to update their rulebooks upon the effectiveness of a rule amendment, product listing or rule certification that has been filed with the Commission. While proposed § 38.401(c) maintained the general

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[316] Id. at 13.
[317] Id.

requirement for posting rules in the DCM rulebook upon their effectiveness, the Commission believed that market participants and the public would benefit from notifications of proposed rule amendments, product listing (or de-listings) and rule certifications in advance of their taking effect.[318] Accordingly, proposed § 38.401(c) required each DCM to post on its website all rule filings and submissions that it makes to the Secretary of the Commission. The proposed rule required that this information be posted on the DCM's website simultaneous with the filing of such information with the Commission. The DCM NPRM stated that, where applicable, the DCM website should make clear that the posted submissions are pending before the Commission.[319] This requirement was designed to provide market participants with advance notice of rule amendments and certifications, consistent with the goal of Core Principle 7 to make pertinent information available to market participants and the public. This proposed posting requirement was in addition to the obligation of DCMs to update their rulebooks upon the effectiveness of a rule submission or certification.

To the extent that a DCM requests confidential treatment of certain information filed or submitted to the Commission, the proposed rule required the DCM to post the public portions of the filing or submission on its website.

Summary of Comments

CME and KCBT both contended that the requirement that DCMs post regulatory submissions on their website simultaneously with their filing with the Commission is

[318] This is especially relevant when the Commission determines to stay the certification of a DCM submission, as provided by the Dodd-Frank Act, for a 90-day review period, thereby triggering a public comment period.

[319] The DCM NPRM noted, for example, that a DCM's website may contain a separate web page for "regulatory filings" or "rule certifications" for posting submissions or certifications pertaining to new product listings, new rules, rule amendments or changes to previously-disclosed information. DCM NPRM at 80586.

duplicative, as the Commission already posts these submissions on the CFTC website.[320] CME and KCBT further argued that they use other methods to communicate regulatory changes to the public, including bulletins, email notifications, and press releases.[321] CME requested that if the Commission does choose to retain this requirement, that a DCM be given a minimum of one business day to post such filings, rather than having to post "simultaneously" with the Commission filing.[322] CME noted that even a one-day standard would be a significantly higher standard than the Commission holds itself to with respect to posting the filings it receives from DCMs today.[323]

Discussion

The Commission is adopting the proposed rule, with certain modifications. The Commission believes it is important for market participants and the public to have advance notice of rule amendments and certifications prior to their taking effect, consistent with the goal of Core Principle 7 to make pertinent information available to market participants and the public. Where applicable, the DCM website should make clear that the posted submissions have been submitted to the Commission, but are not yet in effect. For example, a DCM could post its submissions or information filed with the Commission on a separate web page that is designated as "regulatory filings" or "proposed rulebook amendments." The Commission notes that the requirement to make information available to the public necessitates that such information can be accessed by visitors to the website without the need to register, log in, provide a user name or obtain a

[320] CME Comment Letter 28-29 (Feb. 22, 2011); KCBT Comment Letter at 6 (Feb. 22, 2011).
[321] CME Comment Letter at 29 (Feb. 22, 2011); KCBT Comment Letter at 6 (Feb. 22, 2011).
[322] CME Comment Letter at 29 (Feb. 22, 2011).
[323] Id.

password, as is the current practice under Commission regulations.[324] In response to CME, the Commission notes that it adopted a similar requirement in the final rulemaking pertaining to Provisions Common to Registered Entities.[325] In that final rulemaking, the Commission codified in § 40.5(a)(6) the requirement that a registered entity submitting a voluntary rule submission post such submission on its website concurrent with the filing of such submission with the Commission.[326] Consistent with § 40.5, the Commission is revising the posting requirement in the proposed rule from "simultaneous" to "concurrently" with the filing of the information with the Commission. The proposed rule is also being revised to clarify that the posting requirement applies to any information or "submission" provided to the Commission.

iv. § 38.401(d) - Rulebook

Proposed § 38.401(d) codified the pre-existing DCM practices pertaining to updating DCM rulebooks.[327] The proposed rule required that DCMs post and routinely update, their rulebooks, which appear on their websites. The proposed rule required that each DCM update its rulebook the day that a new product is listed or a new or amended rule takes effect. The proposed rule further required that DCM websites be readily accessible to the public, and that the information posted therein be available to visitors to the website without requiring registration, log-in, or user name or password.

Discussion

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[324] See former acceptable practices to Core Principle 7. 17 CFR part 38, appendix B (2010).
[325] See 76 FR 44776, 44794, July 27, 2011.
[326] Id.
[327] As noted above, the requirement to maintain an accurate and updated rulebook does not relieve DCMs of their obligations under proposed paragraph (c) to post on their websites all rule filings and submissions submitted to the Commission.

The Commission did not receive comments regarding this proposed rule and is adopting the rule as proposed. As noted in the DCM NPRM, the vast majority of DCMs maintain websites that comply with the requirements in the rule.

8. Subpart I - Daily Publication of Trading Information

Core Principle 8 requires that DCMs make available to the public accurate information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market. The Dodd-Frank Act did not amend Core Principle 8. Accordingly, proposed § 38.451 codified the pre-existing acceptable practices, which largely required that DCMs comply with § 16.01 (Trading volume, open contracts, prices and critical dates) of the Commission's regulations.

In addition, the Commission proposed certain revisions to § 16.01, consistent with the Dodd-Frank Act amendments to the CEA, including revisions regarding the information a reporting market must record and publish on futures, swap, and options contracts on a commodity.[328] Specifically, the proposed amendments to part 16 specified the type of information that DCMs or SEFs must publish daily regarding the swaps contracts traded. The proposed rule required that DCMs and SEFs publish specified information for each trading day, for each swap, class of swaps, option on a swap, or class of options on a swap, as appropriate. For swap contracts that are standard-sized contracts (i.e., contracts that have a set contract size for all contracts), the proposed rule required the reporting of volume and open interest for swaps and options on swaps in terms of number of contracts traded, similar to how futures contracts currently are reported. For swap contracts that are non-standard-sized (i.e., contracts whose contract

[328] The term commodity also includes "excluded commodities."

size can vary for each transaction), the proposed rule required that the volume and open interest be reported in terms of total notional value traded for that trading day.

The Commission also proposed to amend § 16.01(b) to require each DCM or SEF to publish for each trading day, by commodity and contract month or by tenor of the swap, the opening price, high price, low price and settlement price of the swap or option on swap contract.

The Commission requested comments on end-of-day price reporting for swaps. Specifically, the Commission requested comments on the following issues:

- For interest rate swaps, because the tenor on an interest rate swap can be one of thousands of possible periods, what would be an appropriate manner to display end-of-day prices for each interest rate swap?
- Would certain end-of-day swap price reporting be more meaningful than others? If so, which methods of price reporting would be more meaningful and why?
- Would certain end-of-day swap price reporting be misleading? If so, which methods of price reporting would be misleading and why?

The Commission also proposed to revise § 16.01 to require reporting markets to report directly to the Commission pursuant to the requirements of 16.01(d), information pertaining to the total volume of block trades that are included in the total volume of trading.

Finally, the Commission also proposed to codify the statutory text of the core principle in § 38.450, and is adopting the rule, as proposed.

Summary of Comments

Several commenters discussed the revised reporting requirements that were proposed in § 16.01. Eris stated that DCMs and SEFs should be held to the same reporting standards for interest rate swaps.[329] In particular, Eris commented that a DCM or SEF should report real-time, intraday prices for par swaps at standard maturities, publish open interest grouped in maturity buckets based on the remaining tenor of each instrument, and publish at the end of day the settlement curve from the clearinghouse as well as the specific settlement values applied to each cleared swap.[330] Specifically, Eris recommended: (1) that daily open interest should be published publicly in a summary fashion with open interest grouped in maturity buckets based on the remaining tenor of each instrument, (2) that end of day pricing should be based upon a market-driven curve where the clearinghouse's methodology to generate the daily settlement curve, as well as all of the inputs and components of the settlement curve, are made transparent to the full trading community, and (3) the clearinghouse should publish the specific daily settlement values applied to each cleared swap, without revealing open interest at a granular level.[331]

Better Markets recommended that proposed § 16.01 also require the daily publication of the number of orders and order cancellations separately for futures, options and swaps.[332] According to Better Markets, that data would indicate the levels of high frequency trading activity within market segments.[333]

CME stated that while it does not object to reporting block trades that are included in the daily volume of trading, this new requirement will require it to ascertain what systems changes will be necessary and how long such changes will take to

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[329] Eris Comment Letter at 4 (Feb. 22, 2011).
[330] Id. at 4-5.
[331] Id.
[332] Better Markets Comment Letter at 9 (Feb. 22, 2011).
[333] Id.

implement.[334] CME also stated that the end of day price reporting of interest rate swaps should be addressed as a separate initiative outside of the DCM and SEF rulemakings given the state of change in the swaps markets and how the market is expected to evolve as a result of regulatory reforms underway.[335]

Discussion

The Commission is codifying § 16.01 as proposed, with a technical revision to renumber paragraph (a).

The Commission recognizes that the end-of-day reporting for interest rate swaps by each DCM and SEF may require a more flexible reporting scheme to take into account the venue in which the interest-rate swap is cleared. In this respect, the daily settlement curve (the yield curve for particular interest rate (e.g., LIBOR, TIBOR, Euribor, etc.)) at each clearinghouse may differ based on the assumptions of the curve. The Commission has considered the proposed reporting standard put forth by Eris, however, in light of the novelty of swaps trading on DCMs, the Commission believes that the more detailed reporting obligations under §16.01 are warranted at this time. The Commission did not receive any objections to the additional reporting of block trades or to the swaps reporting standards. The Commission further clarifies that in making information available to the general public, as required in 16.01(e), DCMs should ensure that such information can be accessed by visitors to the website without the need to register, log in, provide a user name or obtain a password.[336]

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[334] CME Comment Letter at 29 (Feb. 22, 2011).
[335] Id.
[336] See e.g., former acceptable practices to Core Principle 7 (imposing similar requirement with respect to rulebooks). 17 CFR part 38, appendix B (2010).

Better Markets' comments pertaining to high frequency trading are addressed under the general discussion in Core Principle 4 pertaining to HFTs.

9. Subpart J - Execution of Transactions

The Dodd-Frank Act revised Core Principle 9 to read as follows:

> The board of trade shall provide a competitive, open and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade. . . . The rules of the board of trade may authorize, for bona fide business purposes:
> (a) Transfer trades or office trades;
> (b) An exchange of:
> (1) Futures in connection with a cash commodity transaction;
> (2) Futures for cash commodities; or
> (3) Future for swaps; or
> (c) A futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization.[337]

In view of Congress' revisions to Core Principle 9, and the Commission's own experience over the past decade in overseeing compliance with former Core Principle 9[338] and related regulation 1.38,[339] the Commission proposed a number of new and revised rules, guidance and acceptable practices in order to implement the revised core principle, which requires DCMs to provide a competitive, open and efficient market and

[337] 7 U.S.C. 7(d)(9). The language that provides that off-exchange transactions are permitted for bona fide business purposes if authorized by the board of trade's rules was formerly contained in Designation Criteria 3.

[338] Former Core Principle 9 provided as follows: "[T]he board of trade shall provide a competitive, open and efficient market and mechanism for executing transactions."

[339] As described in the DCM NPRM, regulation 1.38 (Execution of Transactions) of the Commission's regulations requires, among other things, that all purchases and sales of a commodity for future delivery or a commodity option on or subject to the rules of a DCM be executed by open and competitive methods, with certain exceptions for transactions that are executed noncompetitively pursuant to a DCM's rules. See DCM NPRM, 75 FR at 80588 (discussing regulation 1.38).

mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade.

Proposed § 38.500 codified the statutory text of Core Principle 9.[340] Proposed § 38.501 specified the manner in which transactions on the DCM's centralized market must be executed, and set forth the requirements applicable to transactions that are executed off of the DCM's centralized market, and incorporated certain clarifications pertaining to the allowable types of off-exchange transactions. Proposed § 38.502 implemented the core principle's requirement that DCMs provide a market and mechanism for executing transactions that protects the price discovery process of trading in its centralized market. The rule proposed a centralized market trading requirement for all contracts listed on a DCM.

Proposed § 38.503 set forth revised rules and related guidance pertaining to block transactions in futures contracts, including the appropriate size, price and reporting of block trades; proposed § 38.504 set forth rules pertaining to block transactions in swap contracts. Finally, the DCM NPRM proposed new and revised rules under Core Principle 9 that clarified other off-exchange transactions, referred to collectively as "exchanges of derivatives for related positions" and office trades and transfer trades.

Summary of Comments and Discussion

The Commission received a significant number of comments on all aspects of the proposed rules under Core Principle 9, comprising both general and specific comments pertaining to the Commission's interpretation of Core Principle 9 and various other aspects of the proposed rules.

[340] The Commission is finalizing regulation 38.500 in this release.

In particular, commenters raised numerous questions pertaining to the centralized market trading requirement rule's delisting requirement for non-compliant contracts and the available alternatives for trading such contracts.[341] Commenters also raised questions pertaining to certain aspects of the proposed rules for block transactions and exchanges of derivatives for related position transactions.[342] The Commission has considered these comments, along with comments pertaining to other aspects of the proposed rules under Core Principle 9, and believes that additional time is appropriate before finalizing the proposed rules for Core Principle 9. In particular, the Commission plans and expects to take up the proposed rules under Core Principle 9 when it considers the final SEF rulemaking. The additional time will allow the Commission to consider the available alternatives for contracts that may not comply with the proposed centralized market trading requirement (including listing contracts on a SEF), as well as the related implications of the rules for off-exchange transactions, including block transactions and exchange of derivatives for relates position transactions ("EDRPs"). At that time, the Commission will address the comments received in connection with proposed §§ 38.501-38.506.

10. Subpart K - Trade Information

Section 5(d)(10) of the CEA (Core Principle 10), as amended by the Dodd-Frank Act, requires DCMs to capture, verify, and retain detailed trade information (i.e., audit

[341] See, e.g., CME Comment Letter at 4-8, 29-30 (Feb. 22, 2011); CME Comment Letter at 2-6 (April 18, 2011); CME Joint Comment Letter at 2-6 (June 3, 2011); CME Comment Letter (Aug. 3, 2011); BlackRock Comment Letter at 2-3 (Feb. 22, 2011); ICE Comment Letter at 3-6 (Feb. 22, 2011); CFE Comment Letter at 4-7 (Feb. 22, 2011); CFE Comment Letter (June 3, 2011); OCX Comment Letter at 2-5 (Feb. 22, 2011); Eris Comment Letter at 1-3 (Feb. 22, 2011); Eris Comment Letter at 3 (June 3, 2011); GreenX Comment Letter at 8-11 (Feb. 22, 2011); GreenX Comment Letter at 4 (April 18, 2011); and, GreenX Comment Letter (June 3, 2011).

[342] See, e.g., ICE Comment Letter at 7 (Feb. 22, 2011); CME Comment Letter at 31 (Feb. 22, 2011); ELX Comment Letter at 3 (Feb. 22, 2011); and, KCBT Comment Letter at 6 (Feb. 22, 2011).

trail data) for all transactions in their markets. The core principle requires DCMs to maintain rules and procedures that provide for the recording and safe storage of all identifying trade information in a manner that enables the DCM to assist in the prevention of customer and market abuses and to provide evidence of any rule violations. The Dodd-Frank Act did not substantively revise Core Principle 10, and therefore, the application guidance and acceptable practices for former Core Principle 10 provided the basis for the Commission's proposed audit trail regulations in subpart K.[343] In addition, the Commission also looked to the issues that arose in the context of RERs pertaining to Core Principle 10.

The Commission proposed to codify the statutory text of Core Principle 10 in proposed § 38.550, and is adopting that rule as proposed.

i. § 38.551 – Audit Trail Required

Proposed § 38.551 is based on the application guidance and acceptable practices for former Core Principle 10.[344] Proposed § 38.551 established the overarching requirement that a DCM's audit trail program must help to ensure that the DCM can appropriately monitor and investigate any potential customer and market abuse. The proposed rule also provided that the audit trail data captured by a DCM must be sufficient to reconstruct all transactions within a reasonable period of time, and to provide evidence

[343] The Commission previously expressed the regulatory requirements of former Core Principle 10 through its application guidance for that core principle. See 17 CFR part 38, app. B, Application Guidance and Acceptable Practices for Core Principle 10. It also provided additional insight regarding the core principle through detailed acceptable practices that all DCMs could use to demonstrate compliance with former Core Principle 10. The acceptable practices explained that "the goal of an audit trail is to detect and deter customer and market abuse." Id. at (b)(1). It also outlined the elements of an effective audit trail. Those elements included original source documents, which help to establish the accuracy and authenticity of an audit trail. Also included is a transaction history database and electronic analysis capability, which allow a DCM to more easily access and review audit trail data to identify possible trading abuses and rule violations. Finally, the acceptable practices pointed to a DCM's safe storage capability, emphasizing that audit trail data must be stored in a manner that protects it from unauthorized alteration, accidental erasure, or other loss.

[344] 17 CFR part 38, app. B, Core Principle 10, Application Guidance and Acceptable Practices.

of any rule violations that may have occurred. The proposed rule further provided that audit trails must be sufficient to track customer orders from the time of receipt through fill, allocation, or other disposition. Proposed § 38.551 applied equally to open-outcry and electronic trading.[345]

Summary of Comments

Two commenters stated that the proposed rule is too prescriptive.[346] CME argued that the proposals were a departure from a principles-based regulatory regime and would stifle growth and innovation.[347] Similarly, MGEX argued that prescriptive rules would impose additional burdens and costs upon DCMs.[348]

Chris Barnard agreed with the proposed requirement that all DCMs have the ability to reconstruct all trading.[349] Mr. Barnard suggested that the requirement that an exchange be able to reconstruct trading should include "all trading events, including the entry of bids and offers in the order of their occurrence, as well as executed trades..." in order to permit exchanges to fully reconstruct and verify all trading activities.[350]

Discussion

The Commission is adopting § 38.551 as proposed. While the Commission acknowledges CME and MGEX's comments, the Commission does not believe that requiring an exchange to capture and retain all audit trail data—to ensure that the exchange can reconstruct all transactions on its markets—places an undue burden on exchanges or stifles innovation. As noted above, the requirement that DCMs capture and

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[345] 75 FR 80572, 80617-80618, Dec. 22, 2010.
[346] CME Comment Letter at 33-34 (Feb. 22, 2011); and MGEX Comment Letter at 7 (Feb. 22, 2011).
[347] CME Comment Letter at 34 (Feb. 22, 2011).
[348] MGEX Comment Letter at 7 (Feb. 22, 2011).
[349] Barnard Comment Letter at 2 (May 20, 2011).
[350] Id.

retain all audit trail data is central to ensuring that the DCM can appropriately monitor and investigate any potential customer and market abuse, as required by the core principle. The Commission is not persuaded that this requirement would unduly burden DCMs, as these requirements are the same as the responsibilities currently outlined in the Acceptable Practices and Application Guidance for Core Principle 10. In addition, exchanges are free to decide the manner and the technology they use to capture and retain audit trail data. The Commission is not prescribing how this should be done and therefore does not believe that this requirement will stifle innovation.

The Commission also notes that the text of § 38.551 defines certain regulatory outcomes that exchanges must achieve, but does not prescribe a specific means by which exchanges must achieve those outcomes. Accordingly, the rule is not prescriptive as it permits an exchange to achieve the required outcome in a number of ways.

Proposed § 38.551 required that a DCM "must capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses."[351] The creation and retention of a comprehensive audit trail enables exchanges to properly reconstruct any and all trading events and to conduct a thorough forensic review of all trade information. The Commission believes that the ability to reconstruct trading is a fundamental element of a DCM's surveillance and rule enforcement programs.

ii. § 38.552 – Elements of an Acceptable Audit Trail Program

Proposed § 38.552 established the four elements of an acceptable audit trail program. First, proposed § 38.552(a) required a DCM's audit trail to include original source documents, defined to include unalterable, sequentially-identified records on which trade execution information is originally recorded, whether manually or

[351] DCM NPRM at 80617-18.

electronically. Additionally, the proposal required that customer order records indicate the terms of the order, the account identifier that relates to the account owner, and the time of the order entry. Finally, proposed § 38.552(a) required that, for open-outcry trades, the time of report of order execution also be captured in the audit trail.

Second, proposed § 38.552(b) required that a DCM's audit trail program must include a transaction history database. Proposed § 38.552(b) specified the trade information required to be included in a transaction history database, including a history of all orders and trades; all data input in the trade matching system for clearing; the categories of participants for which trades were executed (i.e., customer type indicator or "CTI" codes); timing and sequencing data sufficient to reconstruct trading; and identification of each account to which fills were allocated.

Third, proposed § 38.552(c) required that a DCM's audit trail program have electronic analysis capability for all data in its transaction history database, and that such electronic analysis capability allow the exchange to reconstruct trades in order to identify possible rule violations.

Finally, proposed § 38.552(d) required that a DCM's audit trail program include the ability to safely store all audit trail data, and to retain data in accordance with the recordkeeping requirements of DCM Core Principle 18 and associated regulations. Safe storage capability required a DCM to protect its audit trail data from unauthorized alteration, accidental erasure, or other loss.

Summary of Comments

In addition to submitting general comments asserting that the proposed rules are overly prescriptive, CME stated that while it currently maintains a database that includes

a history of all orders and trades for electronic trading, the open outcry trading venue "does not support an electronic transaction history database that captures the history of all orders, including orders that may be cancelled prior to execution."[352] CME requested that, in the event that open-outcry orders are not entered into an electronic order routing system, the Commission clarify the requirements to take into account the distinctions between electronic and open-outcry trading.[353]

Better Markets requested that the Commission consider the impact that high-frequency traders may have on creation and maintenance of an exchange's audit trail data.[354] Specifically, Better Markets commented that each of the elements of an exchange's audit trail, including all customer orders, should be "time-stamped at intervals consistent with the capabilities of [high-frequency traders]..."[355]

Discussion

The Commission is adopting § 38.552 as proposed, with certain revisions in response to comments received, and additional clarifications as explained below.

First, in response to CME's comment that the Commission's audit trail rules should recognize the distinctions between electronic trading and open outcry trading, the Commission is revising § 38.552(b) to specify that a transaction history database must include a history of all trades, whether executed electronically or via open-outcry. However, order information must be included in the database only to the extent that such orders are entered into an electronic trading system. In addition, § 38.552(b) also clarifies that order data includes modifications and cancellations of such orders. This

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[352] CME Comment Letter at 33 (Feb. 22, 2011).
[353] Id.
[354] Better Markets Comment Letter at 9 (Feb. 22, 2011).
[355] Id. at 10.

reflects a regulatory requirement previously proposed as part of § 38.156, but moved to § 38.552(b) in the final rules. The final rules further revise § 38.552(b)(2) by replacing the customer type indicators listed in the proposed rule with the term "customer type indicator code."

The final rules also revise § 38.552(c) to include the requirement that an exchange's electronic analysis capability must provide it with the ability to reconstruct trading and identify possible trading violations.[356]

The Commission acknowledges Better Markets' comments regarding audit trail data with respect to high-frequency trading. However, the Commission believes that the audit trail rules adopted herein, particularly the requirements that an exchange retain and maintain all data necessary to permit it to reconstruct trading, will help ensure that information and trades entered into an electronic trading system by high-frequency traders will be collected and retained as any other audit trail data would be collected and retained.

The Commission believes that the four elements set forth in § 38.552 are necessary to ensure that a DCM can capture and retain sufficient trade-related information, can reconstruct trading promptly, and has the necessary tools to detect and deter potential customer and market abuses through its audit trail. Specifically, original source documents must include all necessary trade information to reconstruct trading on the DCM. The transaction history database facilitates rapid access and analysis of all original source documents, thereby aiding DCMs in monitoring for customer and market abuses, while electronic analysis capability helps ensure effective use of audit trail data

[356] The text added to regulation 38.552(c) is language originally proposed in regulation 38.156 and has now been deleted from regulation 38.156.

by requiring appropriate tools to use in conjunction with a DCM's transaction history database. Safe storage capability enables a DCM to properly preserve and protect the audit trail data so that it is readily available for the DCM to use in any future investigation or inquiry into possible violations of DCM rules.

With the clarifications and revisions discussed above, the Commission adopts § 38.552 as the elements required of an acceptable audit trail program.

iii. § 38.553 - Enforcement of Audit Trail Requirements

Proposed § 38.553 established the elements of an effective audit trail enforcement program. The proposed rule was organized in two parts. First, proposed § 38.553(a) required a DCM to develop an effective audit trail enforcement program. The proposed rule provided that an effective enforcement program must, at a minimum, review all members and market participants annually to verify their compliance with all applicable audit trail requirements.

Proposed § 38.553(a) was further divided into two paragraphs. Paragraph (a)(1) set forth minimum review criteria for an electronic trading audit trail, including annual examinations by DCMs of randomly selected samples of front-end audit trail data from order routing systems to ensure the presence and accuracy of required audit trail data. In addition, paragraph (a)(1) required that exchanges: review the processes used by members and market participants to assign and maintain exchange user identifications; review usage patterns associated with user identifications; and review account numbers and CTI codes in trade records to test for accuracy and improper usage. Paragraph (a)(2) of proposed § 38.553 established minimum review criteria for open-outcry trading, requiring DCMs to conduct annual reviews of all members and market participants to

verify their compliance with their trade timing, order ticket, and trading card requirements.

Second, proposed § 38.553(b) required DCMs to develop programs to ensure effective enforcement of their audit trail and recordkeeping requirements. This requirement applied equally to both open-outcry and electronic trading. Proposed § 38.553(b) required exchanges' enforcement programs to identify members and market participants that routinely failed to comply with the requirements of Core Principle 10 and to levy meaningful sanctions when deficiencies were found. Such sanctions could not include more than one warning letter or other non-financial penalty for the same violation within a rolling 12 month period.

Summary of Comments

As noted above with respect to other rules, several commenters requested clarification of the term "market participant" in § 38.553(a) and § 38.553(b), including questioning who qualifies as a "market participant."[357] Specifically, MGEX and NYSE Liffe suggested that the term "market participant" should be limited to only those participants who have direct access to the trading platform.[358] CME commented that the Commission should limit the requirement for annual audit trail reviews to the "clearing firm level rather than the market participant level" because conducting an annual audit trail and recordkeeping review of "every participant who enters an order into [a trading system would be] exceptionally onerous, costly and unproductive."[359] Additionally, MGEX argued that exchanges should be permitted to conduct annual reviews by testing a

[357] CME Comment Letter (Feb. 22, 2011); NYSE Liffe Comment Letter (Feb. 22, 2011); MGEX Comment Letter (Feb. 22, 2011).
[358] MGEX Comment Letter at 7 (Feb. 22, 2011); NYSE Liffe Comment Letter at 12 (Feb. 22, 2011).
[359] CME Comment Letter at 33(Feb. 22, 2011).

sample of market participants in order to make the annual reviews of audit trail and recordkeeping requirements "more efficient, adequate and less burdensome."[360]

In response to the proposed § 38.553(b)'s requirement for sufficient sanctions for violations of audit trail and recordkeeping requirements, MGEX argued that such a requirement is "arbitrary and counterproductive."[361] MGEX proposed that the Commission should simply require exchanges to have an adequate audit trail program, including adequate enforcement of the audit trail requirements.[362] MGEX argued that such an approach would allow an exchange to develop "what works best for their business while meeting intended audit trail requirements."[363]

Discussion

The Commission adopts proposed § 38.553, with certain amendments.

The Commission has considered the comments pertaining to this rule and believes that the term "market participants," as used in §§ 38.553(a) and 38.553(b), requires clarification. Accordingly, "market participants" is amended to instead state "persons and firms subject to designated contract market recordkeeping rules" throughout § 38.553. The Commission recognizes that the term "market participants" may be viewed to capture a wider range of persons than the Commission intended to subject to the proposed regulation. Therefore, this amendment to § 38.553 clarifies that its requirements apply to those individuals and firms that are subject to DCM recordkeeping rules.

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[360] MGEX Comment Letter at 7 (Feb. 22, 2011).
[361] Id.
[362] Id.
[363] Id.

The Commission does not believe that sampling-based reviews of audit trail and recordkeeping requirements are adequate to reasonably ensure compliance with audit trail rules. Sections 38.553(a) and 38.553(b) require audit trail enforcement programs that will yield some certainty with respect to exchanges' accurate and consistent access to all data necessary to reconstruct all transactions in their markets and provide evidence of customer and market abuses. Absent reliable audit trail data, an exchange's ability to detect or investigate customer or market abuses may be severely diminished.

The Commission does not believe that requiring exchanges to issue no more than one warning letter for the same violation within a rolling 12-month time period is arbitrary and counterproductive. The proposed requirement to limit DCMs to no more than one warning letter for the same violation within a rolling 12-month time period helps ensure that exchanges levy meaningful fines and sanctions to deter recidivist behavior. However, the Commission is amending § 38.553(b) to clarify that its requirements with respect to warning letters only apply where exchange compliance staff finds an actual rule violation, rather than just the suspicion of a violation.

The Commission notes that § 38.553 reflects staff's findings and recommendations in recent RERs regarding DCMs' audit trail enforcement programs, including recommendations regarding more frequent audit trail reviews and larger sanctions for audit trail violations. The proposed rule also reflects the Commission's directive to DCMs in recent RERs to develop audit trail programs for electronic trading that are comparable in rigor and scope to their audit trail programs for open-outcry

trading.[364] Accordingly, the Commission is adopting § 38.553 with the aforementioned modifications.

11. Subpart L - Financial Integrity of Transactions

The Dodd-Frank Act amended the text of Core Principle 11 largely to incorporate the language from former Designation Criteria 5.[365]

This core principle requires that a DCM establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into, on, or through the facilities of the contract market, including the clearing and settlement of the transactions with a DCO. Core Principle 11 also requires that a DCM establish and enforce rules to ensure: (i) the financial integrity of any futures commission merchant ("FCM") and introducing broker ("IB"); and (ii) the protection of customer funds. Because the substance of this core principle is unchanged, the Commission interpreted the statutory provisions in the same manner as they are currently interpreted. The Commission proposed to codify current practices carried out by the industry, as well as practices listed in the application guidance for Core Principle 11 and former Designation Criterion 5. In addition, based upon its experience, the Commission proposed some new practices and requirements for DCMs in implementing Core Principle 11.[366] Among other rules, the Commission proposed to codify the statutory text of Core Principle 11 in § 38.600, and is adopting the rule as proposed.

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[364] See Rule Enforcement Review of the Minneapolis Grain Exchange (August 27, 2009), and Rule Enforcement Review of ICE Futures U.S. (Feb. 2, 2010).

[365] Former Designation Criterion 5 stated that "the board of trade shall establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into by or through the facilities of the contract market, including the clearance and settlement of the transactions with a derivatives clearing organization." 17 CFR Part 38, app. A (2010).

[366] The Commission received five comment letters that discussed proposed regulations 38.600 through 38.607. The comments were received from ICE Comment Letter (Feb. 22, 2011), ELX Comment Letter (Feb. 22, 2011), MGEX Comment Letter (Feb. 22, 2011), KCBT Comment Letter (Feb. 22, 2011), and CME Comment Letter (Feb. 22, 2011).

i. § 38.601 - Mandatory clearing

Proposed § 38.601 provided that all transactions executed on or through a DCM, other than transactions in security futures products, be cleared through a Commission-registered DCO.

Summary of Comments

CME commented that the mandatory clearing requirement should not apply to swaps traded on a DCM because not all swap contracts will be required to be cleared, such as foreign exchange swaps and swaps for end users.[367] CME further stated that this requirement would put a DCM at a competitive disadvantage to a SEF without justification, and recommended that the Commission revise proposed § 38.601 to exclude swaps from the clearing rule.[368]

Discussion

The Commission is adopting the proposed rule, with certain amendments. The Commission believes that the language of the core principle specifically imposes a clearing obligation for all transactions executed on a DCM (as is the current practice) and has therefore not revised the rule to exclude swaps.[369]

However, the Commission has revised the rule to make clear that transactions in security futures products that are executed on or through a DCM are also subject to the

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[367] CME Comment Letter at 34 (Feb. 22, 2011).

[368] Id.

[369] Although the DCM and SEF Financial Integrity Core Principles are similar, the SEF core principle contains the language "including the clearance and settlement of the swaps pursuant to section 2(h)(1)." Section 5h(f)(7) of the CEA, 7 U.S.C. 7b-2(f)(7), as added by section 733(f) of the Dodd-Frank Act. The DCM core principle states "including the clearance and settlement of the transactions with a derivatives clearing organization." The Commission reads section 2(h)(1) as a limitation on the clearing obligation for SEFs, and as a result, proposed regulation 37.701 requires all transactions executed on a SEF to be cleared unless the transaction is exempted from clearing under section 2(h)(7) of the CEA or the Commission determines that the clearing requirement under section 2(h)(1) of the CEA is inapplicable. Since Congress did not provide for a limitation on the clearing obligation in the DCM core principle, all transactions executed on or through a DCM must be cleared through a Commission-registered DCO.

mandatory clearing requirement. Such products may be cleared either through a DCO or through a clearing agency registered pursuant to section 17A of the Securities Exchange Act of 1934.[370]

ii. § 38.602 - General Financial Integrity

Proposed § 38.602 provided that DCMs must adopt rules establishing minimum financial standards for both member FCMs and IBs and non-intermediated market participants.

Summary of Comments

ICE contended that the Commission has expanded the standard in Core Principle 11 by requiring DCMs to establish minimum financial standards for all of their members and non-intermediated market participants.[371] ICE further stated that many DCMs eliminated specific financial standards for their non-FCM members and instead require that non-FCM member transactions be guaranteed by a clearing member.[372] As a result, ICE requested confirmation that a DCM rule requiring such clearing arrangements to be in place would satisfy proposed § 38.602.[373] ICE also requested confirmation that a DCM rule requiring an FCM to maintain capital in accordance with applicable Commission regulations would satisfy the DCM's duty to set financial requirements for its FCM members.[374]

Discussion

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[370] 15 U.S.C. 78a et seq. (2010)
[371] ICE Comment Letter at 12 (Feb. 22, 2011).
[372] Id. at 13.
[373] Id.
[374] Id.

The Commission is adopting the rule as proposed. In response to ICE's comments, the Commission confirms that a DCM rule requiring that transactions by a non-FCM member be guaranteed by a clearing member will satisfy § 38.602.[375]

However, a DCM rule requiring an FCM to maintain capital in accordance with applicable Commission regulations will not, in itself, satisfy the DCM's duty to set minimum financial standards for its FCM members. The term "minimum financial standards" used in § 38.602 is not intended to cover only capital requirements. Rather, § 38.602 should be read in conjunction with § 38.604, which requires surveillance by a DCM of financial and related information from each of its members. The Commission notes that a DCM's duty to set financial standards for its FCM members involves setting capital requirements, conducting surveillance of the potential future exposure of each FCM as compared to its capital, and taking appropriate action in light of the results of such surveillance.

iii. § 38.603 - Protection of Customer Funds

Proposed § 38.603 provided that DCMs must adopt rules for the protection of customer funds, including the segregation of customer and proprietary funds, the custody of customer funds, the investment standards for customer funds, intermediary default procedures and related recordkeeping.

Summary of Comments

KCBT stated that because its rules incorporate by reference the requirements of the CEA, the requirement to implement exchange rules that mirror Commission

[375] The Commission notes that this requirement does not speak to DCO requirements under, for example, Core Principle D (Risk Management) for its clearing members.

regulations is duplicative, unnecessary and burdensome.[376] In addition, KCBT noted that its clearing corporation already has rules in place to address intermediary default procedures.[377]

Discussion

The Commission is adopting the rule as proposed. In response to the comments, the Commission confirms that DCMs must adopt rules as required under § 38.603. Establishing such rules is important because it will provide evidence: (i) that each DCM has focused attention on the specific regulations promulgated under the CEA; and (ii) that such regulations are appropriately implemented. Section 38.603 does not specify the exact rules to be implemented by each DCM, but sets forth the substance of what the rules of each DCM must address.

In response to KCBT's comment that its clearing corporation already has rules in place to address intermediary default procedures, the Commission notes that DCO rules protect the DCO, not fellow customers. Nonetheless, the performance of the functions required by § 38.603 may be allocated between a DCO and DCM pursuant to appropriate written agreements. Such agreements would have to include an arrangement between the DCO and DCM that the DCO would undertake the responsibility to protect the individual customers of the DCM.

iv. § 38.604 - Financial Surveillance

Proposed § 38.604 required that a DCM must routinely receive and promptly review financial and related information from its members, and conduct ongoing financial surveillance of the risk created by the positions taken by an FCM's customers.

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[376] KCBT Comment Letter at 7 (Feb. 22, 2011).
[377] Id.

To meet this requirement, the DCM must have rules pertaining to minimum financial standards of intermediaries that include, among other things, rules prescribing minimum capital requirements for member FCMs and IBs.[378] The DCM must also have rules pertaining to the protection of customer funds that must include, among other things, that each DCM must continually survey the obligations of each FCM created by its customers' positions and, as appropriate, compare those obligations to the financial resources of the FCM. If the obligations of a member FCM appear excessive as compared to the FCM's capital, a DCM should take appropriate action, including contacting the FCM or the FCM's designated self-regulatory organization ("DSRO").

Summary of Comments

KCBT commented that it already reviews on a daily basis the open positions and percentage of open interest held by each clearing member, and "pay/collect information" based upon open positions and reportable positions.[379] KCBT is concerned that the use of the terms "continually" and "excessive" in the proposed regulation is vague.[380] In addition, KCBT noted that the DSRO should continue to review the obligations of each firm for which it is the DSRO because the DSRO has access to all customer positions being carried by the FCM in all markets and thus is in a better position to ensure that the FCM has sufficient capital for the overall positions being carried by the FCM.[381]

Discussion

The Commission is adopting the rule as proposed and notes that the rule codifies existing industry practice. In response to comments raised by KCBT, the Commission

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[378] An FCM that is a clearing member will also have additional obligations to the DCO as a result of its clearing membership.
[379] See KCBT Comment Letter at 7 (Feb. 22, 2011).
[380] Id.
[381] Id.

notes that the term "continually" in the proposed rule requires that a DCM survey the obligations of each FCM created by the positions of its customers throughout the trading day, not just based upon end-of-day positions. Financial risk can shift dramatically throughout the day as a result of the combination of price move and new trades, making it difficult for a DCM to fulfill its obligations to establish and enforce rules to ensure: (i) the financial integrity of FCMs and IBs and (ii) the protection of customer funds pursuant to Core Principle 11, if such DCM limited its monitoring to daily. FCMs and IBs could be exposed to excessive risk if they are taking on risky positions during the day with the expectation that those risks will be offset prior to the daily review period set by the DCM. The Commission also notes that an arrangement between a DCO and a DCM, whereby the DCO is responsible to a DCM for the performance of certain functions, including the monitoring required pursuant to § 38.604, will continue to be permitted by the Commission.

In response to KCBT's comment regarding the vagueness of the word "excessive," the Commission expects a DCM to exercise professional judgment in monitoring the risks of its FCMs as compared to their available capital, and to take follow-up action to inquire into and address any exceptional situations. This monitoring should occur in addition to any DSRO review.

v. § 38.605 - Requirements for Financial Surveillance Program

Proposed § 38.605 required DCMs, as self-regulatory organizations ("SROs"), to comply with the standards of amended § 1.52 to ensure the financial integrity of intermediaries by establishing and carrying out an SRO program for the examination and financial supervision of intermediaries. Section 1.52, as proposed to be amended, sets

forth the required elements of SRO supervisory programs and permits one or more SROs to establish, subject to Commission approval, a joint audit plan to provide for the SRO supervision of members of more than one SRO. As noted in the DCM NPRM, proposed amendments to § 1.52 included references to existing guidance to SROs contained in the Financial and Segregation Interpretation No. 4-1 (Advisory Interpretation for Self-Regulatory Organization Surveillance Over Members' Compliance with Minimum Financial, Segregation, Reporting, and Related Recordkeeping Requirements), and Addendums A and B to Financial and Segregation Interpretation No. 4-1, and Financial and Segregation Interpretation No. 4-2 (Risk-Based Auditing), which guided the practices of members of the Joint Audit Committee ("JAC") operating a joint audit plan that had been approved by the Commission.[382]

Discussion

No comments were received pertaining to the proposed rules, and the Commission is adopting proposed § 38.605 and § 1.52 without modification.

The Commission notes that the staff guidance contained in Division of Trading and Markets Financial and Segregation Interpretations 4-1 and 4-2, and related Addendums A and B to Financial and Segregation Interpretations 4-1, remains effective. Accordingly, while the revised § 1.52(b)(4) provides that an SRO's financial surveillance program must include the onsite examination of each member FCM no less frequently than once every 18 months, Financial and Segregation Interpretation No. 4-2 provides that FCMs should generally be subject to an onsite examination at least once every 9 to 18 months, with examination cycles exceeding 15 months only for registrants with a

[382] See 73 FR 52832, Sept. 11, 2008 (requesting comments prior to the Commission's approval of the most recent Joint Audit Committee agreement, which approval was granted March 18, 2009). See also, DCM NPRM, 75 FR at 80596.

demonstrated history of strong compliance and risk management in order to provide flexibility for unexpected events or to vary examination dates.

While § 1.52 now codifies long established staff positions, and SRO practice, with respect to the manner in which SROs execute their financial surveillance and supervisory programs with respect to member intermediaries, the Commission will continue to evaluate options to further enhance the manner in which intermediaries are supervised and to strengthen the protection of customer funds.

vi. § 38.606 - Financial Regulatory Services Provided by a Third Party

Proposed § 38.606 provided that DCMs may satisfy their financial surveillance responsibilities under proposed §§ 38.604 and 38.605 by outsourcing such responsibilities to a registered futures association or other regulated entity, including, for example, a DCO. Proposed § 38.606 provided that a DCM must ensure that the regulatory service provider has the capacity and resources to conduct the necessary financial surveillance and, notwithstanding the use of a regulatory service provider, the DCM remains responsible for compliance with its financial surveillance obligations.

Summary of Comments

MGEX commented that the proposed requirements seem reasonable, and stated that the requirements could be satisfied under the current delegation and information sharing agreements such as the Commission-approved JAC Agreement for Services.[383] MGEX also commented that DCMs should not be required to audit third party regulatory providers because that would frustrate the purpose, efficiency, and economic value of outsourcing to a third party.[384]

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[383] MGEX Comment Letter at 8 (Feb. 22, 2011).
[384] Id.

Discussion

The Commission is adopting the proposed rule without modification. In response to MGEX's comments, the Commission notes that § 38.606 would not be satisfied solely by relying on a DCM's JAC Agreement. The current JAC Agreement does not cover the type of financial surveillance specified in § 38.604, nor does it, by its terms, serve as an outsourcing regulatory services agreement for the type of outsourcing contemplated under § 38.606. Accordingly, in order to satisfy the requirements of both §§ 38.604 and 38.605, a regulatory services agreement must specifically include the following: (i) the regulatory services to be performed, which to satisfy § 38.604 must include intraday monitoring of FCM obligations and positions; (ii) to whom and for whom such services are to be provided; and (iii) a statement or representation that the provider of the services has the capacity and resources to perform the identified services.

vii. § 38.607 - Direct access

Proposed § 38.607 required a DCM that allows customers direct access to its contract market to implement certain direct access controls and procedures in order to provide member FCMs with tools to manage their financial risk. The proposed rule contemplated that an FCM would continue to have primary responsibility for overall risk management, but that the DCM would be required to establish an automated risk management system permitting an FCM to set appropriate risk limits for each customer with direct access to the contract market.

Summary of Comments

CME supports risk controls at both the DCM and DCO levels, and also at clearing firm and direct access client levels.[385] CME supports the discretion that the proposed rules provide a DCM in terms of the control model for access, and recommended a level of standardization with respect to the types of DCM pre-trade controls in the form of acceptable practices.[386] ELX recommended that the Commission consider allowing an FCM to bypass use of DCM-provided controls if an FCM has its own controls that a DCM tests and deems to be sufficient.[387] MGEX commented that the Commission should not mandate that a DCM provide the technology as a prescriptive rule, and further claimed that such tools are the FCM's responsibility and DCMs should not be required to assume these responsibilities.[388]

Discussion

After reviewing the comments discussed above, the Commission is adopting the proposed rule without modification and believes that risk controls are appropriate at the FCM, DCO and DCM levels. The Commission notes that it is impossible for an FCM to protect itself without the aid of the DCM when a customer has direct access to a DCM and thus completes trades that are the financial responsibility of such customer's FCM before the FCM's systems have an opportunity to prevent the execution of such trades. As a result, DCMs allowing customers direct access to their markets must implement certain controls and procedures to allow FCMs to manage their risk. As stated in the proposed rule, these controls would not be required for a DCM that permits only intermediated transactions and does not permit direct access.

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[385] CME Comment Letter at 34 (Feb. 22, 2011).
[386] Id.
[387] ELX Comment Letter at 5 (Feb. 22, 2011).
[388] MGEX Comment Letter at 8 (Feb. 22, 2011).

The responsibility to utilize these controls and procedures remains with the FCM. Each FCM permitting direct access must use DCM-provided controls, regardless of the purported efficacy of an FCM's controls.[389] This principle is supported by CME's comment letter, the Commission's Technology Advisory Committee report (the "DMA Report"),[390] and the FIA Report on Market Access Risk Management Recommendations (the "FIA Report").[391]

As discussed in the DCM NPRM, the Technical Committee of the International Organization of Security Commissions ("IOSCO") published a final report on principles for direct electronic access in August of 2010 (the "IOSCO DEA Report") stating that, in an automated trading environment, the only controls that can effectively enforce limitations on risk are automated controls.[392] Further, the IOSCO DEA Report noted that a market should not permit direct electronic access unless effective systems and controls are in place to enable risk management, including automated pre-trade controls enabling intermediaries to implement appropriate trading limits.[393] The IOSCO DEA Report stated that "[t]here is no convincing rationale for not using automated credit limit system

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[389] The efficacy of these controls also hinge, in part, on the proper functioning of the electronic systems of DCMs, FCMs and direct access market participants, and thus, necessitates that such electronic systems are routinely tested and monitored. Accordingly, the Commission may address additional electronic system testing and supervision-related issues in the future.

[390] See Pre-Trade Functionality Subcommittee of the CFTC Technology Advisory Committee report, "Recommendations on Pre-Trade Practices for Trading Firms, Clearing Firms, and Exchanges Involved in Direct Market Access" (March 1, 2011), accepted by the TAC and available at: http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_ptfs2.pdf . The DMA Report recommends specific controls that should be adopted by each FCM and DCM and notes that "the exchanges are the point furthest downstream, so coordination at this level has the greatest leverage to impact the industry as a whole." DMA Report at p. 4. The controls provided by the DCM serve as the backstop, in the event that an FCM's controls are insufficient. The DMA Report notes that, although the recommendations may seem redundant, it "strongly believes that an approach of multiple, redundant checks across the supply chain offers the most robust protection to markets." Id. at p. 5.

[391] See FIA report on "Market Access Risk Management Recommendations" (April 2010), available at: http://www.futuresindustry.org/downloads/Market_Access-6.pdf. ("FIA Report").

[392] IOSCO, Final Report of the IOSCO Technical Committee, "Principles for Direct Electronic Access to Markets," at 20, IOSCO Doc. FR08/10 (August 12, 2010), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD332.pdf.

[393] Id.

filters...it will be critical for intermediaries, third party vendors and markets to cooperate in putting into place appropriate systems and controls."[394] One example provided in the report was that a market could provide and operate an automated system (i.e., software and hardware) that would be used by the intermediary and clearing firm.[395]

Further, the FIA's working group, consisting of DCMs, clearing firms, and trading firms, recommended that pre-trade controls be set at the exchange level, and that the controls be mandatory to ensure that there are no latency disadvantages.[396] In a publication in January 2011, the FIA reported that the majority of exchanges have policies and tools in place that comply with those recommendations.[397] The DMA Report also discussed the latency for an FCM that elects to use a DCM's controls as compared to an FCM that does not.[398] This disadvantage is eliminated if each DCM requires all FCMs to use the DCM-provided protections.

12. Subpart M - Protection of Markets and Market Participants

Core Principle 12, as amended by the Dodd-Frank Act, requires that DCMs establish and enforce rules to protect markets and market participants from abusive practices committed by any party, including abusive practices committed by a party acting as an agent for a participant, and promote fair and equitable trading on the contract market.

The Commission proposed to codify the statutory text of the core principle in § 38.650, and is adopting the rule as proposed.

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[394] Id. at p. 22.
[395] Id.
[396] See e.g., FIA Report.
[397] See Leslie Sutphen, "Exchange Survey Finds Wide Range of Risk Controls in Place" (January 2011), at 28, available at: http://www.futuresindustry.org/downloads/RC-survey.pdf.
[398] See DMA Report at p. 4.

i. § 38.651 – Additional Sources for Compliance

Proposed § 38.651 required that a DCM have and enforce rules that are designed to promote fair and equitable trading and to protect the market and market participants from abusive practices including fraudulent, noncompetitive or unfair actions, committed by any party. The rule also required that DCMs must have methods and resources appropriate to the nature of the trading system and the structure of the market to detect trade practice and market abuses and to discipline such behavior, in accordance with Core Principles 2 and 4, and the associated regulations in subparts C and E of this part, respectively. The proposed rule required that DCMs also must provide a competitive, open and efficient market and mechanism for executing transactions in accordance with Core Principle 9 and the associated regulations under subpart J of this part.

Summary of Comments

Chris Barnard and Better Markets referenced a discussion from the DCM NPRM preamble that provided that a DCM must establish rules that require the fair, equitable, and timely provision of information regarding prices, bids, and offers to market participants.[399] Mr. Barnard requested that the Commission amend the wording of proposed §§ 38.650 and 38.651 to include this language and Better Markets requested that the proposed rules prohibit privileged access to data feeds, arguing that the practice is disruptive of fair and equitable trading.[400]

Discussion

The Commission is adopting the rule with a technical modification to revise the heading of the rule from "Additional sources for compliance" to the more appropriate

[399] Better Markets Comment Letter at 10 (Feb. 22, 2011) and Barnard Comment Letter at 4 (May 20, 2011) (citing DCM NPRM at 80597).
[400] Id.

"Protection of markets and market participants." All other aspects of the proposed rule will remain unchanged.

The Commission believes that Mr. Barnard's concerns are adequately addressed by the rules adopted in this release. As an initial matter, § 38.650 simply codifies the language of Core Principle 12 and thus cannot be amended by the Commission. Additionally, the broad requirement to promote "fair and equitable trading" contained in §§ 38.650 and 38.651, as well as the Core Principle 9 requirement to provide a "competitive, open, and efficient market and mechanism for executing transactions," are sufficient to capture the obligation to provide fair, equitable, and timely information regarding prices, bids, and offers. With respect to Better Markets' comment, the Commission notes that the language from the DCM NPRM cited by Better Markets was not intended to preclude co-location. Instead, the DCM NPRM provides that a market should be fair and equitable in its information distribution, meaning all participants in co-location agreements should pay the same price for a given level of service and access. This does not mean that everyone in the market is required to get information at the same time, but rather that every member of a connection or access type class must be treated equally in terms of service and cost. The faster access to price, bid, and offer information afforded by co-location is no different than the faster access to information afforded to traders in the pits prior to the markets becoming electronic. The Commission believes that prohibiting co-location, or requiring that co-location services be throttled to a point that all participants are able to consume information or access the matching engine at the same speed, would not be practical or reasonable. The Commission also notes that it

recently addressed co-location fees in a separate proposed rulemaking for "Co-location/Proximity Hosting Services."[401]

13. Subpart N - Disciplinary Procedures

Core Principle 13 is a new core principle, created by section 735 of the Dodd-Frank Act. The core principle incorporates the concepts from former Designation Criterion 6 (Disciplinary Procedures) and former DCM Core Principle 2.[402] The core principle specifically requires that DCMs establish and enforce disciplinary procedures that authorize the DCM to discipline, suspend or expel market participants and members that violate the DCM's rules, or delegate the function to third parties.

Summary of Comments

Several commenters submitted letters discussing the disciplinary procedures contained in subpart N. While the comments were generally supportive of the Commission's objectives, commenters expressed a general desire for the Commission to

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[401] See, Notice of proposed rulemaking, 75 FR 33198, Jun. 11, 2010.

[402] Compare former CEA section 5(b)(6) and section 5(d)(2) with CEA section 5(d)(13) as amended by the Dodd-Frank Act. Prior to the passage of the Dodd-Frank Act, the standards for DCMs' disciplinary practices were found in Designation Criterion 6 and the statutory language, guidance, and acceptable practices for former Core Principle 2. Designation Criterion 6 required that a DCM establish and enforce disciplinary procedures that authorized it to discipline, suspend, or expel members or market participants that violated the rules of the DCM, or similar methods for performing the same functions, including delegation of the functions to third parties. Paragraph (a)(2) of the application guidance for former Core Principle 2 required DCMs to have the "arrangements, resources, and authority [necessary] for effective rule enforcement," and the "authority and ability to discipline and limit, or suspend the activities of a member or market participant pursuant to clear and fair standards." 17 CFR part 38, app. B, Application Guidance for Core Principle 2 at (a)(2) (2010). In addition, paragraph (b)(4) of the former core principle's acceptable practices required any DCM that wished to take advantage of the acceptable practice's safe harbor to have "prompt and effective disciplinary action for any violation...found to have been committed." 17 CFR part 38, app. B, Acceptable Practices for Core Principle 2 at (b)(4) (2010). Paragraph (b)(4) also referenced part 8 of the Commission's regulations as an example that DCMs could follow to comply with Core Principle 2. 17 CFR 8.01 et seq. In its experience, the Commission has found that many DCMs' disciplinary programs do in fact model the disciplinary structures and processes in part 8. While the acceptable practices for former Core Principle 2 offered the disciplinary procedures in part 8 as an example of appropriate disciplinary procedures, DCMs were exempt from part 8 pursuant to regulation 38.2. The disciplinary procedures proposed herein do not re-subject DCMs to part 8 of the Commission's regulations, but rather propose new disciplinary procedures for inclusion in part 38.

rely on a more principles-based approach, and argued that the proposed rules were overly prescriptive. Some commenters also articulated specific concerns regarding several rules that they believed would adversely impact DCMs.

Discussion

The Commission thoroughly reviewed and considered all comments received and, where appropriate, made modifications to the proposed rules, including converting some proposed rules into guidance. These modifications, explained further below, have resulted in changes to the numbering of the proposed regulations and in a reduction in the number of separately-enumerated rules, from 16 proposed rules to 12 final rules.

The Commission proposed to codify the statutory text of the core principle in proposed §38.700, and adopts the rule as proposed. The Commission is also adding § 38.712 to refer applicants and DCMs to the guidance in appendix B to part 38.

i. § 38.701 - Enforcement Staff

Proposed § 38.701 required that a DCM establish and maintain sufficient enforcement staff and resources to effectively and promptly prosecute possible rule violations within the jurisdiction of the contract market. The proposed rule also required a DCM to monitor the size and workload of its enforcement staff annually and increase its resources and staff as appropriate. The Commission recognized that at some DCMs, compliance staff also serves as enforcement staff. That is, they both investigate cases and present them before disciplinary panels. These proposed rules were not intended to prohibit that practice.

The Commission believes that adequate staff and resources are essential to the effective performance of a DCM's disciplinary program. This has repeatedly been

reflected in Commission staff's findings and recommendations in recent RERs, in which DMO staff recommended that DCMs increase their compliance and/or enforcement staff levels and monitor the size of their staff and increase the number of staff appropriately as trading volume increases, new responsibilities are assigned to staff, or internal reviews demonstrate that work is not completed in an effective or timely manner.

Proposed § 38.701 also provided that a DCM's enforcement staff may not include members of the exchange or persons whose interests conflict with their enforcement duties. Moreover, the proposed rule prohibited a member of the enforcement staff from operating under the direction or control of any person or persons with trading privileges at the contract market. These provisions sought to ensure the independence of enforcement staff, and help promote disciplinary procedures that are free of potential conflicts of interest.

Summary of Comments

MGEX noted that, as a combined DCM/DCO, it interprets the rule to allow staff to serve as enforcement and review staff for both the DCM and DCO divisions of MGEX, and any other entities that become a combined DCM/DCO.[403]

Discussion

The Commission is adopting the rule as proposed. The Commission believes that adequate staff and resources are essential to the effective performance of a DCM's disciplinary program. This has repeatedly been reflected in Commission staff's findings and recommendations in recent RERs, in which Commission staff recommended that DCMs increase their compliance and/or enforcement staff levels and monitor the size of their staff and increase the number of staff appropriately as trading volume increases,

[403] MGEX Comment Letter at 8 (Feb. 22, 2011).

new responsibilities are assigned to staff, or internal reviews demonstrate that work is not completed in an effective or timely manner.[404]

The Commission notes that MGEX's interpretation regarding the sharing of compliance staff across a combined DCM/DCO is acceptable, provided that the combined DCM/DCO has sufficient staff to meet the DCM's regulatory compliance needs in an effective and timely manner. In addition, with respect to DCM matters, staff must be accountable to the DCM and its Regulatory Oversight Committee. The Commission also notes, however, that its a priori acceptance of integrated compliance staff is limited to the unique circumstances of a fully integrated exchange and clearing house.

ii. § 38.702 - Disciplinary Panels

Proposed § 38.702 required a DCM to establish one or more Review Panels and one or more hearing panels (together, "disciplinary panels") to fulfill its obligations under this section. The composition of both panels was required to meet the composition requirements of proposed § 40.9(c)(3)(ii)[405] and could not include any members of the DCM's compliance staff, or any person involved in adjudicating any other stage of the same proceeding. Paragraph (b) of the proposed rule provided that a Review Panel must

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[404] See Rule Enforcement Review of the Minneapolis Grain Exchange (Aug. 27, 2009), Rule Enforcement Review of ICE Futures U.S. (Feb. 2, 2010), Rule Enforcement Review of the Chicago Board of Trade and the Chicago Mercantile Exchange (Sep. 13, 2010), and Rule Enforcement Review of New York Mercantile Exchange and Commodity Exchange (August 30, 2011) for findings and recommendations pertaining to the adequate size of DCM compliance and enforcement staffs.

[405] Section 40.9(c)(3)(ii), as proposed in the separate release titled "Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest", provided that "Each Disciplinary Panel shall include at least one person who would not be disqualified from serving as a Public Director by regulation 1.3(ccc)(1)(i)–(vi) and (2) of this chapter (a "Public Participant"). Such Public Participant shall chair each Disciplinary Panel. In addition, any registered entity specified in paragraph (c)(3)(i) of this section shall adopt rules that would, at a minimum: (A) Further preclude any group or class of participants from dominating or exercising disproportionate influence on a Disciplinary Panel and (B) Prohibit any member of a Disciplinary Panel from participating in deliberations or voting on any matter in which the member has a financial interest." See 75 FR 63732, Oct. 18, 2010.

be responsible for determining whether a reasonable basis exists for finding a violation of contract market rules, and for authorizing the issuance of a notice of charges against persons alleged to have violated exchange rules. If a notice of charges is issued, then paragraph (c) of the proposed rule helped to ensure an impartial hearing by requiring a separate hearing panel to adjudicate the matter and issue sanctions. While proposed § 38.702 required DCMs to empanel distinct bodies to issue charges and to adjudicate charges in a particular matter, the rule permitted DCMs to determine for themselves whether their review and hearing panels are separate standing panels or ad hoc bodies whose members are chosen from a larger "disciplinary committee" to serve in one capacity or the other for a particular disciplinary matter.

Summary of Comments

A number of commenters opposed the two-panel approach described in proposed § 38.702. CME stated that the Commission should rely on core principles, rather than what it sees as a prescriptive approach, as DCMs may have an established structure or may develop new structures that clearly satisfy the objective of the core principle, but that may not precisely comply with the language.[406] CME illustrated two practices it believed may be precluded by the text of proposed § 38.702: (1) CME's Market Regulation staff determines whether certain non-egregious rule violations merit referral to a Review Panel and they issue warning letters on an administrative basis; and (2) CME's hearing panel adjudicates a disciplinary case prior to the issuance of charges pursuant to a supported settlement agreement.[407]

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[406] CME Comment Letter at 35 (Feb. 22, 2011).
[407] Id.

ELX contended that the proposed rule would impose the need to create processes and procedures for certain functions already carried out by its Compliance Director, who is supervised by the Regulatory Oversight Committee.[408] ELX suggested that a DCM should be able to obtain a waiver from the two-panel requirement if it already has been designated as a contract market and currently operates under an alternative structure with respect to disciplinary procedures that have sufficient controls.[409]

MGEX argued that the rule is overly prescriptive, that there is no reasonable basis for the distinction between the two panels, and that one panel would maximize resources and streamline the process for all involved.[410] MGEX argued that staff is able to differentiate between the roles, and that the Commission should simply have the right to inquire if it has a question surrounding disciplinary panels or processes.[411]

Discussion

The Commission is adopting the proposed rule with certain modifications to address comments. The Commission considered commenters' views and believes that the proposed rule can be modified to address concerns without diminishing the purpose of the proposed rule. Accordingly, the final rule will require DCMs to have one or more disciplinary panels, without imposing a specific requirement for DCMs to maintain a "review panel" and a "hearing panel." The final rules replace specific panel names (i.e. "review panel" and "hearing panel") with a generic reference to the "disciplinary panel" throughout part 38. However, even under a single-panel approach, individuals who determine to issue charges in a particular disciplinary matter may not also adjudicate the

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[408] ELX Comment letter at 5 (Feb. 22, 2011).
[409] Id.
[410] MGEX Comment Letter at 9 (Feb. 22, 2011).
[411] Id.

matter. The final text of § 38.702 permits flexibility in the structure of DCMs' disciplinary bodies, but not in the basic prohibition against vesting the same individuals with the authority to both issue and adjudicate charges in the same matter. The modifications reflected in the final text of § 38.702, together with the revisions made to the final text of § 38.703, permit DCMs to rely on their senior-most compliance officer (i.e., a DCM's Chief Regulatory Officer), rather than on a disciplinary panel, to issue disciplinary charges, as suggested by ELX. However, the Commission notes that the adjudication of charges must still be performed by a disciplinary panel. Finally, the composition and conflicts requirements for disciplinary panels will be adopted with one modification, by replacing the reference to § 40.9(c)(3)(ii) with a reference to the more general "part 40."

iii. § 38.703 - Review of Investigation Report

The introductory paragraph of proposed § 38.703 required a Review Panel to promptly review an investigation report received pursuant to proposed § 38.158(c), and to take action on any investigation report received within 30 days of such receipt. Under paragraph (a) of the proposed rule, after receipt of the investigation report, if a Review Panel determined that additional investigation or evidence was needed, it would be required to promptly direct the compliance staff to conduct further investigation. In the alternative, under paragraph (b) of the proposed rule, if a Review Panel determined that no reasonable basis existed for finding a violation, or that prosecution was unwarranted, it would be permitted to direct that no further action be taken, and that a written statement be provided setting forth the facts and analysis supporting the decision.

Finally, under paragraph (c) of the proposed rule, if a Review Panel determined that a reasonable basis existed for finding a violation and adjudication was warranted, it was required to direct that the person or entity alleged to have committed the violation be served with a notice of charges.

Summary of Comments

While CME agreed that an investigation report should include the subject's disciplinary history, CME disagreed with the requirement in proposed § 38.158 that the disciplinary history be included in the version of the investigation report sent to the Review Panel.[412] CME believed that the disciplinary history should not be considered by the Review Panel at all when determining whether to issue formal charges, arguing that a market participant's disciplinary history is not relevant to the consideration of whether it committed a further violation of DCM rules.[413]

Discussion

Consistent with revisions to proposed § 38.702, the Commission is modifying proposed § 38.703 to provide greater flexibility to market participants in determining an approach to disciplinary panels. The Commission is eliminating all but paragraph (c) of the proposed rule, and is moving paragraph (c) to § 38.704 (Notice of charges), which the Commission is renumbering as § 38.703. The revisions to proposed rules § 38.702 and § 38.703 will provide DCMs with the flexibility to follow a single-panel approach, provided that a single panel does not perform the function of issuing and adjudicating the same charges. In addition, a DCM will have the flexibility to allow its senior-most

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[412] CME Comment Letter at 35 (Feb. 22, 2011).
[413] Id. While the Commission largely agrees with CME's comment, the Commission directs interested parties to regulation 38.158 for a further discussion of the required components of investigation reports.

regulatory officer, such as its Chief Regulatory Officer, to review an investigation report and determine whether a notice of charges should be issued in a particular matter.

iv. § 38.704 - Notice of Charges

Proposed § 38.704 described the minimally acceptable contents of a notice of charges ("notice") issued by a Review Panel. The rule required that the notice adequately state the acts, conduct, or practices in which the respondent is alleged to have engaged; state the rule, or rules, alleged to have been violated; and prescribe the period within which a hearing on the charges may be requested. Further, the proposed rule also required that the notice advise the respondent charged that he is entitled, upon request, to a hearing on the charges. Paragraphs (a) and (b) of the proposed rule provided that a DCM may adopt rules providing that: (1) the failure to request a hearing within the time prescribed in the notice, except for good cause, may be deemed a waiver of the right to a hearing; and (2) the failure to answer or expressly deny a charge may be deemed to be an admission of such charge.

Discussion

No comments were received regarding proposed § 38.704, and the Commission is adopting the proposed rule with certain modifications.

Given that paragraphs (a) and (b) of proposed § 38.704 allowed, but did not require, a DCM to issue rules regarding failures to request a hearing and expressly answer or deny a charge, the Commission believes that the language in these paragraphs is better suited as guidance rather than a rule. The Commission will adopt this language as guidance in appendix B to part 38.

In addition to the aforementioned revisions, and as described above, the Commission is moving paragraph (c) of proposed § 38.703 to proposed § 38.704, and is renumbering proposed § 38.704 as § 38.703.

v. § 38.705 - Right to Representation

Proposed § 38.705 required that, upon being served with a notice of charges, a respondent must have the right to be represented by counsel or any other representative of his or her choosing in all succeeding stages of the disciplinary process. Together with proposed §§ 38.704 (requiring an adequate notice of charges to the respondent), 38.708 (conferring the right to hearing), and 38.710 (hearing procedures), § 38.705 helped ensure basic fairness for respondents in disciplinary proceedings.

Summary of Comments

CME commented that the language of this rule should be limited to avoid conflicts in representation and, accordingly, requested that the rule be revised to clarify that a respondent may not be represented by: (1) a member of the DCM's disciplinary committees; (2) a member of the DCM's Board of Directors; (3) an employee of the DCM; and (4) a person substantially related to the underlying investigation, such as a material witness or other respondent.[414]

Discussion

The Commission is adopting the proposed rule with certain modifications. The Commission acknowledges CME's concern and is amending the proposed rule to incorporate CME's suggestion to clarify that a respondent must have the right to be represented by legal counsel or any other representative of its choosing in all succeeding stages of the disciplinary process, except any member of the designated contract market's

[414] CME Comment Letter at 35 (Feb. 22, 2011).

board of directors or disciplinary panel, any employee of the designated contract market, or any person substantially related to the underlying investigations, such as material witness or respondent. Additionally, as a result of the rule deletions and modifications discussed above, proposed § 38.705 as modified is being adopted as § 38.704.

vi. § 38.706 - Answer to Charges

Proposed § 38.706 provided that a respondent must be given a reasonable period of time to file an answer to a charge. In general, paragraphs (a) through (c) of the proposed rule provided that the rules of the DCM may require that: (1) the answer must be in writing and include a statement that the respondent admits, denies or does not have and is unable to obtain sufficient information to admit or deny each allegation; (2) failure to file an answer on a timely basis shall be deemed an admission of all allegations in the notice of charges; and (3) failure in an answer to deny expressly a charge shall be deemed to be an admission of such charge.

Discussion

Although no specific comments were received on proposed § 38.706, commenters generally requested greater flexibility to establish their own disciplinary procedures.[415] The Commission believes that proposed § 38.706 is a rule where greater flexibility can reasonably be accorded. Accordingly, the Commission is maintaining as a rule the requirement that a respondent must be given a reasonable period of time to file an answer to a notice of charges, and is condensing the remainder of the proposed rule by replacing subparagraphs (a), (b), and (c) with a requirement that any rules adopted by a DCM governing the requirements and timeliness of a respondent's answer to charges must be "fair, equitable, and publicly available." Finally, as a result of the rule deletions and

[415] See generally, CME Comment Letter (Feb. 22, 2011); and MGEX Comment Letter (Feb. 22, 2011).

modifications discussed above, proposed § 38.706 as modified is being adopted as § 38.705.

vii. § 38.707 - Admission or Failure to Deny Charges

Proposed § 38.707 provided that, if a respondent admits or fails to deny any of the violations alleged in a notice of charges, then a hearing panel may find that the violations admitted or not denied have in fact been committed. If a DCM adopted a rule concerning the admission or failure to deny charges, then paragraphs (a) through (c) of the proposed rule provided that: (1) the hearing panel must impose a sanction for each violation found to have been committed; (2) the DCM must promptly notify the respondent in writing of any sanction to be imposed and advise the respondent that they may request a hearing on such sanction within the period of time stated in the notice; and (3) the rules of the DCM may provide that if the respondent fails to request a hearing within the period of time stated in the notice, then the respondent will be deemed to have accepted the sanction.

Discussion

Although the Commission did not receive specific comments pertaining to the proposed rule, the Commission is moving the entire rule, with certain modifications, to the guidance in appendix B. Given that proposed § 38.707 allowed, but did not require, a DCM to issue rules regarding a respondent's admission or failure to deny charges, the Commission believes that the proposed rule is better suited as guidance in appendix B to part 38 rather than a rule. The Commission believes adopting the proposed rule as guidance, rather than a rule, will grant DCMs greater flexibility in administering their obligations, consistent with the general comments seeking the same. Furthermore, the text that will now be included as guidance is being modified to reflect the single-panel

approach adopted in § 38.702, replacing specific panel names with a generic reference to the "disciplinary panel."

viii. § 38.708 - Denial of Charges and Right to Hearing

Proposed § 38.708 provided that in every instance where a respondent has requested a hearing on a charge that he or she denies, or on a sanction set by the hearing panel pursuant to proposed § 38.707, the respondent must be given the opportunity for a hearing in accordance with the requirements of proposed § 38.710. The DCM's rules were permitted to provide that, except for good cause, the hearing must be concerned only with those charges denied or sanctions set by the hearing panel under proposed § 38.707 for which a hearing has been requested.

Discussion

The Commission did not receive comments pertaining to this rule, but is adopting the proposed rule with modifications.

The Commission is revising the proposed rule to reflect the single-panel approach adopted in § 38.702, replacing specific panel names with a generic reference to the "disciplinary panel." In order to provide DCMs with greater flexibility in establishing disciplinary procedures, the Commission also is removing the section of the proposed rule which was optional—allowing a DCM's rules to provide that, except for good cause, a hearing must be concerned only with those charges denied or sanctions set by the panel for which a hearing has been requested. Finally, as a result of the withdrawal of certain preceding rules discussed above, proposed § 38.708 as modified is being adopted as § 38.706.

ix. § 38.709 - Settlement Offers

Proposed § 38.709 provided the procedures a DCM must follow if it permits the use of settlements to resolve disciplinary cases. Paragraph (a) of the proposed rule stated that the rules of a DCM may permit a respondent to submit a written offer of settlement any time after an investigation report is completed. The proposed rule permitted the disciplinary panel presiding over the matter to accept the offer of settlement, but prohibited the panel from altering the terms of the offer unless the respondent agreed. In addition, paragraph (b) of the proposed rule provided that the rules of the DCM may allow a disciplinary panel to permit the respondent to accept a sanction without admitting or denying the rule violations upon which the sanction is based.

Paragraph (c) of proposed § 38.709 stated that a disciplinary panel accepting a settlement offer must issue a written decision specifying the rule violations it has reason to believe were committed, and any sanction imposed, including any order of restitution where customer harm has been demonstrated. Importantly, paragraph (c) also provided that if an offer of settlement is accepted without the agreement of a DCM's enforcement staff, the decision must carefully explain the disciplinary panel's acceptance of the settlement. Finally, paragraph (d) of proposed § 38.709 allowed a respondent to withdraw his or her offer of settlement at any time before final acceptance by a disciplinary panel. If an offer is withdrawn after submission, or is rejected by a disciplinary panel, the respondent must not be deemed to have made any admissions by reason of the offer of settlement and must not be otherwise prejudiced by having submitted the offer of settlement.

Discussion

Although no specific comments were received in regards to this proposed rule, the Commission is adopting the provisions of the proposed rule as guidance in appendix B. The Commission believes that adopting the proposed rule as guidance rather than a rule will grant DCMs greater flexibility in administering their obligations, consistent with the general comments seeking the same. Furthermore, the Commission is revising the guidance text to make it consistent with its modifications regarding the single-panel approach adopted in § 38.702 and the customer restitution revisions adopted below with respect to proposed § 38.714.

x. § 38.710 – Hearings

Proposed § 38.710 required a DCM to adopt rules that provide certain minimum requirements for any hearing conducted pursuant to a notice of charges. In general, sections (a)(1) through (a)(7) of the proposed rule required the following: (1) a fair hearing; (2) authority for a respondent to examine evidence relied on by enforcement staff in presenting the charges contained in the notice of charges; (3) the DCM's enforcement and compliance staffs must be parties to the hearing and the enforcement staff must present its case on those charges and sanctions that are the subject of the hearing; (4) the respondent must be entitled to appear personally at the hearing, have the authority to cross-examine persons appearing as witnesses at the hearing, and call witnesses and present evidence as may be relevant to the charges; (5) the DCM must require persons within its jurisdiction who are called as witnesses to participate in the hearing and produce evidence; (6) a copy of the hearing must be made and become a record of the proceeding if the respondent has requested a hearing; and (7) the rules of the DCM may provide that the cost of transcribing the record must be borne by a respondent

who requests a transcript. Additionally, proposed paragraph (b) specified that the rules of the DCM may provide that a sanction be summarily imposed upon any person within its jurisdiction whose actions impede the progress of a hearing.

Summary of Comments

Two commenters requested that the Commission revise proposed § 38.710(a)(2). CFE commented that proposed § 38.710(a)(2) should limit a respondent's access only to evidence a DCM plans to introduce at a hearing.[416] CFE further requested the exclusion of evidence covered under attorney-client privilege, attorney work product privilege, or other confidential reports and methodologies, including the disclosure of the name of a confidential complainant.[417] CFE also argued that investigation and examination materials prepared by a DCM should be protected from disclosure as internal work product unless the DCM intends to introduce them at the hearing.[418]

CME similarly argued that proposed § 38.710(a)(2) should be revised so that a respondent may not access protected attorney work product, attorney-client communications, and investigative work product (such as investigation and exception reports).[419]

Discussion

The Commission is adopting paragraph (a) of the proposed rule with certain modifications, and is converting paragraph (b) of the proposed rule to guidance in appendix B.

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[416] CFE Comment Letter at 5 (Feb. 22, 2011).
[417] Id.
[418] Id.
[419] CME Comment Letter at 36 (Feb. 22, 2011).

The Commission has considered CFE and CME's comments, and believes that a DCM should be permitted to withhold certain documents from a respondent in certain circumstances, and thus, is revising proposed § 38.710(a)(2) (now § 38.707(a)(2)) accordingly. Because proposed § 38.710(b) (which provided that the DCMs' rules may provide that a sanction may be summarily imposed upon any person whose actions impede the progress of a hearing) was an optional requirement for DCMs, the Commission is adopting this language as guidance in appendix B to part 38. Furthermore, the Commission is eliminating proposed § 38.710(a)(7), an optional rule that in certain cases allowed for the cost of transcribing the record of the hearing to be borne by the respondent. The Commission also is revising the rule text to make it consistent with its modifications regarding the single-panel approach adopted in § 38.702 and its modifications to proposed § 38.712 discussed below. Finally, as a result of the withdrawal and renumbering of the rules discussed above, proposed § 38.710 as modified is being adopted as § 38.707.

xi. § 38.711 - Decisions

Proposed § 38.711 detailed the procedures that a hearing panel must follow in rendering disciplinary decisions. The proposed rule required that all decisions include: (1) a notice of charges or a summary of the charges; (2) the answer, if any, or a summary of the answer; (3) a summary of the evidence produced at the hearing or, where appropriate, incorporation by reference in the investigation report; (4) a statement of findings and conclusions with respect to each charge, and a careful explanation of the evidentiary and other basis for such findings and conclusions with respect to each charge; (5) an indication of each specific rule with which the respondent was found to have

violated; and (6) a declaration of any penalty imposed against the respondent, including the basis for such sanctions and the effective date of such sanctions.

Discussion

No comments were received on proposed § 38.711. The Commission is adopting § 38.711 as proposed with minor modifications to reflect the single-panel approach adopted in § 38.702, and replacing specific panel names with a generic reference to the "disciplinary panel." In addition, as a result of the withdrawal and renumbering of preceding rules discussed above, proposed § 38.711 as modified is being adopted as § 38.708.

xii. § 38.712 - Right to Appeal

Proposed § 38.712 provided the procedures that a DCM must follow in the event that the DCM's rules authorize an appeal of adverse decisions in all or in certain classes of cases. Notably, the proposed rule required a DCM that permits appeals by disciplinary respondents to also permit appeals by its enforcement staff. For DCMs that permit appeals, the language in paragraphs (a) through (d) of proposed § 38.712 generally required the DCM to: (1) establish an appellate panel that is authorized to hear appeals; (2) ensure that the appellate panel composition is consistent with § 40.9(c)(iv) of the Commission's regulations and does not include any members of the DCM's compliance staff, or any person involved in adjudicating any other stage of the same proceeding; (3) except for good cause shown, conduct the appeal or review solely on the record before the hearing panel, the written exceptions filed by the parties, and the oral or written arguments of the parties; and (4) issue a written decision of the appellate panel and provide a copy to the respondent promptly following the appeal or review proceeding.

Discussion

Although no specific comments were received on proposed § 38.712, the Commission is converting the proposed rule to guidance in appendix B. Given that proposed § 38.712 allowed, but did not require, a DCM to issue rules regarding a respondent's right to appeal, the Commission is moving this provision to guidance in appendix B to part 38. The Commission believes that adopting the proposed rule as guidance rather than a rule, will grant DCMs greater flexibility in administering their obligations, consistent with the general comments seeking the same.

The Commission notes that the reference to § 40.9(c)(iv) in the proposed rule was a technical error. Instead, proposed § 38.712 should have referenced the composition requirements of an appellate panel outlined in § 40.9(c)(3)(iii). Accordingly, the Commission is replacing the reference to § 40.9(c)(iv) with a reference to the more general "part 40" in the guidance text. Furthermore, the Commission is revising the guidance text to reflect the single-panel approach now adopted in § 38.702, replacing specific panel names with a generic reference to the "disciplinary panel."

xiii. § 38.713 - Final Decisions

Proposed § 38.713 required that each DCM establish rules setting forth when a decision rendered under this subpart N will become the final decision of the DCM.

Discussion

No comments were received in regards to the proposed rule, and the Commission is adopting the proposal without modification. However, as a result of the renumbering of certain preceding rules discussed above, proposed § 38.713 is being adopted as § 38.709.

xiv. § 38.714 - Disciplinary Sanctions

Proposed § 38.714 required that every disciplinary sanction imposed by a DCM must be commensurate with the violations committed and must be clearly sufficient to deter recidivism or similar violations by other market participants. Additionally, the proposed rule required that, in the event of demonstrated customer harm, any disciplinary sanction must include full customer restitution. In evaluating appropriate sanctions, the proposed rule required the DCM to take into account a respondent's disciplinary history.[420]

Summary of Comments

CFE supported the goal articulated in proposed § 38.714, but argued that in certain situations, the requirement for customer restitution should not apply where it may not be possible for a DCM to determine the amount of customer harm, which parties may have been harmed, and/or how the harm was allocated among potentially aggrieved parties.[421] CFE requested that the Commission clarify that the requirement to include customer restitution in a disciplinary sanction does not apply to the extent that a DCM is unable to determine with reasonable certainty what the restitution should be, to whom to provide restitution, and/or how to allocate restitution.[422]

Chris Barnard argued that sanctions should include a public reprimand and/or be published.[423]

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[420] Proposed regulation 38.158(c), which was proposed with respect to Core Principle 2, required that a copy of a member or market participant's disciplinary history be included in the compliance staff's investigation report.
[421] CFE Comment Letter at 6 (Feb. 22, 2011).
[422] Id.
[423] Barnard Comment Letter at 2, 4 (May 20, 2011) (Barnard stated that under a properly functioning sanctions regime, sanctions must be: (1) significantly greater than potential benefits derived from a breach of rules; (2) targeted at those parties who stand to gain from a breach of rules, whether natural or legal persons; and (3) include a public reprimand and/or be published).

Discussion

The Commission is adopting the proposed rule with certain modifications. The Commission has considered CFE's comment, and is revising the proposed rule so that it does not require customer restitution if the amount of restitution, or the recipient, cannot be reasonably determined. Furthermore, the Commission is revising the proposed rule to clarify that a respondent's disciplinary history should be taken into account in all sanction determinations, including sanctions imposed pursuant to an accepted settlement offer. The Commission also notes that final disciplinary actions taken against registered persons and entities are recorded in the National Futures Association's Background Affiliation Status Information Center ("BASIC") database, which is available to the public online. Finally, as a result of the renumbering of preceding rules discussed above, the Commission is renumbering the proposed rule as § 38.710.

xv. § 38.715 - Summary Fines for Violations of Rules Regarding Timely Submission of Records, Decorum, or other Similar Activities.

Proposed § 38.715 permitted a DCM to adopt a summary fine schedule for violations of rules relating to timely submission of accurate records required for clearing or verifying each day's transactions, decorum, attire, or other similar activities. Under the proposed rule, a DCM may authorize its compliance staff to summarily impose minor sanctions against persons within the DCM's jurisdiction for violating such rules. The proposed rule made clear that a DCM should issue no more than one warning letter in a rolling 12-month period for the same violation before sanctions are imposed. Additionally, the proposed rule specified that a summary fine schedule must provide for progressively larger fines for recurring violations.

Summary of Comments

CME objected to the restriction of one letter of warning per rolling 12-month period.[424]

Discussion

The Commission is partially adopting the proposed rule, and is converting the remaining portion of the rule to guidance in appendix B.

The Commission is maintaining as a rule the provision in the proposed rule that prohibits a DCM from issuing more than one warning letter per rolling 12-month period for the same violation. Commission staff has consistently recommended in RERs that DCMs must engage in progressive discipline in order to deter recidivism.

The Commission is converting the remainder of proposed § 38.715 to guidance in appendix B because the proposed rule allowed, but did not require, a DCM to adopt a summary fine schedule.

Finally, the proposed rule is being renumbered in its adopted form from § 38.715 to § 38.711, and is retitled as "Warning letters."

xvi. § 38.716 - Emergency Disciplinary Actions

Proposed § 38.716 provided that a DCM may impose a sanction, including a suspension, or take other summary action against a person or entity subject to its jurisdiction upon a reasonable belief that such immediate action is necessary to protect the best interest of the marketplace. The proposed rule also provided that any emergency action taken by the DCM must be in accordance with certain procedural safeguards that protect the respondent, including the right to be served with notice before the action is taken or otherwise at the earliest possible opportunity after action has been taken; the right to be represented by legal counsel in any proceeding subsequent to the emergency

[424] CME Comment Letter at 36 (Feb. 22, 2011).

disciplinary action; the right to a hearing as soon as reasonably practical; and the right to receive a written decision on the summary action taken by the DCM.

Discussion

No comments were received on proposed § 38.716. Given that proposed § 38.716 allowed, but did not require, a DCM to adopt rules regarding emergency disciplinary actions, the Commission is moving the text of proposed § 38.716 to guidance in appendix B to part 38.

Due to the renumbering described above, the Commission is also replacing proposed § 38.712 with new § 38.712 (titled "Additional sources for compliance") that simply permits DCMs to rely upon the guidance in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.700 of this part.

14. Subpart O - Dispute Resolution

The Dodd-Frank Act re-designated former Core Principle 13 as Core Principle 14. Aside from renumbering the core principle, the language of the core principle remained substantively unchanged. The core principle governs the obligations of DCMs to implement and enforce a dispute resolution program for their market participants and market intermediaries.[425]

In addition to proposing to codify the statutory text of the core principle in proposed § 38.750, the Commission proposed to maintain the guidance and acceptable practices.

Discussion

[425] 17 CFR part 38, app. B.

No comments were received on proposed § 38.750, § 38.751, or the proposed guidance under Core Principle 14. The Commission is adopting the rules and guidance as proposed.

15. Subpart P - Governance Fitness Standards

Other than to re-designate former Core Principle 14 as Core Principle 15, the Dodd-Frank Act did not revise the text of this core principle. Core Principle 15 requires DCMs to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other persons with direct access to the facility (including any parties affiliated with any of the persons described in this core principle). In the DCM NPRM, the Commission proposed to codify the statutory text of the core principle in § 38.800. The Commission did not receive comments pertaining to proposed § 38.800, and is adopting the rule as proposed.

As noted in the DCM NPRM, the substantive regulations implementing Core Principle 15 were proposed in a separate rulemaking that also would implement Core Principles 16 (Conflicts of Interest), 17 (Composition of Governing Boards of Contract Markets) and 22 (Diversity of Boards of Directors).[426] Until such time as the Commission may adopt the substantive rules implementing Core Principle 15, the Commission is maintaining the current Guidance under part 38 applicable to Governance Fitness Standards (formerly Core Principle 14). Accordingly, the existing Guidance from appendix B of Part 38 applicable to Core Principle 15 is being codified under the revised

[426] See "Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest," Notice of Proposed Rulemaking, 76 FR 722, January 6, 2011. CME submitted a comment letter discussing proposed regulation 38.801 in connection with 76 FR 722.

appendix B adopted in this final rulemaking.[427] At such time as the Commission may adopt the final rules implementing Core Principle 15, appendix B will be amended accordingly.

CME submitted a comment letter discussing proposed § 38.801 in connection with the separate proposed rulemaking implementing Core Principle 15. CME's comments will be considered in connection with that rulemaking.

16. Subpart Q - Conflicts of Interest

The Dodd-Frank Act re-designated current Core Principle 15 (Conflicts of Interest) as Core Principle 16, and in all other respects, did not substantively amend the core principle. The Commission proposed to codify the statutory text of the core principle in proposed § 38.850, and is codifying the statutory text of Core Principle 16 in § 38.850 as proposed.

As noted in the DCM NPRM, the substantive regulations implementing Core Principle 16 were proposed in two separate rulemakings that also would implement Core Principles 15 (Governance Fitness Standards), 17 (Composition of Governing Boards of Contract Markets) and 22 (Diversity of Boards of Directors).[428] Until such time as the Commission may adopt the substantive rules implementing Core Principle 16, the Commission is maintaining the current guidance and acceptable practices under Part 38 applicable to Conflicts of Interest (formerly Core Principle 15). Accordingly, the existing Guidance and Acceptable Practices from appendix B of part 38 applicable to Core

[427] The Commission is also adding regulation 38.801 to simply permit DCMs to continue to rely upon the guidance in appendix B to demonstrate to the Commission compliance with regulation 38.800.
[428] See "Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest," Notice of Proposed Rulemaking, 76 FR 722, January 6, 2011; and "Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest," 75 FR 63732, Oct. 18, 2010.

Principle 16 are being codified in the revised appendix B adopted in this final rulemaking.[429] At such time as the Commission may adopt the final rules implementing Core Principle 16, appendix B will be amended accordingly.

CME submitted a comment letter that referenced comments it submitted in connection with the separate rulemakings implementing Core Principle 16. CME's comments will be considered in connection with those rulemakings.

17. Subpart R - Composition of Governing Boards of Contract Markets

The Dodd-Frank Act re-designated former Core Principle 16 (Composition of Governing Boards of Mutually Owned Contract Markets) as Core Principle 17, and revised the title of the core principle to "Composition of Governing Boards of Contract Markets." In addition, while the core principle formerly applied only to mutually owned DCMs, and required such DCMs to ensure that the composition of their governing boards included market participants, the amended core principle was amended to require the governance arrangements of all DCM to be designed to permit the consideration of the views of market participants.[430] The Commission proposed to codify the statutory text of the core principle in proposed § 38.900, and is adopting the rule as proposed.

As noted in the DCM NPRM, the substantive regulations implementing Core Principle 17 were proposed in a separate rulemaking that also would implement Core Principles 15 (Governance Fitness Standards), 16 (Conflicts of Interest), and 22

[429] The Commission is also adding regulation 38.851 to simply permit DCMs to continue to rely upon the guidance in appendix B to demonstrate to the Commission compliance with section 38.850.
[430] 7 U.S.C. 7(d)(17).

(Diversity of Boards of Directors).[431] The rules implementing Core Principle 17 will be adopted in that separate rulemaking.

18. Subpart S – Recordkeeping

Core Principle 18, as amended by section 735 of the Dodd-Frank Act, requires all DCMs to maintain records of all activities related to their business as contract markets, in a form and manner acceptable to the Commission, for at least five years.[432]

The Commission proposed to codify the statutory text of the core principle in § 38.950, and is adopting the rule as proposed.

i. § 38.951 - Additional Sources for Compliance

Proposed § 38.951 required all DCMs to maintain records, including trade records and investigatory and disciplinary files, in accordance with Commission regulation § 1.31, and in accordance with proposed Commission regulation § 45.1 with respect to swap transactions.[433] The proposed rule reiterated DCMs' obligation to comply with § 1.31(a), which requires that DCM books and records be readily accessible for the first two years of the minimum five-year statutory period, and be open to inspection by any representatives of the Commission or the United States Department of Justice.[434] Section 1.31(a) also requires DCMs to promptly provide either copies or original books and records upon request of a Commission representative.[435] As noted in the preamble, the proposed rule also incorporated by reference § 1.31(b)'s description of the acceptable

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[431] See "Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest," Notice of Proposed Rulemaking, 76 FR 722, January 6, 2011. CME submitted a comment letter discussing proposed regulation 38.801 in connection with 76 FR 722.
[432] See section 5(d)(18) of the CEA, 7 U.S.C. 7(d)(18).
[433] See DCM NPRM at 80622.
[434] Id.
[435] Id.

methods of storing books and records.[436] Finally, proposed § 38.951 also incorporated by reference the requirements set forth in § 1.31(c) regarding electronic storage systems, and the requirements in § 1.31(d) regarding retention of trading cards and of other trade, order, and financial reports.[437] Separately, proposed § 38.951 also required DCMs to comply with the recordkeeping requirements in § 45.1 with respect to swaps transactions.[438]

Summary of Comments

MGEX argued that the proposed rule is too prescriptive in requiring that all records and data must be indexed and duplicated.[439] MGEX also commented that the requirement to retain records for "at least 5 years" created uncertainty and requested clarification on how long records must be kept.[440] MGEX questioned the rationale for obligating DCMs to keep Commission-required data separate from other data.[441] Further, MGEX stated that "DCMs should not be substitute storage facilities for Commission data, nor should they be required to relocate and resubmit data that has already been submitted to the Commission."[442] Chris Barnard recommended that records should be required to be kept indefinitely rather than for at least five years.[443]

Discussion

The Commission is adopting the proposed rules under Core Principle 18 with the modification described below.

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[436] Id. at 80601.
[437] Id. at 80622.
[438] See proposed regulation 38.951. At the time of the DCM NPRM, the part 45 rules were proposed. See 75 FR 80622, Dec. 22, 2010. The part 45 rules were recently codified. See 77 FR 2136, Jan. 13, 2012.
[439] MGEX Comment Letters at 9 (Feb. 22, 2011) and at 3 (June 3, 2011).
[440] Id. (requesting a limit on the length of time a DCM should be required to hold data).
[441] Id.
[442] Id.
[443] Barnard Comment Letter at 4 (Feb. 22, 2011).

The Commission acknowledges MGEX's comment but notes that § 38.951 incorporates recordkeeping requirements to which DCMs are already subject by direct operation of § 1.31. Even if the Commission were to amend § 38.951 as requested, many of the concerns expressed by MGEX would remain, including the obligation to keep certain data separately. In this regard, the Commission notes that the Acceptable Practices for former Core Principle 17 stated that § 1.31 "governs recordkeeping requirements under the Act."[444] Upon adopting §§ 38.950 and 38.951, § 1.31 will still govern significant elements of recordkeeping under the Act. Accordingly, the Commission is largely adopting § 38.951 as proposed. The Commission is making one modification to the proposed rule, however, by replacing the reference to § 45.1 with a reference to the more general "part 45."

In response to MGEX's request for clarification regarding the requirement to retain records for "at least 5 years," the Commission notes that the recordkeeping requirement for swaps is governed by rules that were recently codified in part 45, which requires DCMs to maintain all requisite records from the date of the creation of the swap through the life of the swap and for a period of at least five years from the final termination of the swap.[445] With respect to all other records, DCMs can satisfy their recordkeeping requirement pursuant to § 38.950 by retaining such records for five years, unless the Commission determines prior to the expiration of the five-year term that the records must be retained for a longer period of time. The Commission also notes that the "at least 5 years" obligation is required under statute. Specifically, as noted in the preamble of the proposed rule, one notable difference between the former Core Principle

[444] See 17 CFR part 38, app. B, Application Guidance and Acceptable Practices for Core Principle 17.
[445] 77 FR 2136, Jan. 13, 2012.

18, and the current amended version, is that while records were previously required to be maintained "for a period of 5 years," Core Principle 18 now requires that records must be retained for "at least 5 years."[446] Accordingly, the proposed rule required a DCM maintain records of all activities related to its business as a DCM in a form and manner acceptable to the Commission for at least five years.[447] Similarly, in response to Chris Barnard's recommendation that the records be held indefinitely, the Commission believes that the current statutory requirement to maintain records for at least 5 years is sufficient at this time, but notes that it may extend the time period if it determines that an extended recordkeeping time is necessary.

19. Subpart T - Antitrust Considerations

The Dodd-Frank Act renumbered former Core Principle 18 as Core Principle 19, and in all other respects, maintained the statutory text of the core principle. As noted in the DCM NPRM, the Commission believed that the existing guidance to this Core Principle remained appropriate. Accordingly, other than to codify the statutory text of Core Principle 19 into proposed § 38.1000, the Commission did not propose any amendments to the pre-existing guidance under part 38.

Proposed § 38.1001 referred applicants and DCMs to the guidance in appendix B to part 38 for purposes of demonstrating to the Commission their compliance with the requirements of proposed § 38.1000.

Discussion

No comments were received in regards to the proposed rule and guidance, and the Commission is adopting the rule and guidance as proposed.

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[446] See preamble to proposed regulation 38.950. 75 FR 80601, Dec. 22, 2010.
[447] See proposed regulation 38.950(a). 75 FR 80622, Dec. 22, 2010.

20. Subpart U – System Safeguards

Core Principle 20 is a new core principle created by the Dodd-Frank Act, and pertains to the establishment of system safeguards by all DCMs. Core Principle 20 specifically requires DCMs to: (1) establish and maintain a program of risk oversight to identify and minimize sources of operational risk through the development of appropriate controls and procedures and the development of automated systems that are reliable, secure, and have adequate scalable capacity; (2) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for the timely recovery and resumption of operations and the fulfillment of the responsibilities and obligations of the DCM; and (3) periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail. The rules proposed under subpart U implement these requirements. The Commission proposed to codify the statutory text of the core principle in proposed § 38.1050, and adopts the rule as proposed.

i. § 38.1051 – General Requirements

The rules proposed under § 38.1051 (a) and (b) would require a DCM's program of risk analysis and oversight to address six categories of risk analysis and oversight, including information security; business continuity-disaster recovery ("BC-DR") planning and resources; capacity and performance planning; systems operations; systems development and quality assurance; and physical security and environmental controls.

The proposed rule in § 38.1051(c) specifically would require each DCM to maintain a BC-DR plan and BC-DR resources sufficient to enable resumption of trading

and of all of the responsibilities and obligations of the DCM during the next business day following any disruption of its operations, either through sufficient infrastructure and personnel resources of its own or through sufficient contractual arrangements with other DCMs or disaster recovery service providers.

The proposed rule also would require each DCM to notify Commission staff of various system security-related events, including prompt notice of all electronic trading halts and systems malfunctions in § 38.1051(e)(1), timely advance notice of all planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems in § 38.1051(f)(1), and timely advance notice of all planned changes to programs of risk analysis and oversight in § 38.1051(f)(2). The proposed rule also required DCMs to provide relevant documents to the Commission in § 38.1051(g) and to conduct regular, periodic, objective testing and review of its automated systems in § 38.1051(h). Moreover, proposed § 38.1051(i) would require each DCM, to the extent practicable, to coordinate its BC-DR plan with those of the members and market participants upon whom it depends to provide liquidity, to initiate coordinated testing of such plans, and to take into account in its own BC-DR plan, the BC-DR plans of relevant telecommunications, power, water, and other essential service providers.

Summary of Comments

CME commented that recovery time objectives ("RTOs") in each catastrophic situation should consider the impact on all market participants and independent technology services providers in the context of determining a proper RTO.[448] CME also objected to what it considers to be an overly broad requirement in § 38.1051(e)(1) to notify Commission staff promptly of all electronic trading halts and systems

[448] CME Comment Letter at 36 (Feb. 22, 2011).

malfunctions.[449] CME argued that required reporting should be limited to any material system failures. Further, CME criticized § 38.1051(f)(1), arguing that the mandate that DCMs provide the Commission with timely advance notice of all planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems is overly burdensome, and not cost effective.[450] Additionally, CME argued that the § 38.1051(f)(2) requirement that DCMs provide timely advance notice of all planned changes to their program of risk analysis and oversight is too broad and generally unnecessary.[451] Finally, CME noted that it does not control, or generally have access to, the details of the disaster recovery plans of its major vendors.[452]

Discussion

The Commission is adopting the proposed rule, with the modifications described below. As noted in the DCM NPRM, automated systems play a central and critical role in today's electronic financial market environment, and the oversight of core principle compliance by DCMs with respect to automated systems is an essential part of effective oversight of both futures and swaps markets. Advanced computer systems are fundamental to a DCM's ability to meet its obligations and responsibilities.[453]

The Commission has considered CME's comment, and believes that timely advance notice of all planned changes to address system malfunctions is not necessary and is revising the rule to provide that DCMs only need to promptly advise the Commission of all significant system malfunctions. With respect to planned changes to automated systems or risk analysis and oversight programs, the revised rule will require

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[449] Id. at 37.
[450] Id.
[451] Id.
[452] Id.
[453] See 75 CFR 80572, 80601-80602, Dec., 22, 2010.

timely advance notification of material changes to automated systems or risk analysis and oversight programs. Finally, the rule does not require DCMs to control or have access to the details of the disaster recovery plans of its major vendors. Rather, the rule suggests coordination to the extent possible.

21. Subpart V - Financial Resources

New Core Principle 21 requires DCMs to have adequate financial resources to discharge their responsibilities, and specifically requires that DCMs maintain financial resources sufficient to cover operating costs for a period of at least one year, calculated on a rolling basis.

i. § 38.1100 – Core Principle 21, and § 38.1101 (a) and (c) General Rule and Computation of Financial Resources Requirement

Proposed § 38.1100 codifies the statutory text of the core principle and is being adopted as proposed.

Proposed § 38.1101(a)(1) and (3) required DCMs to maintain sufficient financial resources to cover operating costs for at least one year, calculated on a rolling basis, at all times. Proposed § 38.1101(a)(2) would require any entity operating as both a DCM and a DCO to comply with both the DCM financial resources requirements, and also the DCO financial resources requirements in § 39.11.[454] Proposed § 38.1101(c) required a DCM to make a reasonable calculation of the financial resources it needs to meet the requirements of proposed § 38.1101(a) at the end of each fiscal quarter.

Summary of Comments

[454] See 76 FR 69334, Nov. 8, 2011. Commission regulation 39.11 establishes requirements that a DCO will have to meet in order to comply with DCO Core Principle B (Financial Resources), as amended by the Dodd-Frank Act. Amended Core Principle B requires a DCO to possess financial resources that, at a minimum, exceed the total amount that would enable the DCO to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible conditions; and enable the DCO to cover its operating costs for a period of 1 year, as calculated on a rolling basis.

OCX requested that the Commission define whether "operating costs" are gross or net.[455] GreenX recommended that the Commission expressly state that "operating costs" should be determined from a cash flow statement perspective.[456]

Chris Barnard recommended that each DCM calculate and regularly publish its solvency ratio, defined as the DCM's available financial resources divided by the DCM's financial resources requirement.[457] Chris Barnard stated that the Commission should be notified when this ratio falls below 105 percent.[458]

KCBT stated that the proposed requirements would result in duplication for entities that operate both a DCM and a DCO, because proposed § 39.11 imposed similar requirements on DCOs.[459] KCBT stated that its DCO was established as its wholly-owned subsidiary corporation for purposes of limiting liability and that as a "privately-owned, for-profit corporation, it should be able to determine its own levels of capital resources and deployment."[460] KCBT referenced this rationale in response to proposed § 38.1101(a)(3), (b), (e), and (f).[461]

Discussion

The Commission is adopting proposed § 38.1101 (a) and (c) with the modification described below. The Commission notes that specifically defining "operating costs" could result in unintended restrictions on DCMs. The Commission will maintain the flexibility of the proposed rule by not further defining "operating costs" and instead permitting each DCM to have reasonable discretion in determining the methodology it

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[455] OCX Comment Letter at 5 (Feb. 22, 2011).
[456] GreenX Comment Letter at 19 (Feb. 22, 2011).
[457] Barnard Comment Letter at 5 (May 20, 2011).
[458] Id.
[459] KCBT Comment Letter at 8 (Feb. 22, 2011).
[460] Id.
[461] Id.

will use to make the calculation. For these reasons, the Commission also declines to incorporate a solvency ratio requirement to the final rules.

Finally, the Commission has revised the text of § 38.1101(a)(2) (redesignated as paragraph (a)(3)) to clarify that a DCM that is also registered with the Commission as a DCO must demonstrate that it has sufficient resources to operate the combined entity as both a DCM and DCO,[462] and further, that such combined entity need only file single quarterly financial resources reports in accordance with § 39.11(f). The Commission is not requiring a dually-registered entity to file two separate reports because the operating resource requirements for a DCM and DCO are the same, and the combined DCM/DCO is required to have sufficient financial resources to cover its operating costs as a combined entity. The DCO financial resource requirements in § 39.11 differ from those in § 38.1101 only insofar as they add a requirement for default resources, which is applicable only to a DCM/DCO acting in its capacity as a DCO.

ii. § 38.1101(b) - Types of Financial Resources

Under proposed § 38.1101(b), financial resources available to DCMs to satisfy the applicable financial requirements would include the DCM's own capital (assets in excess of liabilities) and any other financial resource deemed acceptable by the Commission. A DCM would be able to request an informal interpretation from Commission staff on whether a particular financial resource would be acceptable.

Summary of Comments

[462] The Commission anticipates that a corporate entity that operates more than one registered entity may share certain costs, and may allocate those costs among the registered entities as determined by the Commission on a case by case basis.

OCX stated that the proposed rule may encourage DCMs to cut services in order to reduce their operational need for cash.[463]

Several commenters recommended that the Commission include specific examples of financial resources that might satisfy the requirement. OCX inquired whether firm commitments from owners to honor capital calls would be acceptable under the proposed rule.[464] CME contended that the intent of Congress was to construe the terms "financial resources" broadly and include anything of value at the DCM's disposal, including operating revenues.[465] CME stated that if Congress wanted to exclude operating revenues from what would be considered financial resources, Congress could have incorporated an "equity concept."[466]

GreenX contended that the Commission should continue to permit flexibility for DCMs, but also requested that the Commission provide specific examples of which assets can be included in the calculation of "financial resources."[467] GreenX requested confirmation that accounts receivable and other assets that are reasonably expected to result in payments to the DCM, as well as subordinated loans, are acceptable financial resources.[468] GreenX also stated that committed lines of credit and similar facilities should be considered "good" financial resources, and that such interpretation is standard in the ordinary business world.[469] GreenX stated that the proposed increase in the amount

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[463] OCX Comment Letter at 5 (Feb. 22, 2011).
[464] Id.
[465] CME Comment Letter at 37 (Feb. 22, 2011).
[466] Id.
[467] GreenX Comment Letter at 19 (Feb. 22, 2011).
[468] Id.
[469] Id. at 18.

of financial resources needed by DCMs, and the restrictions on the use of debt financing, would impede the ability of start-ups to become and remain DCMs.[470]

GreenX proposed language to replace proposed § 38.1101(a)(3), (b), and (e) that would provide that a DCM "be required to maintain sufficient financial resources to cover its projected operating costs for a period of at least one year, including unencumbered, liquid assets equal to at least six months of such projected operating costs, and that committed lines of credit or various debt instruments may be included in calculating those financial resources, as long as the DCM is not incurring indebtedness secured by its assets and counting both those assets and the indebtedness as part of its financial resources."[471] GreenX further contended that if the Commission is unwilling to accept this language, the Commission should: (i) clearly specify that the "financial resources" requirement in proposed § 38.1101(a)(3) is a separate requirement from the liquidity requirement in proposed § 38.1101(e), and (ii) delete the language in the proposed liquidity requirement suggesting that proposed § 38.1101(e) is part of the proposed one year's required operating costs coverage.[472] Absent revision, GreenX stated that the current proposal could result in a requirement of up to 18 months of financial resources if a DCM used a line of credit to satisfy the liquidity requirement.[473] Moreover, if this provision is not changed, GreenX recommended that the Commission undertake a cost-benefit analysis of requiring DCMs to maintain financial resources in excess of one year's operating costs. [474] GreenX also stated that the Commission should

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[470] GreenX Comment Letter at 14 (Feb. 22, 2011).
[471] Id. at 17.
[472] Id. GreenX recommended striking the words in proposed regulation 38.1101(e) "to meet the requirements of paragraph (a) of this section" and "If any portion of such financial resources is not sufficiently liquid."
[473] Id. at 14-15.
[474] Id. at 17-18.

not adopt a "one-size-fits-all approach" to the financial resources requirements as between DCOs and DCMs, since different circumstances and different purposes support differential treatment.[475]

Discussion

The Commission is adopting the proposed rule with one modification.

The provision in § 38.1101(b) stating that acceptable financial resources include a DCM's own capital and "any other financial resource deemed acceptable by the Commission" was meant to capture other types of resources on a case-by-case basis and provide flexibility to both DCMs and the Commission. Accordingly, the Commission notes that a DCM's own capital means its assets minus its liabilities calculated in accordance with the Generally Accepted Accounting Principles ("GAAP"). The Commission believes that if a certain financial resource is deemed to be an asset under GAAP, it is appropriate for inclusion in the calculation for this rule, and the rule has been revised accordingly. To the extent a certain financial resource is not considered an asset under GAAP, but based upon the facts and circumstances a DCM believes that the particular asset should be so considered, Commission staff will work with the DCM to determine whether such resource is acceptable. In response to comments pertaining to the acceptable forms of financial resources, the Commission may consider projected revenues as an acceptable financial resource for established DCMs that can demonstrate a

[475] GreenX discussed the significantly different roles played by DCMs and DCOs (*i.e.*, DCMs do not guarantee or novate trades and their capital is not at risk in the event of a default) and further states that the "Commission should not adopt a one-size-fits-all approach and should not treat DCOs and DCMs in the same manner where different circumstances and different purposes support differential treatment." GreenX notes that "the role of financial resources (and letters of credit) in the DCM context is to ensure that DCMs can continue to operate in the ordinary course of business and make payments as they become due, which does not have the same time sensitivity that it does in the DCO context." See GreenX Comment Letter at 17 (Feb. 22, 2001).

historical record of revenue; but not for DCM applicants, relatively new DCMs or DCMs with no such record.

The Commission believes that GreenX misinterprets the relationship of § 38.1101(a)(3) and § 38.1101(e). The Commission clarifies that the one-year financial resources requirements in § 38.1101(a)(3) and the six month liquidity requirement in § 38.1101(e) could be met by using the same financial resources. GreenX is correct that if a sufficient portion of the financial resources used for the one-year financial resources requirement in § 38.1101(a)(3) are illiquid, it is possible that an entity could be required to have 18 months of financial resources to meet the requirements of these two sections. However, the Commission is requiring only one-year of financial resources, six months of which must be liquid financial resources. Each DCM may exercise discretion in determining how to meet this requirement (e.g., six months of liquid financial resources combined with six months of illiquid ones, 12 months of liquid financial resources, or 12 months of illiquid financial resources with a line of credit covering six months of financial resources). Indeed, the Commission notes that most, if not all, DCMs have considerably more financial resources than the minimum one-year required by this rule. In addition, if a DCM does not have this liquidity, it is not achieving the goal of the core principle, as it will be unable to pay its creditors. Further, the language of the core principle does not limit the resource requirement to one year, as it specifically states that a DCM's financial resources are adequate if the value of such resources exceeds one year of operating costs. Also in response to GreenX, the costs and benefits associated with all of the rules being adopted in this release, including § 38.1101, are discussed in the cost benefit section of the release.

In response to GreenX's comment regarding the financial resources requirements of DCOs and DCMs, the Commission notes that the financial resources requirements in § 38.1101, for DCMs, and in § 39.11, for DCOs, are different. In addition to the requirement to maintain financial resources sufficient to cover operating costs for one year, § 39.11 also requires DCOs to possess a certain level of default resources.[476] As GreenX correctly notes, DCMs do not guarantee or novate trades and a "one-size-fits-all" approach is not being applied here.

iii. § 38.1101(d) - Valuation of Financial Resources

Proposed § 38.1101(d) required DCMs to calculate the current market value of each financial resource used to meet their obligations under these proposed rules, no less frequently than at the end of each fiscal quarter. The proposed rule required DCMs to perform the valuation at other times as appropriate. As the Commission noted in the DCM NPRM, the proposed rule is designed to address the need to update valuations in circumstances where there may have been material fluctuations in market value that could impact a DCM's ability to meet its obligations on a rolling basis as required by proposed § 38.1101(a). The proposed rule requires that when valuing a financial resource, the DCM reduce the value, as appropriate, to reflect any market or credit risk specific to that particular resource, i.e., apply a haircut.[477] Under the proposed rule, DCMs would be permitted to exercise discretion in determining the applicable haircuts, although such haircuts would be subject to Commission review and acceptance.

Summary of Comments

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[476] See 76 FR 69334, Nov. 8, 2011.

[477] A "haircut" is a deduction taken from the value of an asset to reserve for potential future adverse price movements in such asset.

GreenX recommended an explicit statement that the use of GAAP principles in calculating the market value of each financial resource in meeting obligations under the rules would satisfy the requirements of this subsection, without limiting other potential methods of complying.[478]

Discussion

The Commission is adopting the proposed rule without modification. In response to GreenX's comment, the Commission notes that GAAP does not include haircuts, but valuation under GAAP does take into account current market values. The Commission expects each DCM to monitor the value of its resources to be certain that the calculation of the value of its assets reflects current market conditions in accordance with GAAP. A haircut is not intended to be applied in the ordinary course, but to be used in those unusual market circumstances that require an accounting intervention. As stated in the DCM NPRM, the Commission will permit DCMs discretion to, in the first instance, choose an appropriate haircut methodology. The Commission will evaluate the appropriateness of such methodology on a case-by-case basis.

iv. § 38.1101(e) - Liquidity of Financial Resources

Proposed § 38.1101(e) required that DCMs maintain unencumbered liquid financial assets, such as cash or highly liquid securities, equal to at least six months' operating costs. As noted in the DCM NPRM, the Commission believes the requirement to have six months' worth of unencumbered liquid financial assets would give a DCM time to liquidate the remaining financial assets it needs to continue operating for the last six months of the required one-year period. A DCM would be permitted to use a

[478] GreenX Comment Letter at 19 (Feb. 22, 2011).

committed line of credit or similar facility to satisfy the requirement, in the event that the DCM does not have six months' worth of unencumbered liquid financial assets.

The Commission notes that a DCM may only use a committed line of credit or similar facility to meet the liquidity requirements set forth in proposed § 38.1101(e). Accordingly, a committed line of credit or similar facility is not listed in proposed § 38.1101(b) as a financial resource available to a DCM to satisfy the requirements of proposed § 38.1101(a).

Summary of Comments

CME stated that the liquidity measurement is only relevant in the context of winding-down, and claims that a three month period, rather than six months, is a more accurate assessment of how long it would take for a DCM to wind down.[479]

GreenX requested clarification of the terms "unencumbered" and "committed."[480] GreenX suggested that assets should be considered unencumbered even if they are "subject to security interests or adverse claims, as long as the DCM can use and expend those assets in the ordinary course without requiring consent of lenders or claimants."[481] GreenX also requested that the Commission clarify whether "committed" is intended to mean anything other than a line of credit or similar facility that has been extended pursuant to a legally binding agreement.[482] Finally, GreenX recommended that the Commission expressly state that lines of credit and similar facilities incurred from banks and other commercial financial institutions on market standard terms will presumptively qualify as good "committed lines of credits and similar facilities" for purposes of

[479] CME Comment Letter at 37 (Feb. 22, 2011).
[480] GreenX Comment Letter at 18 (Feb. 22, 2011).
[481] Id.
[482] Id.

proposed § 38.1101.[483] GreenX requested that any requirements applicable for lines of credit be specified in the final regulations.[484]

Discussion

The Commission is adopting the proposed rule without modification.

The Commission believes that a six month period is appropriate for a wind down period and notes that commenters did not provide any support for the claim that a wind down would take only three months.

In response to GreenX's request for clarification, the Commission notes that it is using "unencumbered" in the "normal commercial sense" to "refer to assets that are not subject to a security interest or other adverse claims."[485] By "committed line of credit or similar facility," the Commission means a committed, irrevocable contractual obligation to provide funds on demand with preconditions limited to the execution of appropriate agreements. In other words, a facility with a material adverse financial condition restriction would not be acceptable. The purpose of this requirement is for a DCM to have no impediments to accessing its line of credit at the time it needs liquidity. Further, DCMs are encouraged to periodically check their line of credit arrangements to confirm that no operational difficulties are present.

v. § 38.1101(f) - Reporting Requirements

Proposed § 38.1101(f) required DCMs, at the end of each fiscal quarter, or at any time upon Commission request, to report to the Commission: (i) the amount of financial resources necessary to meet the requirements set forth in the regulation; and (ii) the value of each financial resource available to meet those requirements. The proposed rule also

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[483] Id.
[484] Id.
[485] Id.

required a DCM to provide the Commission with a financial statement, including the balance sheet, income statement, and statement of cash flows, of the DCM or of its parent company (if the DCM does not have an independent financial statement and the parent company's financial statement is prepared on a consolidated basis).

Under the proposed rule, a DCM was required to provide the Commission with sufficient documentation explaining the methodology it used to calculate its financial requirements, and the basis for its valuation and liquidity determinations. The proposed rule also required the DCM to provide copies of any agreements establishing or amending a credit facility, insurance coverage, or any similar arrangement that evidences or otherwise supports its conclusions. The Commission, in its sole discretion, would determine the sufficiency of the documentation provided. According to the proposed rule, the DCM would have 17 business days[486] from the end of the fiscal quarter to file the report, unless it requests an extension of time from the Commission.

Summary of Comments

Three commenters requested an extended deadline for filing the financial reports required as a result of the proposed rule. CFE stated that for DCMs that are public, or have financial statements consolidated with those of a public company, the filing deadlines should be the same as those required by the SEC for Forms 10-Q and 10-K.[487] CME provided a similar comment stating that the proposed 17 day filing deadline is not feasible and that instead, the requirement should be consistent with the SEC's reporting requirements.[488] Similarly, GreenX stated that it has procedures in place to comply with

[486] This filing deadline is consistent with the deadline imposed on FCMs for the filing of monthly financial reports. See 17 CFR regulation 1.10(b).
[487] CFE Comment Letter at 6 (Feb. 22, 2011).
[488] CME Comment Letter at 38 (Feb. 22, 2011).

the SEC's requirements and that the proposed requirements in this rule would require new programming and resources.[489] GreenX recommended extending the reporting deadline to 30 calendar days, noting that this is still more burdensome than the requirements imposed by the SEC on national securities exchanges.[490] Rather than recommending an extended deadline, KCBT objected to the proposed quarterly filings and stated that the annual submissions that it provides to the Commission should suffice.[491]

In addition to the comments received regarding the reporting deadline, two commenters requested clarification as to the confidentiality of any filings made pursuant to proposed § 38.1101(f).[492] Further, CME requested clarification that consolidated financial statements covering multiple DCMs, and DCOs where relevant, comply with the proposed rule.[493]

Discussion

The Commission is adopting the proposed rule with certain amendments.

The Commission is persuaded that the proposed 17 business day filing deadline may be overly burdensome. The SEC requires its quarterly reports on Form 10-Q to be filed with the SEC 40 calendar days after the end of the fiscal quarter for accelerated filers and 45 calendar days after the end of the fiscal quarter for all other SEC-registered entities.[494] The SEC requires annual reports on Form 10-K to be filed with the SEC 60 calendar days after the end of the fiscal year for large accelerated filers, 75 calendar days

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[489] GreenX Comment Letter at 20 (Feb. 22, 2011) (GreenX also stated that normal year-end adjustments typically require much more than 17 business days to complete).
[490] Id.
[491] KCBT Comment Letter at 8 (Feb. 22. 2011).
[492] CFE Comment Letter at 6 (Feb. 22, 2011); CME Comment Letter at 37-38 (Feb. 22, 2011).
[493] CME Comment Letter at 37-38 (Feb. 22, 2011).
[494] See 17 CFR 249.308a.

for other accelerated filers and 90 calendar days for non-accelerated filers.[495] The Commission has extended the 17 business day proposed filing deadline to 40 calendar days for the required reports for the first three quarters. This revision to the rule will harmonize the Commission's financial resource filing requirement with the SEC's requirements for its Form 10-Q. Similarly, the Commission has extended the filing deadline for the fourth quarter report to 60 days in order to harmonize the requirement with the SEC's filing deadline for the Form 10-K. However, to the extent that a DCM is also registered as a DCO, the DCM must file its quarterly financial reports in accordance with the requirement of § 39.11 (which requires that reports be filed within 17 business days after the end of each fiscal quarter). The shorter time frame for submission of a dual registrant's quarterly financial reports is based on the heightened significance of financial oversight for the clearinghouse, which serves as the central counterparty for all cleared transactions.

The Commission has considered KCBT's comments, but does not believe that annual submissions are sufficient. The Commission believes that prudent financial management requires DCMs to prepare and review financial reports more frequently than annually, and expects that DCMs currently are reviewing their finances on at least a quarterly basis.

In response to the comments requesting clarification on the confidentiality of the filings made pursuant to the financial resources regulations, the Commission does not plan to make such reports public. However, where such information is, in fact, confidential, the Commission encourages DCMs to submit a written request for

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[495] See 17 CFR 249.310.

confidential treatment of such filings under the Freedom of Information Act ("FOIA"),[496] pursuant to the procedures established in § 145.9 of the Commission's regulations.[497] The determination of whether to disclose or exempt such information in the context of a FOIA proceeding would be governed by the provisions of part 145, and any other relevant provision.

In response to the request for clarification in regard to consolidated financial statements, the Commission clarifies that consolidated financial statements would comply with the rule.

Section 38.1101(g) delegates authority to perform certain functions that are reserved to the Commission under § 38.1101 to the Director of the Division of Market Oversight.

22. Subpart W - Diversity of Boards of Directors

Core Principle 22 is a new core principle that was added by the Dodd-Frank Act. The core principle requires that publicly traded DCMs must endeavor to recruit individuals to serve on their board of directors from among a broad and culturally diverse pool of qualified candidates.

In the DCM NPRM, the Commission proposed to codify the statutory text of the core principle in proposed § 38.1150, and is adopting § 38.1150 as proposed.

As noted in the DCM NPRM, the substantive regulations implementing Core Principle 22 were proposed in a separate rulemaking that also would implement Core Principles 15 (Governance Fitness Standards), 16 (Conflicts of Interest), and 17

[496] 5 U.S.C. 552 et seq. (2010).
[497] 17 CFR 145.9 (2010).

(Composition of Governing Boards of Contract Markets).[498] The rules implementing Core Principle 22 will be adopted in that separate rulemaking.

CME submitted a comment letter responding to the DCM NPRM that referenced comments it submitted in connection with that rulemaking. CME's comments will be considered in connection with that rulemaking.

23. Subpart X - Securities and Exchange Commission

The Dodd-Frank Act added new Core Principle 23, requiring that DCMs keep any records relating to swaps defined in CEA section 1a(47)(A)(v), as amended by the Dodd-Frank Act, open to inspection and examination by the SEC.[499] Consistent with the text of this core principle, the Commission proposed guidance under part 38 that provided that each DCM should have arrangements and resources for collecting and maintaining accurate records pertaining to any swap agreements defined in section 1a(47)(A)(v) of the amended CEA.

i. § 38.1200 - Core Principle 23, § 38.1201 (Additional Sources for Compliance), and Guidance in Appendix B

The Commission proposed a combination of rules and guidance to implement the core principle. Proposed § 38.1200 codified the statutory text of the core principle. Proposed § 38.1201 referred applicants and DCMs to the guidance in appendix B to part 38 for purposes of demonstrating to the Commission their compliance with the requirements of the core principle. The proposed guidance stated that DCMs should have

[498] See "Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest," Notice of Proposed Rulemaking, 76 FR 722, January 6, 2011. CME submitted a comment letter discussing proposed regulation 38.801 in connection with 76 FR 722.
[499] 7 U.S.C. 7; see also section 5(d)(23) of the CEA, as amended by the Dodd-Frank Act.

arrangements and resources for collecting and maintaining accurate records pertaining to any swaps agreements defined in section 1a(47)(A)(v) of the Act.

Summary of Comments

CME requested guidance on what records need to be retained and for how long they must be retained.[500]

Discussion

The Commission is adopting the proposed rules and guidance, with the modifications described below.

In response to CME's comment, the Commission notes that the guidance provides that DCMs should retain "any" records relevant to swaps defined under CEA section 1a(47)(a)(v), and that the DCM should leave such records open to inspection and examination, for a period of five years. Commission staff consulted with representatives from the SEC, who confirmed that SEC's relevant recordkeeping requirements typically extend for a period of five years.[501] The five year requirement is also consistent with the recordkeeping requirement under Core Principle 18 and § 1.31 of the Commission's regulations.

III. RELATED MATTERS

A. Regulatory Flexibility Act

[500] CME Comment Letter at 38 (Feb. 22, 2011).

[501] See 76 FR 10982, Feb. 28, 2011,(Proposed regulation 818(b) requires security-based swap execution facilities to keep books and records "for a period of not less than five years," the first two years in an easily accessible place). Rule 17a-1(b) (240.17a-1(b) requires national securities exchanges, among others, to keep books and records for a period of not less than five years, the first two years in an easily accessible place, subject to a destruction and disposition provisions, which allows exchanges to destroy physical documents pursuant to an effective and approved plan regarding such destruction and transferring/indexing of such documents onto some recording medium.).

The Regulatory Flexibility Act ("RFA")[502] requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. The rules adopted herein will affect designated contract markets ("DCMs"). The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its rules on small entities in accordance with the RFA.[503] The Commission previously determined that DCMs are not small entities for the purpose of the RFA.[504] The Commission received no comments on the impact of the rules contained herein on small entities. Therefore, the Chairman, on behalf of the Commission and pursuant to 5 U.S.C. 605(b), certifies that the rules will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

This final rulemaking contains information collection requirements. The Paperwork Reduction Act ("PRA")[505] imposes certain requirements on federal agencies in connection with their conducting or sponsoring any collection of information as defined by the PRA. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Commission proposed to amend collection 3038-0052 to allow for an increase in response hours for the proposed rulemaking amending part 38, which included the increase in burden hours that will result from the amendments to rules 1.52 and 16.01 that are also part of this rulemaking.[506] Notably, most of the collection burdens associated with part 38 are covered by a currently approved collection of information for

[502] 5 U.S.C. 601 et seq. (2010).
[503] 47 FR 18618-21, Apr. 30 1982.
[504] Id.
[505] 44 U.S.C. 3501 et seq.
[506] See 75 FR 80572, 80603, Dec. 22, 2010 .

part 38, or by other existing or pending collections of information. Thus, only those burdens that are not covered elsewhere are included in the Commission's proposed amendment.

The title of the collection will continue to be "Part 38 - Designated Contract Markets." The Commission submitted the amended collection to the Office of Management and Budget ("OMB") for its review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR § 1320.11. Pursuant to a notice of action from OMB in March 2011, approval of the amended collection is pending a resubmission of the proposed information collection that includes a description of the comments received on the collection and the Commission's responses thereto, which will be made available by OMB at www.reginfo.gov.

Responses to this collection of information will be mandatory. The Commission will protect proprietary information gathered according to the FOIA and 17 CFR part 145, "Commission Records and Information." In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public "data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers."[507] The Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974.[508]

Proposed Collection

In its existing collection of information for part 38, the Commission estimated 300 hours average response time from each respondent for the collection of designation

[507] 7 U.S.C. 12.
[508] 5 U.S.C. 552a.

and compliance information.[509] Based on its experience with administering registered entities' submission requirements since implementation of the Commodity Futures Modernization Act of 2000,[510] the Commission estimated in the DCM NPRM that the response time for the designation and compliance collections in the proposed rule would generally increase the information collection burden by 10 percent. This increase is due to the introduction of swaps trading on DCMs permitted under section 723(a)(3) of the Dodd-Frank Act and the addition of new core principles with which DCMs must comply, excepting Core Principle 21 (Financial Resources), for which a separate burden estimate is discussed below, and the burdens associated with any information collection requirements that are being accounted for in other existing or pending collections. With respect to all but financial resources compliance, the Commission estimated in the DCM NPRM that it would collect information from 17 respondents.[511] Accordingly, a 10 percent estimated increase would result in 30 additional hours per respondent and 510 additional hours annually for all respondents for designation and compliance.

With respect to Core Principle 21, the Commission estimated in the DCM NPRM that each of the 17 anticipated respondents may expend up to 10 hours quarterly for filings required under the proposed regulations, totaling 40 hours annually for each respondent and 680 hours across all respondents with respect to compliance with Core Principle 21.

Commission staff estimated that respondents could expend up to an additional $3,640 annually based on an hourly wage rate of $52 (30 hours + 40 hours x $52) to

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[509] 66 FR 42256, 42268, Aug. 10, 2001.
[510] Pub. L. 106-554, 114 Stat. 2763 (2000).
[511] The number of designated contract markets increased from 13 to 17 since the last amendment to Collection 3038-0052 and from 17 to 18 since the DCM NPRM was published in the Federal Register.

comply with the proposed rules. This would result in an aggregated additional cost of $61,880 per annum (17 respondents x $3,640).

Summary of Comments and Discussion

Estimated Burden Hours for Compliance for Part 38 Amendments

The Commission received several comments regarding the estimated hours of burden for compliance with the proposal to amend part 38.[512]

In particular, the Commission confirms that that the new DCM application form, Form DCM, provides a roadmap of required documentation, balances the needs of the Commission with the needs of the marketplace, and should result in a streamlined and standardized review process, as was noted by Eris.[513]

Other commenters suggested that the 60 days proposed in § 38.3(g) for existing DCMs to certify compliance with the core principles and the rules implementing them would be unduly burdensome.[514] As discussed in the preamble, the Commission is eliminating this provision from the final rules.

CME stated that it would be costly to comply with the proposed § 38.151(a) requirement that clearing firms obtain every customer's consent to the regulatory jurisdiction of each DCM.[515] The Commission believes that § 38.151(a) codifies requirements necessary to effectuate Core Principle 2's statutory mandate; a DCM must have an agreement in place prior to granting members and market participants access to its markets in order to ensure that the DCM has the capacity to detect, investigate, and

[512] As noted above, the Commission is not finalizing proposed regulations 38.501 - 38.506 at this time, and expects and plans to do so when it considers the final SEF rulemaking, The Commission will consider all comments related to these provisions at such time.
[513] Eris Comment Letter at 4 (Feb. 22, 2011).
[514] See, e.g., GreenX Comment Letter at 21 (Feb. 22, 2011); KCBT Comment Letter at 2 (Feb. 22, 2011); Nodal Comment Letter at 4 (Feb. 22, 2011); NYSE Liffe Comment Letter at 14 (Feb. 22, 2011); CME Comment Letter at 12 (Feb. 22, 2011); and CFE Comment Letter at 7 (Feb. 22, 2011).
[515] CME Comment Letter at 16 (Feb. 22, 2011).

apply appropriate sanctions to persons that violate DCM rules. Any incremental costs associated with this rule are covered by the 10 percent increase contained in the Commission's amended information collection.

CME stated that an increased documentation burden associated with the submission process would greatly increase the cost and timing for DCMs to list products, without providing any corresponding benefit to the marketplace.[516] CME stated that the Commission indicated that the proposed rules for Provisions Common to Registered Entities will increase the overall collection burden on registered entities by approximately 8,300 hours per year.[517] The referenced burden was accounted for in the Commission's information collection for the part 40 rules that were adopted in July, 2011, however, and therefore the burden associated with that collection is not duplicated here.[518] Notwithstanding this, the Commission believes that any DCM must have an agreement with its customers such that the customer agrees to cooperate with the DCM, where necessary, in order for the DCM to perform its statutory functions.

Similarly, CME commented on the burdens associated with rules implementing Core Principles 8 and 18, in particular, the requirement to separately identify block trading in daily volume reports.[519] The burden associated with block trading is accounted for in the information collection associated with the Commission's Real-Time Public Reporting of Swap Transaction Data rulemaking.[520] To avoid double-counting, no adjustment is being made to the amendment to this part 38 collection.

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[516] CME Comment Letter at 10 (Feb. 22, 2011).
[517] See 75 FR 67282, 67290, Nov. 2, 2010.
[518] See Collection 3038-0093.
[519] CME Comment Letter at 30-31 (Feb. 22, 2011).
[520] See "Real Time Public Reporting of Swap Transaction Data," 77 FR 2909, Jan. 20, 2012.

In addition, MGEX commented on the rules implementing the general recordkeeping requirements of Core Principle 18.[521] Core Principle 18 incorporates by reference § 1.31 of the Commission regulations and the recordkeeping requirements in the Commission's Swap Data, Recordkeeping, and Reporting Requirements rulemaking.[522] The § 1.31 requirements are already covered by the existing information collection for part 38, with the incremental costs associated with the introduction of swap trading, if a DCM elects to do so, covered by the 10 percent increase contained in the Commission's amended information collection. The recordkeeping requirements in the proposed Swap Data, Recordkeeping, and Reporting Requirements rulemaking are accounted for in the information collection request that was developed for that rulemaking. To avoid double-counting, no adjustment is being made to the amendment to the part 38 information collection in response to the comment.

With respect to the information collection in rules implementing Core Principle 10, CME and MGEX commented that establishing specific audit trail requirements would be burdensome, costly, and unnecessary.[523] DCM compliance with Core Principle 10 should predate the enactment of the Dodd-Frank Act, however, and the information collections associated with Core Principle 10 are covered by the Commission's existing part 38 information collection. Any burden increase associated with the maintenance of additional records resulting from the introduction of swap trading, if a DCM elects to do so, has been accounted for in the 10 percent increase in designation and compliance costs discussed above.

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[521] MGEX Comment Letter at 9 (Feb. 22, 2011).
[522] See "Swap Data Recordkeeping and Reporting Requirements," 77 FR 2136, Jan. 13, 2012.
[523] CME Comment Letter at 33 (Feb. 22, 2011) and MGEX Comment Letter at 7 (Feb. 22, 2011).

CME submitted a comment regarding the information collection burdens associated with rules that were proposed to implement new Core Principle 20, which requires each DCM to maintain a business continuity-disaster recovery plan and to report system security-related events and all planned changes to automated systems that may impact the reliability, security, or scalability of the systems.[524] In response to CME's concerns that the rule would require reporting of insignificant system events, the Commission is adopting final rules that require reporting only of significant system malfunctions and advance notification only of material system changes. The resulting burden reduction eliminates the need to increase the proposed part 38 information collection amendment.

Finally, MGEX commented that the hours estimated for designation and compliance and the additional new annual cost of compliance with the proposed rules were extremely low, and claimed that due to the vast number of additional requirements, the total burden is becoming "unwieldy and excessive."[525] MGEX did not provide any estimate of what costs would be more accurate for purposes of the part 38 information collection, and thus the Commission could not evaluate alternative estimates to determine whether they would be more appropriate than what was proposed, which was based on past Commission experience with existing collections of information and which accounts only for those collections of information that are not now or will not be covered by other collections of information.

Estimated Burden Hours for Core Principle 21

[524] CME Comment Letter at 36-37 (Feb. 22, 2011).
[525] MGEX Comment Letter at 9-10 (Feb. 22, 2011).

In addition to the general increase proposed for the existing part 38 collection discussed above, the Dodd-Frank Act established new Core Principle 21 (Financial Resources) that requires respondents to have adequate financial, operational and managerial resources.[526] In order to demonstrate compliance with Core Principle 21, each respondent will need to file specific reports with the Commission on a quarterly basis, which would result in four quarterly responses per respondent per year. In the proposed rulemaking, the Commission estimated that each respondent would expend 10 hours to prepare each filing required under the proposed regulations, and the Commission estimated that it would receive filings from 17 respondents.

The Commission received several comments on the proposed financial resources collection. KCBT stated that the financial resources rules, as proposed, would result in duplicative reporting for entities that operate as both a DCM and DCO.[527] In response to this comment, the Commission is now finalizing the rules with revisions that clarify that a DCM that also is registered with the Commission as a DCO is obligated only to file its financial resources reports under the DCO rules, though it nonetheless must maintain the financial resources necessary to satisfy the operating cost requirements of the DCM and the DCO separately.

CFE, GreenX, and KCBT requested that the Commission extend the proposed deadline for filing of financial resources reports from 17 days after the end of each quarter, in particular to accommodate DCMs that are public companies, or that have financial statements that are consolidated with those of a public company, so that the filing requirements would be aligned with the requirements for SEC forms 10-Q and 10-

[526] See section 735(b) of the Dodd-Frank Act.
[527] KCBT Comment Letter at 7-9 (Feb. 22, 2011).

K, which are longer.[528] GreenX stated that failing to extend the time for filing to align with the SEC filing requirements, for which it and other public companies already have procedures and controls in place, would result in unnecessary new programming and staff resources.[529] KCBT objected to the quarterly filing requirement and suggested that annual reporting would be sufficient.[530]

The Commission is not persuaded that an annual reporting requirement would be sufficient in terms of financial management on the part of the DCM or regulatory oversight on the part of the Commission. With respect to regulatory oversight, the adoption of an annual reporting requirement alone would result in a need for periodic checks by the Commission on financial resources compliance by DCMs between annual reports. The multiple unscheduled checks that would be necessary each year, in the form of calls for a demonstration of compliance by a DCM, as well as more formal rule enforcement reviews, would burden the Commission's examination resources. If DCMs are required to report on a quarterly basis, DCMs may be able to demonstrate risks toward which the Commission's resources should be directed. Moreover, unscheduled checks would most likely be more burdensome for DCMs than quarterly reporting. Thus, the Commission is adopting both quarterly and annual reporting requirements in these final rules.

However, in response to the comments, the Commission is adopting final rules that would mitigate the burden that would result from the adoption of filing deadlines that do not align with SEC filing requirements. Accordingly, the final rules establish a

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[528] CFE Comment Letter (Feb. 22, 2011), GreenX Comment Letter (Feb. 22, 2011), KCBT Comment Letter (Feb. 22, 2011).
[529] GreenX Comment Letter at 19-20 (Feb. 22, 2011).
[530] KCBT Comment Letter at 8-9 (Feb. 22, 2011).

deadline for the filing of financial resources reports of 40 calendar days after the end of the quarter for the first three quarters of a DCM's fiscal year, and 60 calendar days after the end of the DCM's fourth quarter.

Final Burden Estimate

The final rules require each respondent to file information with the Commission. Information collections are included in several of the general provisions being adopted in Subpart A, as well as in certain regulations implementing Core Principles 5, 7, 8, 10, 11, 13, 18, 20, and 21. The Commission has carefully evaluated the comments discussed above and determined that the 10 percent general increase by which the Commission seeks to amend its part 38 collection of information is appropriate. The 10 percent increase is intended to cover only the burdens associated with collections of information that are not already covered in the existing part 38 information collection, or in other existing collections or collections that are being established with other rulemakings.

The 10 percent increase tracks the already approved part 38 information collection, which accounted for the many one-time or infrequent information collections contained in part 38 over the assumed life of a DCM. As a general rule, the information collections in this rulemaking that are not already covered have the same characteristics: The required filing of one-time certifications and demonstrations of compliance by existing DCMs; the filing of occasional exemptive requests; reporting of material events that are expected to occur infrequently; the expansion of a DCM's existing audit trail program to cover swap transactions, if the DCM determines to list swaps; and the one-time or infrequent system changes needed to report transactions, such as EDRPs, that are not covered in the information collection requests of other rulemakings.

The changes sought by the commenters that are being adopted would only marginally reduce the overall information collection burden. Thus the Commission has determined not to reduce its burden estimates. Accordingly, the Commission expects that with respect to all but financial resources compliance, a 10 percent estimated increase would result in 30 additional hours per respondent and 540 additional hours annually for all respondents for designation and compliance.

With respect to Core Principle 21, the Commission expects that each of the 18 anticipated respondents may expend up to 10 hours quarterly for filings required under the regulations, totaling 40 hours annually for each respondent and 720 hours across all respondents with respect to compliance with Core Principle 21.

Aggregate Information Burden

In conclusion, amended collection 3038-0052 will result in respondents expending up to an additional $3,640 annually based on an hourly wage rate of $52 (30 hours + 40 hours x $52) to comply with the proposed rules. This would result in an aggregated additional cost of $65,520 per annum (18 respondents x $3,640). This final burden estimate accounts for the 18 respondents that the Commission believes will be affected by the final rule, rather than the 17 initially proposed.[531] Otherwise, there is no change from the rule as proposed.

C. Cost Benefit Considerations

Background on Designated Contract Markets

Designated contract markets ("DCMs") were established by the Commodity Futures Modernization Act of 2000 ("CFMA") as one of two forms of Commission-

[531] The DCM NPRM referenced 17 respondents. The number of respondents was revised to 18 to include Eris, which was designated on October 28, 2011.

regulated markets for the trading of futures and options contracts based on an underlying commodity, index, or instrument. Specifically, the CFMA established, under section 5 of the CEA, eight designation criteria and 18 core principles governing the designation and operation of DCMs. To implement the CFMA, the Commission codified regulations under part 38 consisting largely of guidance and acceptable practices which were illustrative of the types of matters an applicant or DCM may address and at times provided a safe harbor for demonstrating compliance, but did not necessarily mandate the principle means of compliance.

Section 735 of the Dodd-Frank Act amended section 5 of the CEA by: (1) eliminating the eight designation criteria contained in former section 5(b) of the CEA; (2) revising the existing core principles, including the incorporation of many of the substantive elements of the former designation criteria; and (3) adding five new core principles, thereby requiring applicants and DCMs to comply with a total of 23 core principles as a condition of obtaining and maintaining designation as a contract market.

The Dodd-Frank Act also amended Core Principle 1 to provide that in its discretion, the Commission may determine by rule or regulation the manner in which DCMs comply with the Core Principles.[532] Accordingly, in proposing this rulemaking, the Commission undertook a comprehensive evaluation of its existing DCM rules, guidance, and acceptable practices associated with each core principle in order to update those provisions and determine which core principles would benefit from new or revised regulations. As described in this notice of final rulemaking, in addition to codifying new rules for several core principles, the Commission also is maintaining the guidance and

[532]The Dodd-Frank Act amended Core Principle 1 to clarify that boards of trade have reasonable discretion in establishing the manner in which they comply with the core principles, "[u]nless otherwise determined by the Commission by rule or regulation." 7 U.S.C. 7(d)(1).

acceptable practices, with necessary modifications, in many instances. The Commission believes that the promulgation of bright-line requirements in those instances where an industry best practice has developed will better serve the goals of the Dodd-Frank Act, and will provide the industry and market participants with greater specificity and regulatory transparency, and will improve the Commission's ability to effectively enforce its regulations.

The Commission's Cost Benefit Consideration

Section 15(a) of the CEA requires the Commission to "consider the costs and benefits" of its actions in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations.[533]

To further the Commission's consideration of the costs and benefits imposed by its regulations, the Commission requested in the DCM NPRM that commenters provide data and any other information or statistics on which they relied to reach any conclusions regarding the costs and benefits of the proposed rules.[534] The Commission received one comment that provided quantitative information pertaining to the costs relevant to the Commission's proposed rules for Core Principle 9.[535] A number of commenters did, however, express the general view that there would be significant costs associated with implementing and complying with the proposed rules, with some commenters generally

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[533] 7 U.S.C. 19(a).
[534] 75 FR at 80605, Dec. 22, 2010.
[535] CME Comment Letter (Aug. 3, 2011). As discussed above, the Commission will consider all comments related to the proposed rules implementing Core Principle 9 when it finalizes those rules. The Commission expects and plans to finalize the rules implementing Core Principle 9 when it finalizes the SEF rulemaking.

stating their belief that the costs would outweigh any potential benefits.[536] Given the lack of quantitative data provided in the comments or publicly available, the Commission has provided a qualitative description of the costs that would be incurred by DCMs.[537] In a number of instances, the Commission is adopting rules that codify existing norms and best practices of DCMs (often reflected in existing guidance and acceptable practices and recommendations made in recent Rule Enforcement Reviews ("RERs"). In those cases, the existing norms or best practices serve as the baseline – that is, the point from which the Commission considers the incremental costs and benefits of the regulations adopted in this release. In other cases, however, there is no existing baseline either because the requirements arise under the new or revised core principles, or because the Commission determined to revise existing requirements or practices.

To assist the Commission and the public in assessing and understanding the economic costs and benefits of the final rule, the Commission has analyzed the costs of those regulations adopted in this rulemaking that impose additional requirements on DCMs above and beyond the baseline described above. In most instances, quantification of costs is not reasonably feasible because costs depend on the size and structure of DCMs, which vary markedly, or because quantification required information or data in the possession of the DCMs to which the Commission does not have access, and which was not provided in response to the NPRM. The Commission notes that to the extent that the regulations adopted in this rulemaking result in additional costs, those costs will be

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[536] See, e.g., comment letters from CME (Feb. 22, 2011, Apr. 18, 2011, Jun. 3, 2011 and Aug. 3, 2011), MGEX (Feb. 22, 2011 and Jun. 3, 2011), and GreenX (Feb. 22, 2011).

[537] Moreover, for each core principle, the first section of the regulation is a codification of the statutory language of the core principle as a rule—and accordingly, the Commission did not consider the costs and benefits of these rules because they do not reflect the exercise of discretion by the Commission. Where the Commission includes additional regulations for a core principle, the Commission considered the costs and benefits.

realized by DCMs in order to protect market participants and the public. In adopting these final regulations, the Commission attempted to take the least-prescriptive means necessary to promote the interests of the Dodd-Frank Act without impacting innovation and flexibility.

The following costs and benefits are organized, for the most part, by core principle. For each DCM core principle,[538] the Commission summarizes the final regulations, describes and responds to comments discussing the costs and benefits of the proposed regulations, and considers the costs and benefits of the associated regulations, followed by a consideration of those costs and benefits in light of the five factors set out in § 15(a) of the CEA. In addition, the Commission considers the costs and benefits associated with the codification of rules in place of guidance and acceptable practices. The Commission notes that many of its regulations refer to requirements that are contained in other rulemakings, some of which have been finalized and others which are still before the Commission. The costs and benefits of these regulations are discussed in connection with those other rulemakings.

The Commission further notes that certain final rules, including §§ 38.3(b), (c), (e), and (f), §§ 38.5(a) and (b) and §§ 38.256, 38.257, and 38.258 are essentially

[538] The costs and benefits of Core Principles 15, 16, 17, and 22 are discussed in connection with separate rulemakings for "Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest," 76 FR 722, Jan. 6, 2011, and "Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest," 75 FR 63732, Oct. 18, 2010. The substantive regulations implementing Core Principles 15, 16, 17, and 22 were proposed in those separate rulemakings. Until such time as the Commission may adopt the final substantive rules implementing these core principles, the Commission is maintaining the current guidance and acceptable practices under part 38 relevant to Core Principles 15 and 16. Accordingly, the existing guidance and acceptable practices from appendix B to part 38 relevant to these core principles is being codified in the revised appendix B adopted in this final rulemaking. This will not result in additional costs because the Commission is simply codifying existing Guidance and Acceptable Practices. At such time as the Commission may adopt the final rules implementing these core principles, appendix B will be amended accordingly.

unchanged from existing rules applicable to DCMs and are not discussed further in this section, since they do not impose new costs and benefits as a result of the Commission's rulemaking.

Finally, the Commission is obligated to estimate the burden of, and provide supporting statements for, any collections of information it seeks to establish under considerations contained in the Paperwork Reduction Act,[539] and to seek approval of those requirements from the Office of Management and Budget. Therefore, the estimated burden and support for the collections of information in this rulemaking, as well as the consideration of comments thereto, are discussed in the Paperwork Reduction Act section of this rulemaking as required by that statute.

1. Rules in Lieu of Guidance and Acceptable Practices

Appendices A and B to part 38 of the Commission's regulations provide guidance and acceptable practices for DCMs to comply with the CFMA DCM core principles and designation criteria. In this release, the Commission is codifying as rules certain of these obligations of DCMs. The rules codify certain DCM practices that Commission staff has historically recommended in RERs as appropriate under the guidance and acceptable practices, which are already followed by DCMs. In certain cases, the rules are less prescriptive than the existing guidance and acceptable practices they replace, and the rules therefore maintain the flexibility for DCMs to determine many aspects of their compliance programs.

Summary of Comments

As described in this release, the Commission received a number of comments opposing the codification of rules in lieu of guidance and acceptable practices. In

[539] 44 U.S.C. 3501 et seq.

response to commenters' concerns, the Commission is converting some of the proposed rules, in whole or in part, to guidance or acceptable practices.

CME, GreenX, MGEX, and KCBT expressed concern with the costs imposed by the conversion of guidance and acceptable practices to rules, stating that rules are more costly and burdensome to DCMs and will increase costs to the Commission[540] and end-users of derivatives.[541] CME claimed that there is no public policy benefit to what it described as "one-size fits all rules."[542] OCX and CME questioned the benefit of what they viewed as the prescriptive tone of the proposed rules.[543] Commenters also asserted that converting guidance and acceptable practices to rules may hinder or deter innovation for DCMs.[544]

Discussion

As explained throughout this release, in several instances the Commission has converted compliance obligations that were previously proposed as rules to guidance and acceptable practices (in whole or in part) in order to accommodate certain comments raised by market participants. In determining whether to codify a compliance practice in the form of a rule or guidance and acceptable practices, the Commission was guided by: (i) the comment letters that provided a basis for greater flexibility or, in some instances, for greater specificity, with respect to the stated compliance obligation; (ii) whether the practice consisted of a widely-accepted industry practice; and (iii) whether the proposed rules were of a discretionary nature, and thus, were more appropriate as guidance and/or

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[540] See CME Comment Letters (Feb. 22, 2011, Apr. 18, 2011, Jun. 3, 2011 and Aug. 3, 2011); MGEX Comment Letter (Jun. 3, 2011); GreenX Comment Letter (Feb. 22, 2011); KCBT Comment Letter at 9 (Feb. 22, 2011).
[541] CME Comment Letter at 3 (Feb. 22, 2011).
[542] CME Comment Letter at 8 (Feb. 22, 2011).
[543] OCX Comment Letter at 1-2 (Feb. 22, 2011); CME Comment Letter at 2-3 (Feb. 22, 2011).
[544] See e.g., ICE Comment Letter at 1-2 (Feb. 22, 2011), Eris Comment Letter at 2 (Feb. 22, 2011), CME Comment Letter at 3-4 (Feb. 22, 2011), GreenX Comment Letter at 1 (Feb. 22, 2011).

acceptable practices. In other circumstances, the Commission believes that maintaining certain regulations as rules will better serve market participants and the public by providing greater transparency and specificity and by improving the ability of the Commission to effectively enforce its regulations.

While CME claimed that the codification of rules is more costly to the Commission,[545] the Commission does not believe that rules are necessarily more costly to administer than guidance and acceptable practices. To the contrary, guidance and acceptable practices may be more costly to the Commission than rules because of the potential need to review individual exchange actions that do not meet the provisions of guidance and acceptable practices to determine if they comply with the underlying core principle. The Commission also notes that many of the rules are general in nature, allow for innovation and flexibility, and are not intended to be "one size fits all." In response to the comment that rules will be more costly for end-users, the Commission notes that these regulations apply to DCMs, not to end-users, and are intended to protect market participants.

Commenters have suggested that as markets evolve or DCMs innovate, rules may become outdated and may no longer be consistent with evolving industry practice.[546] The Commission notes that in such instances, DCMs could petition the Commission for exemptive orders in order to implement new methods of compliance or request that the Commission propose revisions to its rules. The Commission notes that in accordance with Executive Order 13579, it will periodically review its existing significant regulations to determine whether any such regulations should be modified, streamlined, expanded, or

[545] CME Comment Letter at 2-4 (Feb. 22, 2011).
[546] See e.g., CME Comment Letter at 3 (Feb. 22, 2011), Eris Comment Letter at 3 (Jun. 3, 2011), ICE Comment Letter at 10-11 (Feb. 22, 2011).

repealed so as to make the agency's regulatory program more effective or less burdensome in achieving the regulatory objectives.[547]

Commenters also stated that converting guidance and acceptable practices to rules may hinder or deter innovation for DCMs.[548] The Commission notes, in response to comments received, that many of the rules that commenters interpret as possibly having an effect on innovation, such as those that relate to technology (including certain rules under Core Principle 4, Prevention of Market Disruption), have been moved to guidance and acceptable practices in the final rule in order to provide DCMs with greater flexibility.

Costs

Costs to DCMs

As noted above, the rules finalized in this release generally are designed to codify existing industry practice, and implement new or revised core principles. However, the Commission is cognizant of the possibility that less established DCMs may require more significant modifications to their existing programs to comply with these rules if they do not currently follow industry practices. Nevertheless, it is likely less costly for DCMs to demonstrate compliance with rules than to demonstrate compliance with guidance and acceptable practices, which may require significantly more communications and exchange of documents with Commission staff. Accordingly, the primary cost imposed on DCMs as a result of converting guidance and acceptable practices to rules is the potential inability of DCMs to choose a different method of complying with the core principles as DCMs innovate or industry standards evolve. This cost may be present in

[547] 76 FR 41587, July 14, 2011.
[548] See e.g., ICE Comment Letter at 1-2 (Feb. 22, 2011), Eris Comment Letter at 2 (Feb. 22, 2011), CME Comment Letter at 3 (Feb. 22, 2011), GreenX Comment Letter at 1 (Feb. 22, 2011).

each instance throughout this document where the Commission is replacing guidance or acceptable practices with rules. However, the Commission has made every attempt to provide sufficient flexibility to allow DCMs to continue to pursue the most efficient methods of compliance, within the rules, guidance and acceptable practice structure adopted in this release.

It also is possible that certain DCMs are currently engaged in practices that they consider to be in compliance with core principles, but which do not precisely follow existing guidance or acceptable practices (perhaps because the DCM considers a somewhat different method of complying with the core principle to be more efficient given the nature of the DCM). In such an instance, a DCM would now need to change those practices to be in full compliance with the rule. The Commission is not aware of any specific examples of DCMs that consider themselves to be in compliance with core principles, while not following the Commission's guidance or acceptable practices. Therefore, the Commission is unable to quantify the cost associated with this potential scenario. However, all DCMs should be in compliance with existing guidance and acceptable practices, and the Commission does not believe that DCMs employing variant practices can object to the cost of complying with existing guidance and acceptable practices.

As discussed above, the Commission notes that many of the rules that could affect innovation, such as those that relate to technology, have been moved to guidance and acceptable practices in the final rule in order to provide DCMs with added flexibility. However, even with guidance and acceptable practices in place of rules, innovation costs may still exist to a degree since the Commission may need to modify guidance and

acceptable practices as industry practices evolve. Furthermore, as is the case under current guidance and acceptable practices, a DCM that devises a new method of complying with a core principle may incur certain costs to demonstrate such compliance to the Commission. It is not feasible to quantify these costs since the Commission has no way to predict how industry practices will evolve or what rule adjustments will be needed.

Costs to Market Participants and the Public

If converting guidance and acceptable practices to rules hinders or deters innovation for DCMs, commenters have asserted that DCMs may decline to innovate to the same extent that they innovate at present, potentially depriving market participants and the public of important advancements. However, costs to market participants as a result of converting some of the guidance and acceptable practices to rules should be minimal since existing requirements, including guidance and acceptable practices, would also need to be adjusted as important advancements occur, and commenters provided no specific examples of how converting the guidance and acceptable practices to rules would deter innovation. It is not feasible to quantify these costs since the Commission has no way to predict how DCMs will innovate or industry practices will evolve.

Benefits

Benefits to DCMs, Market Participants, and the Public

The codification of rules in lieu of guidance and acceptable practices provides specificity and transparency to DCMs, market participants, and the public. It also increases the likelihood of prompt compliance with the core principles because DCMs will have a clear understanding of what is required in order to demonstrate compliance

with the applicable core principle. In turn, a DCM's ability to achieve prompt compliance with the rules instills confidence in market participants and the public who utilize the markets to offset risk and who utilize prices derived from the price discovery process of trading in centralized DCM markets. Specific enforceable standards also promote more efficient and effective enforcement by the Commission.

The costs and benefits of each of the rules, including rules that replace guidance or acceptable practices, are set out below in the cost-benefit discussion for the general compliance regulations under part 38 and for each core principle.

2. General compliance regulations under Part 38[549]

§ 38.3(a) (Application procedures)

Rule § 38.3 sets forth the application and approval procedures for new DCM applicants. Rule § 38.3(a) specifies the application process, including the new requirement that the board of trade file the DCM Application Form ("Form DCM") electronically. Rule § 38.3(a) also eliminates the 90-day expedited approval procedures for DCM applications. Accordingly, all DCM applications will be reviewed within the 180-day period governed by procedures specified in CEA section 6(a).[550]

Summary of Comments and Discussion

The Commission did not receive comments on the costs associated with filling out Form DCM.

[549] Proposed regulations 38.1 and 38.2 are not discussed because they impose no requirements on market participants. Regulation 38.1 updates internal references within part 38 and regulation 38.2 specifies the regulations from which DCMs will be exempt. Proposed regulations 38.3(b), (c), (e), and (f) are essentially unchanged from existing rules and impose no new costs or benefits. Additionally, regulation 38.6 is not being revised by this release.

[550] 7 U.S.C. 8(a).

Eris contended that eliminating the 90-day accelerated review process would place new entities at a competitive disadvantage because it would delay their time to market, which they believe is critical for new entrants.[551]

The Commission has found that, in the interest of meeting the expedited approval timeline, applicants seeking expedited review often file incomplete or draft applications without adequate supporting materials. This has resulted in the expenditure of significant amounts of staff time reviewing incomplete or draft applications, necessitating numerous follow-up conversations with applicants, and usually resulting in the removal of applications from the expedited review timeline. Additionally, some applications raise new or unique issues that require additional time for the Commission to review. Notably, since the passage of the CFMA, eleven DCM applicants have requested expedited treatment, but, for some of the reasons noted above, only three were designated within the shortened timeframe.[552] Moreover, eliminating the accelerated 90-day review process will not prevent DCMs from coming to market in an expeditious manner because the rule does not prevent the Commission from continuing to review applications within a shorter timeframe if DCM applicants submit substantially complete applications.

Costs

Form DCM is designed to elicit a demonstration that an applicant can satisfy each of the DCM core principles. Toward this end, Form DCM requires submission of

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[551] Eris Comment Letter at 4 (Feb. 22, 2011). Eris was designated as a contract market on October 28, 2011.

[552] The three applicants that were designated within the shortened timeframe included NYSE Liffe, Chicago Climate Futures Exchange ("CCFE"), and GreenX. The remaining applications that were not approved during the expedited timeframe included: Inet Futures Exchange, OneChicago, CBOE Futures Exchange, U.S. Futures Exchange, ELX Futures, The Trend Exchange, NQLX Futures Exchange, and Cantor Futures. The Commission notes that while NYSE Liffe, CCFE, and GreenX became designated within 90 days, they each submitted multiple draft DCM applications that were processed and reviewed by Commission staff for significantly longer than 90 days.

information about an applicant's intended operations. Much of this information has been required of applicants under previous regulations. Accordingly, the use of Form DCM does not represent a substantive departure from the Commission's practices over the past decade. With respect to new core principles, Form DCM captures information that tracks statutory requirements and applicable Commission implementing regulations. In fact, by providing greater specificity and transparency as to what is expected from an applicant and by reducing the need for Commission staff to request, and the applicant to provide, supplementary information, Form DCM should reduce costs for applicants by minimizing the flow of documentation and discussions between DCM applicants and Commission staff needed for applicants to submit a complete application.

As noted above, eliminating the 90-day expedited review period is unlikely to impose additional costs on DCMs or to result in competitive disadvantage because it does not prevent the Commission from continuing to review applications within a shorter timeframe if DCM applicants submit substantially complete applications.

Benefits

The new application form has several benefits for DCM applicants. The new form is designed to ensure that applicants are in compliance with the DCM Core Principles – as required by the statute. The form improves upon existing practice by standardizing the information that a DCM must provide. The form includes comprehensive instructions that will guide DCM applicants and specify lists of documents and information that must be provided as exhibits. The Commission anticipates that the new application form will streamline the DCM designation process, both for DCM applicants and the Commission. The form will provide applicants with

greater specificity and transparency regarding the type of information that is required. The use of the standardized form is expected to reduce the amount of time Commission staff will need to review applications, which should enable qualified DCMs to begin operating sooner. Other than the specific requirements necessitated by the new and revised core principles, and applicable regulations, the majority of information required under the new form consists of information that the Commission historically has required.

With respect to the elimination of the expedited review period, the Commission determined in the proposal that the 90-day accelerated review process was inefficient and impracticable. Applicants seeking expedited review often filed incomplete or draft applications, without adequate supporting materials, in the interest of meeting the expedited approval timeline.[553] This required Commission staff to expend significant amounts of time reviewing incomplete or draft applications and usually resulted in removal of the application from the expedited review timeline. Eliminating the expedited process is consistent with the statutory 180-day review period, and should result in a better use of Commission resources. During the 180-day review period, applicants will have adequate time to respond to Commission staff requests for additional information, resulting in a more efficient process for applicants and for the Commission.[554]

Section 15(a) Factors

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[553] For example, while NYSE Liffe, GreenX, and CCFE became designated 79, 88, and 60 days, respectively, after they submitted their applications, they each submitted several versions of draft applications that required numerous follow-up conversations with Commission staff. While GreenX technically became designated within 88 days, the Commission actually processed GreenX's application in draft form for nearly a year.

[554] This rule is consistent with the Commission's elimination of the 90-day expedited review procedures for derivatives clearing organization applications under part 39. See "Derivatives Clearing Organization General Provisions and Core Principles," 76 FR 69334, 69337, Nov. 8, 2011.

(1) Protection of market participants and the public. Given the critical role that DCMs play in the financial markets, a role that now includes providing a marketplace for the trading of swaps as well as futures and options, it is essential that the Commission conduct a comprehensive and thorough review of all DCM applications. Such review is essential for the protection of market participants and the public insofar as it serves to limit the performance of DCM functions to only those entities that have provided adequate demonstration that they are capable of satisfying the core principles. The new Form DCM and the elimination of the 90-day application review period will enable the Commission to more efficiently and accurately determine whether it is appropriate to designate a DCM applicant as a contract market.

(2) Efficiency, competitiveness, and financial integrity. The Commission expects that the use of Form DCM will promote efficiency, competitiveness, and financial integrity by requiring at the outset all information the Commission deems necessary to consider an application for designation as a contract market. As discussed above, the Commission's experience with lengthy reviews of draft applications and other materially incomplete submissions highlights the need for a streamlined and formalized process. By replacing a series of provisions under current § 38.3(a) with a streamlined Form DCM, and by eliminating the 90-day expedited application review period, the Commission is promoting increased efficiency by providing specific guidance to applicants and DCMs before they undertake the application process, and by facilitating the submission of a materially complete final application. This also will reduce the need for the submission of supplemental materials and repeated consultation between applicants and Commission staff. The result will be a more cost effective and expeditious review and approval of

applications. This will benefit potential and existing DCMs as well as free Commission staff to handle other regulatory matters.

In addition, the use of Form DCM will make available to the public the Commission's informational requirements so that all prospective applicants have a heightened understanding of what is involved in the preparation and processing of an application. Form DCM will promote greater transparency in the process and will enhance competition among DCMs by making it easier for qualified applicants to undertake and navigate the application process in a timely manner.

Form DCM is designed to address an applicant or a DCM's ability to comply with the core principles, which form the bedrock of the Commission's oversight, and which Congress determined are essential to ensure the financial integrity of transactions and derivatives markets, generally. In particular, the required information in the Form DCM (Exhibits I-J--Financial Information and M and T--Compliance) elicit important information supporting the applicant or DCM's ability to operate a financially sound DCM and appropriately manage the risks associated with its role in the financial markets.

(3) Price discovery. The Commission does not anticipate that use of Form DCM or the elimination of the 90-day review period will impact the price discovery process.

(4) Sound risk management policies. The Commission expects that the use of Form DCM will promote sound risk management practices by requiring applicants and DCMs to examine their proposed risk management program through a series of detailed exhibits and submissions. The submission of exhibits relating to risk management, including exhibits I-J (Financial Information) and M, O, and T (Compliance) aid Commission staff's analysis and evaluation of an applicant's ability to comply with the core principles.

(5) Other public interest considerations. The standardization and streamlining of the DCM application process benefits the public in terms of more efficient use of Commission resources and more cost-effective and transparent requirements for applicants and DCMs. DCMs play a key role in the financial markets, and this role takes on even greater significance now that swaps may be traded on DCMs. A coherent and comprehensive approach to DCM designation is needed to ensure that only qualified applicants will be approved and that they are capable of satisfying the requirements of the core principles and Commission regulations.

§ 38.3(d) (Request for transfer of designation) and § 38.5 (Information relating to contract market compliance)

Rule § 38.3(d) is a new rule that formalizes the procedures under which a DCM may request the transfer of its designation to a new legal entity as a result of a corporate event such as a merger or corporate reorganization. Rule § 38.5(c)[555] is a new rule that requires that the DCM must submit to the Commission a notification of each transaction involving the transfer of ten percent or more of the equity interest in the designated contract market, and that such notification must be provided at the earliest possible time but in no event later than ten business days following the date upon which the designated contract market enters into a legally binding obligation to transfer the equity interest. As described in the preamble, upon receiving a notification of an equity interest transfer, the Commission may request, where necessary, additional information and specific documentation from the DCM pursuant to its authority under § 38.5, although such

[555] The provisions in regulation 38.5 regarding requests for information and demonstrations of compliance (paragraphs (a) and (b) in the final rules) were largely unchanged after Dodd-Frank and will not be discussed in this rulemaking because they do not result in any incremental costs or benefits.

documentation is no longer required with the initial notification. The Commission did not receive any comments discussing the costs or benefits of proposed §§ 38.3(d) or 38.5(c).

Costs

Under § 38.3(d), only DCMs that wish to request the transfer of their designation will incur the one-time cost associated with filing the request with the Commission and preparing the underlying documents and representations that must be included with the request. The Commission notes that it has historically requested that DCMs file similar information in the event of a transfer of designation. The Commission is reducing the burden associated with the proposed regulations by clarifying that DCMs have the flexibility to determine the appropriate form of the documents they are required to submit. The Commission estimates that the submissions and notifications required under § 38.3(d) will take around two hours to compile at a cost of approximately $104.

The Commission is also reducing the burden associated with proposed § 38.5(c) by eliminating the requirement that DCMs must provide a series of documents and a representation along with the notification of an equity interest transfer. DCMs that enter into agreements that could result in equity interest transfers of 10 percent or more will incur one-time costs associated with preparing and submitting the required notification for each event. The Commission estimates that the initial notification required under § 38.5(c)will take around one hour to compile at a cost of approximately $52.

Benefits

Section 38.3(d) formalizes the procedures that a DCM must follow when requesting the transfer of its DCM designation and positions comprising open interest in

anticipation of a corporate event. The provision requiring three months advance notice of an anticipated corporate change will provide the Commission with sufficient time to evaluate the anticipated change and determine the likely impact of the change on the DCM's governance and obligations, as well as the impact of the change on the rights and obligations of market participants holding open positions. The rule will permit the Commission to evaluate the transferee's ability to comply with the applicable laws and regulations. The rule also requires DCMs to submit a representation that they are in compliance with the applicable laws and regulations. This requirement provides regulatory specificity to DCMs regarding their obligations.

Section 38.5 provides Commission staff with an opportunity to determine whether a change in ownership at a DCM resulting from an equity interest transfer will adversely impact the operations of the DCM, or the DCM's ability to comply with the Core Principles and the Commission's regulations. Section 38.5 ensures that DCMs remain mindful of their self-regulatory responsibilities when negotiating the terms of significant equity interest transfers.

Section 15(a) Factors (§§ 38.3(d) and 38.5(c))

(1) Protection of market participants and the public. Given the critical role that DCMs play in the financial markets, a role that now includes providing a marketplace for the trading of swaps as well as futures and options, it is essential that the Commission conduct a comprehensive and thorough review of all requests for transfer of designation and notifications of equity interest transfers. Such review is essential for the protection of market participants and the public insofar as it serves to limit the performance of DCM functions to only those entities that have provided adequate demonstration that they are

capable of satisfying the core principles. The new formalized procedures for transfers of designation and equity interest transfers will provide the Commission with the opportunity to determine the impact those transfers are likely to have on a DCM's ability to comply with the core principles and on the market.

(2) Efficiency, competitiveness, and financial integrity. The Commission expects that the formalized procedures for requesting a transfer of designation and for notifying the Commission of an equity interest transfer will promote efficiency, competitiveness, and financial integrity by providing the Commission with the opportunity to obtain the information the Commission deems necessary to consider such requests. The result will be more cost effective review and approval of requests for transfer of designation and equity interest. This will benefit DCMs. Financial integrity is also promoted as the transferee's ability to meet core principles will be examined.

(3) Price discovery. The Commission does not anticipate that the formalized process for requesting a transfer of designation or notifying the Commission of an equity interest transfer will impact the price discovery process.

(4) Sound risk management policies. The Commission expects that the formalized processes for transfers of designation and equity interests will promote sound risk management practices by requiring DCMs to examine their proposed risk management program through a series of submissions that aid Commission staff's analysis and evaluation of a DCM's ability to comply with the core principles.

(5) Other public interest considerations. The standardization and streamlining of the transfer of designation and equity interest transfer process benefits the public by permitting more efficient use of Commission resources and more cost-effective

requirements for DCMs. A coherent and comprehensive approach to transfers of designations and equity interests is needed to ensure that all DCMs continue to satisfy the requirements of the core principles and Commission regulations.

§ 38.3(g) (Requirements for existing designated contract markets)

Proposed rule § 38.3(g) required existing DCMs to certify compliance with each of the core principles within 60 days of the effective date of the final rules. In response to comments, the Commission has eliminated this requirement from the final rules. The Commission believes that the removal of this provision will decrease costs for DCMs.

§ 38.4 (Procedures for listing products)

Section 38.4 conforms the prior regulation to that of new rules in part 40 of the Commission's regulations.[556] There are no costs imposed by the conforming changes beyond those discussed in connection with that rulemaking.

§ 38.7 (Prohibited use of data collected for regulatory purposes)

Rule § 38.7 is a new rule that prohibits a DCM from using for business or marketing purposes proprietary or personal information that it collects from market participants unless the market participant clearly consents to the use of its information in such a manner.[557]

Costs

The Commission notes that in response to general comments that did not discuss costs or benefits, it has amended this provision to allow DCMs to use this information for business or marketing purposes if the market participant clearly consents to the use of its

[556] "Provisions Common to Registered Entities," 76 FR 44776, Jul. 27, 2011.
[557] The Commission notes that the requirements of regulation 38.7 are in line with similar rules intended to provide privacy protections to certain consumer information finalized in a separate rulemaking implementing regulations under the Fair Credit Reporting Act. See 76 FR 43879, Jul. 22, 2011.

information in such a manner. The costs imposed by this provision are limited to the cost a DCM might incur in obtaining a market participant's consent to use its information for the purposes described above. The Commission does not prescribe the method by which a DCM must obtain such consent and believes that the burden of doing so would be minimal and would likely involve sending an email or a letter.

Benefits

This rule protects market participants' information provided to a DCM for regulatory purposes from being used to advance the commercial interests of the DCM. The rule eliminates incentives on the part of DCMs to use market participants' proprietary or personal information for their own commercial gain. The rule does, however, afford market participants the flexibility to consent to a DCM's use of their personal information for commercial purposes if they so desire.

Section 15(a) Factors

(1) Protection of market participants and the public. This rule protects market participants and the public by ensuring that information they provide to DCMs for regulatory purposes it not used inappropriately to advance the commercial interests of the DCM without their consent.

(2) Efficiency, competitiveness, and financial integrity. This rule encourages greater participation in the markets by ensuring market participants that their proprietary and personal information will not be used by DCMs without their consent. Increased participation by market participants will foster greater liquidity, tighter spreads, and more competitive markets. The rule also promotes efficient and competitive markets by

ensuring that DCMs do not use access to their market participants' data (without their consent) as a source of competitive advantage.

(3) Price discovery. Fostering a competitive environment, as mentioned above, aids in the compilation of information traded in markets to further price discovery.

(4) Sound risk management practices. The Commission has not identified any effects that this rule will have on sound risk management practices.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

§ 38.8 (Listing of swaps on a designated contract market)

Section 38.8(a) provides that a DCM that lists a swap contract for trading on its contract market for the first time must file with the Commission a written demonstration detailing how the DCM is addressing its self-regulatory obligations with respect to swap transactions.

Section 38.8(b) provides that prior to listing swaps for trading on or through the DCM, each DCM must request an alphanumeric code from the Commission for purposes of identifying the DCM pursuant to part 45.

Summary of Comments and Discussion

ELX argued that the DCM NPRM did not make clear what criteria will be used to distinguish between a swap contract and a futures contract and argued that this ambiguity will cause uncertainty and redundant costs for boards of trade that would prefer to follow a DCM model without having to adopt a parallel set of rules and procedures.[558]

[558] ELX Comment Letter at 4 (Feb. 22, 2011).

As noted in the Final Exemptive Order issued July 14, 2011,[559] a DCM may list and trade swaps after July 16, 2011 under the DCM's rules related to futures contracts, without further exemptive relief. In the Order, the Commission noted that if a DCM intends to trade swaps pursuant to the rules, processes, and procedures currently regulating trading on its DCM, the DCM may need to amend or otherwise update its rules, processes, and procedures in order to address the trading of swaps.[560]

Costs and Benefits

In order to comply with new § 38.8(a), DCMs listing swaps for the first time will incur costs associated with filing the required demonstration detailing how the DCM is addressing its self-regulatory obligations and fulfilling its statutory and regulatory obligations with respect to swap transactions. The Commission estimates that this filing will take two hours to complete at a cost of about $104.

With respect to § 38.8(b), the comments, costs, and benefits of this provision will be discussed in the rulemaking that implement swap data recordkeeping and reporting requirements under part 45 of the Commission's regulations.[561]

§ 38.9 (Boards of trade operating both a designated contract market and swap execution facility)

Section 38.9 provides that a board of trade that operates a DCM also may operate a SEF, provided that the board of trade separately register as a SEF pursuant to the requirements set forth in part 37. The rule also requires such boards of trade to comply with the core principles under section 5h of the Act and the SEF rules under part 37, on an ongoing basis.

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[559] 76 FR 42508, Jul. 14, 2011.
[560] Id. at 42518, n. 131.
[561] See 77 FR 2136, Jan. 13, 2012.

Additionally, the rule codifies the requirement contained in section 5h(c) of the CEA, which provides that a board of trade that operates both a DCM and a SEF, and that uses the same electronic trade execution system for executing and trading swaps that it uses in its capacity as a DCM, must clearly identify to market participants for each swap whether the execution or trading is taking place on the DCM or the SEF. The Commission did not receive any comments on the costs or benefits of this provision and is adopting the rule as proposed.

Costs and Benefits

The obligations imposed by § 38.9 are codifications of the new statutory requirement placed on DCMs. The obligations imposed by the CEA are not within the Commission's discretion to change. However, the Commission believes there are several benefits to restating the statutory requirements in the regulations. Codification of statutory requirements in the regulations will improve the Commission's ability to enforce the statutory language and will provide market participants with a more unified regulatory picture and with greater context and specificity regarding the congressional intent underlying the regulations.

§ 38.10 (Reporting of swaps traded on a designated contract market)

Section 38.10 provides that each DCM that trades swaps must report specified swap data as provided under parts 43 and 45.[562] This provision is consistent with the statute's reporting requirements as reflected in sections 2(a)(13)-(14) and 21(b) of the CEA. The costs and benefits of these rules are discussed in connection with those rulemakings.

[562] "Real-Time Public Reporting of Swap Transaction Data," 77 FR 1182, Jan. 9, 2012; "Swap Data Recordkeeping and Reporting Requirements," 77 FR 2136, Jan. 13, 2012.

3. Core Principle 2: Compliance with Rules

For the most part, the regulations adopted under Core Principle 2 codify: (1) language found in the guidance and acceptable practices issued under former Core Principle 2 and former Designation Criterion 8; (2) existing DCM compliance practices that the Commission believes constitute best practices; and (3) recommendations made over the past several years by the Commission in RERs, and which are currently largely followed. The Commission also incorporated into the rules for Core Principle 2 certain concepts contained in part 8 of its regulations—Exchange Procedures for Disciplinary, Summary, and Membership Denial Actions. Most DCMs' compliance and enforcement practices relating to Core Principle 2 obligations historically have been consistent with the rules contained in part 8. The Commission is also adopting some requirements that are new for DCMs. The costs and benefits of each of these requirements are discussed below.

§ 38.151(a) (Jurisdiction), § 38.151(b) (Impartial access by members, persons with trading privileges, and independent software vendors) and § 38.151(c) (Limitations on access)

Section 38.151(a) requires that prior to granting a member or market participant access to its markets, the DCM must require the member or market participant to consent to its jurisdiction. Section 38.151(b)(1) requires a DCM to provide its members, persons with trading privileges, and independent software vendors ("ISVs") with impartial access to its markets and services, including access criteria that are impartial, transparent, and applied in a non-discriminatory manner. Section 38.151(b)(2) requires that the DCM

provide comparable fee structures for members, persons with trading privileges, and ISVs receiving equal access to, or services from, the DCM.

Section 38.151(c) (Limitations on Access) requires a DCM to establish and impartially enforce rules governing any decision by the DCM to deny, suspend, or permanently bar a member's or a person with trading privileges access to the contract market. Accordingly, any decision by a DCM to deny, suspend, or permanently bar a member's or person with trading privileges access to the DCM must be impartial and applied in a non-discriminatory manner. Section 38.151 (a) derives from the statutory language of Core Principle 2. While §§ 38.151(b) and (c) are new rules, they codify existing industry practice and current Commission requirements.

Summary of Comments

CME stated that it would be costly to comply with the proposed § 38.151(a) requirement that clearing firms obtain every customer's consent to the regulatory jurisdiction of each DCM.[563] KCBT questioned the benefit of implementing the proposed rule.[564]

With respect to 38.151(b)(1), MGEX stated that it is generally in the best interest of the DCM to have open and available markets and services. Therefore, MGEX argued that the proposed rule was unnecessary and infringed on the business judgment of the DCM.[565]

[563] CME Comment Letter at 16 (Feb. 22, 2011).
[564] KCBT Comment Letter at 2 (Feb. 22, 2011).
[565] MGEX Comment Letter at 3 (Feb. 22, 2011).

With respect to 38.151(b)(2), CME argued that the Commission does not have the authority to set or limit fees charged by DCMs, likening the requirement for comparable fee structures to an industry-wide fee cap that has the effect of a tax.[566]

Discussion

The Commission believes that § 38.151(a) codifies jurisdictional requirements necessary to effectuate Core Principle 2's statutory mandate that a board of trade "shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rules of the contract market." In the Commission's view, a DCM must establish jurisdiction prior to granting members and market participants access to its markets in order to effectively investigate and sanction persons that violate DCM rules. A DCM should not be in the position of asking market participants to voluntarily submit to jurisdiction after a potential rule violation has been found. In response to CME's comment, the Commission clarifies that each DCM may determine for itself how it will secure such agreements. For example, a DCM could utilize its clearing firms to secure the agreement. The Commission recognizes that DCMs may need additional time to secure market participants' agreements to jurisdiction. Accordingly, in order to reduce the burden associated with this rule, the Commission is granting DCMs up to 180 additional days following the applicable effective date for existing members and market participants to comply with the requirements of § 38.151(a).

With respect to § 38.151(b), and as discussed in further detail in the preamble, the Commission has considered the arguments asserted by commenters and determined that the rule is necessary in order to prevent the use of discriminatory access requirements as a competitive tool against certain participants. The Commission has, however, listened to

[566] CME Comment Letter at 8-9 (Feb. 22, 2011).

commenters' concerns about the costs associated with the regulation and believes the rules strike an appropriate balance.

Any comment implying that the Commission is attempting to set or limit fees charged by DCMs is misplaced. The requirement in § 38.151(b)(2) neither sets nor limits fees charged by DCMs. Rather, the rule states only that the DCM set non-discriminatory fee classes for those receiving access to the DCM as a way to implement the requirement of impartial access to DCMs. Accordingly, DCMs may establish different categories of market participants, but may not discriminate within a particular category. As the Commission noted in the preamble, when a DCM determines its fee structure, it may consider other factors in addition to the cost of providing access. The fee structure was not designed to be a rigid requirement that fails to take account of legitimate business justifications for offering different fees to different categories of entities seeking access. The Commission recognizes that DCMs may also consider services they receive (in addition to costs) when determining their fee structure. Accordingly, the comment suggesting that the Commission does not have authority to set fees is misplaced as the rule neither sets nor limits fees charged by DCMs.

Costs

The costs associated with § 38.151(a) derive from the statute and are likely to be limited to the cost of obtaining customers' consent to the DCM's jurisdiction. In response to comments received, the Commission is not mandating the method for obtaining consent; this may afford cost savings to DCMs. The Commission believes that most DCMs are generally already in compliance with the requirements of § 38.151(b), which require that DCMs provide comparable fee structures for members, persons with

trading privileges, and ISVs receiving equal access to, or services from, the DCM. In addition, the Commission believes that most DCMs currently have rules that comply with the requirements of § 38.151(c), which states that DCMs must establish and enforce rules governing any decisions to deny, suspend, or permanently bar a member's or market participant's access to the contract market. Accordingly, the Commission believes that the final rule is unlikely to impose additional costs on DCMs.

Benefits

The requirements of § 38.151(a) ensure that DCMs can effectively investigate and sanction persons that violate DCM rules, as required by Core Principle 2. A DCM should not be in the position of asking market participants to voluntarily submit to jurisdiction after a potential rule violation has been found. This requirement also ensures that market participants are clear that their trading practices are subject to the rules of a DCM.

As noted above, the impartial access requirements of § 38.151(b) prevent DCMs from using discriminatory access fee requirements as a competitive tool against certain participants. Access (and decisions to limit access) to a DCM should be based on the financial and operational soundness of a participant, rather than discriminatory or other improper motives. Impartial access benefits the market by ensuring that all participants that meet the requirements are able to trade on the DCM, thus potentially increasing liquidity in the marketplace. The preamble's discussion that any participant should be able to demonstrate financial soundness either by showing that it is a clearing member of a DCO that clears products traded on that DCM or by showing that it has clearing arrangements in place with such a clearing member specifies that access will be neutral and non-discriminatory. Granting such impartial access to participants will likely

improve competition within the market by ensuring access criteria do not inappropriately deter market participants from participating in the market.

The benefits described above also apply to the requirement that DCM decisions to deny, suspend, or permanently bar a member or person with trading privileges' access to the DCM should be impartial and applied in a non-discriminatory manner.

Section 15(a) Factors

(1) Protection of market participants and the public. The final rules protect market participants by ensuring that DCMs can effectively investigate and sanction persons that violate DCM rules, and by ensuring that similarly situated market participants receive similar access criteria and comparable fee structures, consistent with the statute. Accordingly, the rules protect market participants from the potential that DCMs may employ unfair or discriminatory practices in rendering access determinations. In addition, the rules will provide market participants with greater specificity regarding DCMs procedures for denials and suspensions. This will benefit the market by ensuring that market participants know what behavior will lead to denials and suspensions and that denials and suspensions are being imposed in a fair and non-discriminatory manner.

(2) Efficiency, competitiveness, and financial integrity. The rules prevent DCMs from employing discriminatory or preferential criteria in granting members, persons with trading privileges, and ISVs access to their market. Accordingly, the rules will likely promote participation and competition within the marketplace by ensuring access criteria do not inappropriately deter market participants from participating in the market. Efficiency is promoted by defining clear rules governing the denial or suspension of a member's or person with trading privileges access to the contract market. The final rules

may also promote financial integrity in the derivatives markets because sound, non-discriminatory access criteria and fee structures are less likely to deter the financial integrity of members and market participants.

(3) Price discovery. As noted above, the rules are likely to increase competition within the market by optimizing market participation. Increased participation is likely to enhance the DCM's liquidity, leading to enhanced price discovery.

(4) Sound risk management practices. The Commission has not identified any effects that this rule will have on sound risk management practices other than the effects related to the factors above, especially with respect to financial integrity.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

§ 38.152 (Abusive trading practices prohibited)

Section 38.152 requires a DCM to prohibit abusive trading practices, including front-running, wash trading, fraudulent trading, and money passes, as well as any other trading practices that the DCM deems to be abusive. The Commission did not receive any comments discussing the costs or benefits of this provision.[567]

Costs

DCMs generally already have rules in place that prohibit the conduct enumerated in the CEA and the final rule. They also have the systems and staff necessary to detect, investigate, and prosecute possible rule violations. Accordingly, the Commission believes that the final rule is unlikely to impose additional costs on most DCMs.

[567] CME commented that the rule is overly prescriptive. CME Comment Letter at 17-18 (Feb. 22, 2011). The Commission considered this comment in preparing this release and discusses the costs and benefits of the codification of rules in lieu of guidance and acceptable practices in further detail in section C(1) above.

Benefits

The rule ensures that DCMs prohibit the specific trading practices identified in the rule, as well as any manipulative or disruptive trading practices prohibited by the CEA or by Commission regulation. Market participants and the public are likely to have greater confidence in markets that are protected from abusive trade practices, and therefore will be more willing to participate in the market, which may enhance liquidity, competition, and price discovery.

Section 15(a) Factors

(1) Protection of market participants and the public. Congress determined in Core Principle 2 that market participants must be protected from abusive trade practices. Market participants rely on properly functioning futures markets in order to hedge risk and must have confidence in the integrity of the markets in order to actively participate. Rule 38.152 requires DCMs to prohibit conduct that could result in harm to market participants, as well as members of the public who rely on the prices derived from the market. The rule protects market participants and the public from possible wrongdoing on the part of firms and commodity professionals with whom they deal.

(2) Efficiency, competitiveness and financial integrity of futures markets. The rule promotes efficiency, competitiveness, and financial integrity in the DCM market because markets that are protected from abusive trade practices will likely attract greater market participation, and increase public confidence in the market, and thereby will likely increase competition and liquidity.

(3) Price discovery. The rule similarly promotes price discovery because markets protected from the trading abuses prohibited by the rule are likely to operate more

efficiently and more accurately and to attract greater market participation and competition; such markets better reflect the forces of supply and demand, leading to greater price discovery.

(4) Sound risk management practices. The Commission has not identified any effects that this rule will have on sound risk management practices, other than the effects related to the factors above.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

§ 38.153 (Capacity to detect and investigate rule violations), § 38.155 (Compliance Staff and Resources), §38.156 (Automated Trade Surveillance System), and §38.157 (Real Time Market Monitoring)

§ 38.153 (Capacity to detect and investigate rule violations)

Section 38.153 requires that a DCM have arrangements and appropriate resources for the effective enforcement of all of its rules, including the authority to collect information and examine books and records of members and persons under investigation, and adequate resources for trade and surveillance programs. While the proposed rule required DCMs to have the authority to collect information and examine books and records for "members" and "market participants," the final rule imposes a lesser burden on DCMs by replacing the term "market participants" with "persons under investigation."

Summary of Comments and Discussion

CFE requested that the Commission clarify the term "market participant," arguing that if the term "market participant" were to be interpreted to apply to all customers – and not just those customers with direct electronic access to the DCM – a DCM's regulatory

responsibilities would greatly expand over participants with whom it has no direct relationship or connection, greatly increasing costs for the DCM.[568]

Similarly, CME stated that the proposed rule implied that the entire class of non-member, non-registered market participants would be subject to the panoply of recordkeeping requirements currently applicable only to members, registrants, and direct access clients of CME.[569] CME stated that there has been no showing that such a requirement will further the DCM's ability to effectively carry out its self-regulatory responsibilities and that it would be imprudent to impose these costs and burdens on market participants.[570]

The Commission notes that Core Principle 2 requires a DCM to have, in addition to appropriate resources for trade practice surveillance programs, appropriate resources to enforce all of its rules. Further, the Commission is cognizant that a broad interpretation of the term "market participant" could significantly increase the regulatory responsibilities for DCMs. In response to the commenters' concerns, the Commission is replacing the term "market participant" in the proposed rule with "persons under investigation" in the final rule, which will reduce the costs of compliance.

Costs

The requirements of this rule are not new for DCMs. Prior to the Dodd-Frank Act, the Commission expected a DCM to have adequate capacity and resources for effective rule enforcement.[571] The existing costs associated with § 38.153 include the initial and recurring costs associated with a DCM investing in the resources and staff

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[568] CFE Comment Letter at 2 (Feb. 22, 2011).
[569] CME Comment Letter at 18 (Feb. 22, 2011).
[570] Id.
[571] Commission staff has recommended these practices through RERs.

necessary to provide effective rule enforcement. A DCM must have sufficient staff and resources, including the resources to collect information and examine books and records of members and persons under investigation and to analyze data to determine whether a rule violation occurred. Other costs include automated systems to assist the compliance staff in carrying out self-regulatory responsibilities for the DCM. The Commission believes that existing DCMs generally already have the systems necessary for effective rule enforcement. Further, replacing the term "market participant" with "persons under investigation" in the final rule will reduce the costs by narrowing the scope of the requirement.

Benefits

The rule ensures that a DCM has arrangements and resources for effective rule enforcement. A DCM can best administer its compliance and rule enforcement obligations when it has the ability to access and examine the books and records of its members and persons under investigation.

§38.155 (Compliance staff and resources)

Section 38.155 requires that a DCM establish and maintain sufficient compliance staff and resources to conduct a number of enumerated tasks, such as audit trail reviews, trade practice surveillance, market surveillance, real-time market monitoring, and the ability to address unusual market or trading events and to complete any investigations in a timely manner. The Commission did not receive any comments discussing the costs or benefits of this provision.

Costs

The Commission notes that it currently requires DCMs to have sufficient compliance staff and resources to perform the noted regulatory functions and that most DCMs have already expended the costs necessary to comply with the requirements under § 38.155. Any DCM not currently in compliance with the rule will incur the cost of hiring and maintaining sufficient staff and resources (e.g. electronic systems) to conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring, to address unusual market or trading events, and to complete any investigations in a timely manner. However, this requirement is consistent with existing practice at many DCMs and reflects staff recommendations made in RERs from time to time. DCMs will also incur the cost of the annual monitoring of the size and workload of compliance staff and resources, which will require oversight time for compliance staff, management and the regulatory oversight committee. Any costs associated with § 38.155 will vary depending upon a DCM's trading volumes, the number of products offered for trading, and the complexity of conducting surveillance on the particular products offered by the DCM. In addition, changes in market characteristics such as volatility, the presence or absence of intermediaries, and the nature and sophistication of market participants may also impact the costs associated with § 38.155.

Benefits

This rule ensures that DCMs have adequate compliance staff and resources to conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring in order to help detect rule violations and abusive trading practices. DCMs must also have adequate resources necessary to address unusual market or trading events in order to help stabilize market conditions if necessary and to complete

any investigations in a timely manner. To this end, the rule promotes market integrity, customer protection, and the effectiveness of DCMs as self-regulatory organizations.

§ 38.156 (Automated trade surveillance system)

Section 38.156 requires a DCM to maintain an automated trade surveillance system capable of detecting and investigating potential trade practice violations and able to process this data on a trade date plus one ("T + 1 basis"). The Commission did not receive any comments discussing the costs or benefits of this provision.[572]

Costs

Costs associated with § 38.156 include the costs of developing and maintaining an automated system capable of conducting trade practice surveillance, as well as requiring a DCM to have adequate compliance staff to administer the trade surveillance system. Adequate staff resources are necessary to administer, maintain, and periodically upgrade the system. For existing DCMs, the costs associated with § 38.156 should not be new, as the regulation generally reflects current industry practices and Commission requirements. Further, any costs will vary according to the complexity and analytical power of the trade surveillance system it builds, as well as the amount of compliance staff necessary to administer, maintain, and upgrade the system given the DCM's product and participant profiles. Moreover, the Commission has found, through RERs, that a DCM's automated surveillance system typically satisfies the requirements set forth in the final rule (e.g., the ability to compute, retain, and compare trading statistics). Therefore, the Commission

[572] In its comment letter, CME stated this rule is overly prescriptive. See CME Comment Letter at 20 (Feb. 22, 2011). The Commission considered this comment in preparing this release and discusses the costs and benefits of the codification of rules in lieu of guidance and acceptable practices in further detail in section C(1) above.

believes that it will be unnecessary for most DCMs to incur costs to significantly upgrade their automated surveillance systems to comply with the final rule.

Benefits

The rule ensures that a DCM has an adequate automated trade practice surveillance system. These systems play a critical role in ensuring that a DCM can effectively conduct investigations and detect and prosecute possible trading abuses, including the abusive trading practices enumerated in § 38.152. Such systems improve DCM compliance staff's ability to sort and query voluminous amounts of data in order to better detect potential rule violations and abusive trading practices that could harm market participants.

§ 38.157 (Real-time market monitoring)

Section 38.157 requires a DCM to conduct real-time market monitoring of all trading activity on its electronic trading platform(s) to identify disorderly trading and any market or system anomalies and to have the authority to cancel trades and adjust trade prices when necessary.[573]

Costs

Costs associated with § 38.157 include the costs of developing and maintaining electronic systems to facilitate real-time monitoring of all trading activity on a DCM's electronic trading platform(s). DCMs will also bear the cost of maintaining sufficient staff to conduct real-time market monitoring and to administer any interventions in the

[573] In its comment letter, CME stated that this rule is overly prescriptive. CME Comment Letter at 20-21 (Feb. 22, 2011). The Commission considered this comment in preparing this release and discusses the costs and benefits of the codification of rules in lieu of guidance and acceptable practices in further detail in section C(1) above. The Commission did not receive any other comments discussing the costs or benefits of this provision.

market that may be required, including the cancellation of trades, suspension and resumption of trading, and responses to any disorderly market conditions requiring human intervention.

The Commission notes, however, that existing DCMs already have market monitoring capabilities, either directly or through a regulatory service provider. In addition, existing DCMs also have rules and procedures in place regarding items such as the cancellation of trades. As such, many of the costs associated with § 38.157 are likely to have been previously expended by existing DCMs. The Commission also notes that the change in the final rule that replaces the requirement to "ensure orderly trading" with a requirement to "identify disorderly trading" will likely reduce the overall burden of the rule. Moreover, any costs associated with § 38.157 will vary widely according to a DCM's trading volumes, the number of products offered for trading, and the complexity of conducting real-time market monitoring on the particular products offered by the DCM. In addition, changes in market characteristics such as volatility, the presence or absence of intermediaries, and the nature and sophistication of market participants may also impact the costs associated with § 38.157 due to their correlation to system and staff requirements.

Benefits

The real-time monitoring requirements imposed by the rule will promote orderly trading and will ensure that DCMs have the capability to promptly identify and correct market or system anomalies. Prompt responses to these anomalies will likely mitigate the effects of these anomalies and may help prevent them from generating systemic risk or other severe problems. The requirement that any price adjustments or trade cancellations

be transparent to the market and subject to clear, fair, and publicly-available standards ensures that market participants are not subject to arbitrary or opaque processes in the event that their trades are involuntarily cancelled.

Section 15(a) Factors (§ 38.153 and §§ 38.155-38.157)

(1) Protection of market participants and the public. The rules protect market participants and the public by requiring that a DCM has the capacity to detect and investigate rule violations, including adequate compliance staff and resources, automated trade surveillance and real time monitoring capability. These rules will help ensure fair and equitable markets that are protected from abusive trading practices or manipulative market conditions. Under the rules, market users are protected from possible wrongdoing on the parts of firms and commodity professionals with whom they deal to access the marketplace. In addition, the rules are likely to protect the public from the potential of price distortion.

Additionally, the requirement in § 38.157 that any price adjustments or trade cancellations are transparent to the market and subject to clear, fair and publicly-available standards protects market participants from opaque rules related to price adjustments and trade cancellations.

(2) Efficiency, competitiveness and financial integrity of futures markets. The requirement that DCMs have the capability to monitor and detect rule and trade practice violations and market anomalies improves market efficiency, promotes financial integrity, and helps to ensure fair and equitable markets by ensuring that violations and market anomalies are promptly addressed and do not generate systemic risk or other severe problems. It also helps to ensure that market prices are not distorted by prohibited

activities. The rules also enhance the competitiveness of the market by increasing participant confidence in the integrity of the market and by requiring DCMs to maintain and establish resources for effective rule enforcement through the collection of relevant information and examination of relevant books and records.

(3) Price discovery. Requiring DCMs to conduct effective monitoring and surveillance of their markets and to have the capacity to detect rule violations will help ensure that legitimate trades with fundamental supply and demand information are accurately portrayed in market prices. Mitigating rule violations, which deter from the price discovery process in DCM markets, helps provide confidence in the prices market participants use to hedge risk and to provide confidence in the price discovery process.

(4) Sound risk management practices. The rules promote sound risk management practices as they would allow DCMs to better evaluate and be aware of risks posed by trading practices or member activities.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

§ 38.154 (Regulatory services provided by a third party)

Section 38.154(a) requires that a DCM that contracts with a registered futures association or another registered entity (collectively, a "regulatory service provider") ensures that its regulatory service provider has sufficient capacity and resources to provide timely and effective regulatory services.

Section 38.154(b) requires that a DCM maintain adequate compliance staff to supervise and periodically review any services performed by a regulatory service provider.

Section 38.154(c) requires a DCM that utilizes a regulatory service provider to retain exclusive authority over certain decisions. While the proposed rule permitted a DCM to retain exclusive authority in other areas of its choosing, it required the decision to open an investigation into a possible rule violation to reside exclusively with the regulatory service provider. As discussed in the preamble, this requirement has been removed from the final rule. These regulations update and clarify the last general public guidance issued approximately 10 years ago by the Commission in this area.[574]

Summary of Comments

MGEX, KCBT, and CME stated that the proposed rule is either overly burdensome or unnecessary.[575] MGEX expressed its general opposition to proposed § 38.154 by stating that if a service has been delegated to another registered entity pursuant to a Commission-approved agreement, then this "should be sufficient and no other formal agreement is necessary."[576] KCBT contended that proposed § 38.154 is overly burdensome and duplicative, particularly when a DCM contracts with a regulatory service provider that is also a DCM required to comply with the same core principles.[577] KCBT noted that it is currently party to a services agreement with another DCM and argued that it will be costly and unnecessary to perform periodic reviews and hold regular meetings with this regulatory service provider.[578] CME contended that the proposed rule is overly prescriptive and suggested that the rule would be better served as guidance and acceptable practices.[579]

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[574] See 66 FR 42256, 42266, Aug. 10, 2001.
[575] MGEX Comment Letter at 3 (Feb. 22, 2011); KCBT Comment Letter at 3 (Feb. 22, 2011); CME Comment Letter at 18-19 (Feb. 22, 2011).
[576] MGEX Comment Letter at 3 (Feb. 22, 2011).
[577] KCBT Comment Letter at 3 (Feb. 22, 2011).
[578] Id.
[579] CME Comment Letter at 18-19 (Feb. 22, 2011).

Discussion

The Commission has determined that, on the whole, § 38.154 strikes the appropriate balance between flexibility and ensuring that a DCM properly oversees the actions of its regulatory service provider to ensure accountability and effective performance. The Commission believes that it is necessary to require a DCM to conduct periodic reviews and to hold regular meetings with its regulatory service provider. A DCM that elects to use a regulatory service provider must properly supervise the quality and effectiveness of the services provided on its behalf, and can only do so by acquiring detailed knowledge during periodic reviews and regular meetings required under § 38.154.

Costs

The costs associated with § 38.154 will include the cost of initially determining whether a regulatory service provider has the capacity and resources necessary to provide timely and effective regulatory services. An existing DCM replacing a current regulatory service provider with a new one will have a similar cost. For existing DCMs with a regulatory service provider, this should not be a new cost as DCMs are currently required to conduct such due diligence when entering into an agreement for regulatory services from a third-party provider, in line with existing industry practices.

The costs associated with § 38.154 will also include the cost of hiring and maintaining sufficient compliance staff at the exchange to effectively supervise the quality and effectiveness of the services provided by a regulatory service provider, including the cost of holding regular meetings with their regulatory service provider and the cost of periodic reviews of the adequacy and effectiveness of services provided.

These costs will vary widely depending upon a DCM's trading volumes, the number of products offered for trading, and the complexity of conducting surveillance on the particular products offered by the DCM. Changes in market characteristics such as volatility, the presence or absence of intermediaries, and the nature and sophistication of market participants may also impact the costs associated with § 38.154. DCMs will also bear the cost of documenting any instances where their actions differed from those recommended by their regulatory service provider. Commenters did not, however, provide any specific costs to the Commission.

The Commission notes that prior to the Dodd-Frank Act, many of the requirements under § 38.154 (and many of the associated costs summarized above), were already required under Commission policy with respect to compliance with Core Principle 2. Section 38.154 communicates the Commission's expectations with respect to supervision of third-party regulatory service providers in a more consistent and explicit manner.

Benefits

The rule ensures that all regulatory service providers have the capacity to provide the services they contract to perform, and that DCMs are aware of the quality and outputs of the services provided on their behalf. Additionally, the rule ensures that all DCMs have the staff to adequately supervise their regulatory service providers and that these regulatory service providers effectively perform the services they are engaged to perform. By requiring that DCMs oversee the services provided by the regulatory service provider, and thereby ensuring that the service provider is meeting the expected standards for compliance, the rule will likely result in cost savings to the DCM, as the failure of a

service provider to adequately fulfill its duties may result in costs to DCMs for not meeting compliance obligations.

Section 15(a) Factors

(1) Protection of market participants and the public. The final rule promotes the protection of market participants and the public because it ensures that regulatory service providers that are utilized by DCMs are properly supervised and have the capacity to perform the services they are engaged to provide, including conducting market surveillance for rule violations and performing other market regulatory activities that protect market participants and the public.

(2) Efficiency, competitiveness and financial integrity of futures markets. Markets that have effective oversight, surveillance, and monitoring are likely to function more efficiently as rule violations and market abuses would be detected more quickly. Proper supervision of a regulatory service provider that provides these functions will ensure the provider has the ability to perform these activities and will in turn promote confidence in the market and likely increase competition.

(3) Price discovery. The Commission has not identified any effects that this rule will have on price discovery.

(4) Sound risk management practices. The Commission has not identified any effects that this rule will have on sound risk management practices, other than those enumerated with regard to the factors above.

(5) Other public interest considerations. Section 38.154 is particularly important in promoting the public interest as regulatory service providers that help DCMs comply

with their obligations are effectively standing in place of their DCM clients in providing elements of front-line self-regulation.

§ 38.158 (Investigations and Investigation Reports)

Section 38.158(a) requires that a DCM have procedures in place to conduct investigations of possible rule violations, and requires an investigation to be commenced upon the request of Commission staff, or upon the discovery by a DCM of information indicating a reasonable basis for a finding that a violation may have occurred or will occur. The final rule reduces the burden imposed by the proposed rule by now requiring that an investigation must be commenced upon receipt of a request from Commission staff or upon the discovery or receipt of information by the DCM that indicates a "reasonable basis" for finding that a violation "may have" occurred or will occur. Section 38.158(b) requires that an investigation be completed within 12 months after an investigation is opened, absent mitigating factors as specified in the rule. Sections 38.158(c) and (d) set forth the elements and information that must be included in an investigation report when there is or is not a reasonable basis for finding a rule violation. Section 38.158(e) provides that no more than one warning letter for the same violation may be issued to the same person or entity during a rolling 12-month period. [580]

Costs

Section 38.158(a) codifies the current practice at DCMs because every DCM already has investigation procedures, guidelines, and compliance staff. Therefore, the

[580] In its comment letter, CME stated that this rule is overly prescriptive. CME Comment Letter at 21-22 (Feb. 22, 2011). The Commission considered this comment in preparing this release and discusses the costs and benefits of the codification of rules in lieu of guidance and acceptable practices in further detail in section C(1) above. The Commission did not receive any other comments discussing the costs or benefits of these provisions.

Commission does not believe the final rule creates any new resource requirements. Unlike the proposed rule, which may have imposed certain costs not currently incurred by DCMs, the final rule limits the situations under which a DCM must conduct an investigation and keeps the final rule in line with current practices.

Under section 38.158(b), a DCM may have to periodically adjust its compliance staff resources to ensure that investigations are completed within the time period specified in the final rule. However, the Commission notes that this is not a new cost for DCMs. The Commission, through RERs, has already communicated to DCMs that it expects a DCM to complete investigations in a timely manner.

Sections 38.158 (c) and (d) require a DCM to have sufficient compliance staff to conduct investigations and to prepare investigation reports. The Commission notes that this is not a new cost for DCMs. The Commission, through RERs, has already communicated to DCMs that it expects a DCM to have adequate staff to perform these responsibilities. The Commission has also reduced the cost associated with proposed § 38.158(c) by eliminating the requirement that an investigation report include the member or market participant's disciplinary history at the DCM.

Under § 38.158(e), a DCM will be required to maintain sufficient compliance staff to conduct investigations and to determine whether a warning letter should be issued for exchange rule violations. The Commission notes that this is not a new cost for DCMs. The Commission, through RERs, has already communicated to DCMs that it expects a DCM to have adequate staff to perform its self-regulatory responsibilities and to issue warning letters when appropriate.

Benefits

Section 38.158(a) provides that a DCM must establish and maintain procedures that require its compliance staff to conduct investigations of possible rule violations. Investigations that examine potential rule violations help to ensure that rule violations are appropriately examined and prosecuted.

The Commission has determined that the completion of investigations in a timely manner, as required by § 38.158(b), increases the effectiveness of a DCM's rule enforcement program because prompt resolution of investigations is essential to discouraging further violations of a DCM's rules and addressing violations before they escalate. Timely investigations also assist the Commission in appropriately and quickly removing bad actors from markets. By ensuring that DCMs are effectively overseeing potential rule violations on a regular and timely basis, the rule helps DCMs to determine and address violations before they escalate, and serves as a beneficial deterrent against misconduct.

The required elements and information that must be included in an investigation report under §§ 38.158 (c) and (d) will assist disciplinary panels in determining whether there is a reasonable basis for finding that a violation of exchange rules warrants the issuance of charges. The investigation reports that must be provided to the Commission will also assist in reviewing the adequacy of a DCM's trade practice and disciplinary programs.

Section 38.158(e) will ensure that warning letters serve as effective deterrents and will protect the public and market participants against individuals engaging in recidivist activity. A policy of issuing repeated warning letters rather than issuing meaningful

sanctions to members and market participants who repeatedly violate the same or similar rules denigrates the effectiveness of a DCM's rule enforcement program.

Section 15(a) Factors

(1) Protection of market participants and the public. The final rule protects market participants and the public by requiring DCMs to flag potential rule violations, providing a framework for which an investigation is conducted, and protecting against individuals who attempt to engage in violative recidivist activity. By ensuring that investigations are adequately performed, the rule protects market participants and the public by ensuring that remedial action is taken as appropriate. Moreover, timely investigation of rule violations will help to promote fair and equitable markets free of abusive trading practices or manipulative market conditions, and will provide market users assurance that the overseers of the markets in which they trade have the capacity to effectively investigate wrongdoing.

(2) Efficiency, competitiveness and financial integrity of futures markets. For the reasons noted above, the final rule also promotes efficiency, competitiveness, and financial integrity in the derivatives markets by requiring that a DCM have adequate resources to commence an investigation upon the discovery or receipt of information indicating that there is a reasonable basis for finding that a violation may have occurred or will occur, and to conduct this investigation in a timely manner.

(3) Price discovery. The requirement that DCMs conduct investigations in a timely manner helps to ensure that the market is protected from disruptive and manipulative practices. This rule will help protect the price discovery process of markets from these

violations, and thus help provide confidence in the prices market participants use to hedge risk.

(4) Sound risk management practices. The Commission has not identified any effects that this rule will have on sound risk management practices other than those enumerated with regard to the factors above.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

§ 38.159 (Ability to obtain information)

Section 38.159 implements the Core Principle 2 requirement that a DCM have the ability and authority to obtain necessary information to perform its rule enforcement obligations, including information sharing agreements. The Commission did not receive any comments discussing the costs or benefits of this provision.

Costs and Benefits

This rule codifies and implements the requirements of Core Principle 2 that DCM must have the ability and authority to obtain any necessary information to perform any required function, including the capacity to carry out such international information-sharing agreements, as the Commission may require. To the extent that a DCM determines it is necessary for it to enter into an information sharing agreement with other DCMs or SEFs, the rule makes it clear that this is permitted. In so doing, DCMs may face additional costs. However, these costs are unlikely to be significant and will only be incurred should a DCM determine that it is necessary to enter into an information sharing agreement with another DCM or with a SEF. Additionally, some DCMs are already parties to such agreements. The Commission is unable to quantify the cost of entering

into such agreements as the costs will vary depending on several factors, including the nature of the agreement, the size of the DCM, and whether the DCM is negotiating a new agreement or signing-on to an existing agreement.

Section 15(a) Factors

(1) Protection of market participants and the public. The final rule protects market participants and the public by providing a mechanism for which DCMs can obtain necessary information to carry out their duties. A DCM's ability and authority to obtain information in order to perform its rule enforcement obligations is imperative in order to identify rule violations and ensure that remedial action is taken as appropriate. Moreover, this requirement will help to promote fair and equitable markets free of abusive trading practices or manipulative market conditions, and will provide market users assurance that the overseers of the markets in which they trade have the capacity to effectively investigate wrongdoing.

(2) Efficiency, competitiveness and financial integrity of futures markets. For the reasons noted above, the final rule also promotes efficiency, competitiveness, and financial integrity in the derivatives markets by requiring that a DCM have an adequate means to obtain information to enforce its rules.

(3) Price discovery. The requirement that DCMs have a mechanism to obtain appropriate information about traders in its markets helps to ensure that the market is protected from disruptive and manipulative practices. This rule will help protect the price discovery process of markets from these violations, and thus help provide confidence in the prices market participants use to hedge risk.

(4) Sound risk management practices. The Commission has not identified any effects that this rule will have on sound risk management practices other than those enumerated with regard to the factors above.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

4. Core Principle 3: Contracts Not Readily Susceptible to Manipulation

§ 38.201 (Additional Sources for Compliance and Appendix C)

Section 38.201 refers applicants and DCMs to the guidance in appendix C to part 38 (Demonstration of Compliance That a Contract is Not Readily Susceptible to Manipulation), for purposes of demonstrating their compliance with the requirements of § 38.200, which codifies Core Principle 3. The guidance under appendix C to part 38 amends and replaces Guideline No. 1 under appendix A to part 40.

Summary of Comments and Discussion

CME commented that the proposed rulemaking did not identify any problems with continuing to use the current methodology to estimate deliverable supply, and claimed that if the proposed standard is adopted, it will impose additional costs on exchanges and market participants with no defined benefit, including requiring exchanges to survey market participants annually.[581] CME also commented on the provision that DCMs submit monthly deliverable supply estimates, stating that this requirement is onerous for DCMs and suggesting that the Commission should only require monthly estimates of deliverable supply for the most recent three years.[582]

[581] CME Comment Letter at 38 (Feb. 22, 2011).
[582] CME Comment Letter at 9 (Mar. 28, 2011).

The Commission notes that the proposed guidance regarding estimating deliverable supply is not a departure from existing and longstanding practice. Estimating deliverable supply has historically required that a DCM consult with market participants on a regular, if not monthly, basis. In that regard, the burden of maintaining contacts with market participants should not be any more or less than it has been. In response to CME's second comment, the Commission has made amendments to its proposed appendix C by requiring DCMs to submit monthly estimates of deliverable supply for the most recent three years rather than for five years.

Costs

In order to comply with this regulation, DCMs would have to incur the cost of supplying supporting information and documentation to justify the contract specifications of a new product or substantial rule amendment. However, the Commission believes there will likely be no additional costs attributed to the rule because under existing practices, DCMs conduct market analysis for new products before deciding whether or not it makes business sense to list a new product for trading, including interviewing market participants. Additionally, DCMs also conduct market analysis before adopting amendments to existing contract terms and conditions.

Benefits

The guidance outlined in appendix C to part 38 provides a reference for existing and new regulated markets for information that should be provided to the Commission for new products and rule amendments based on best practices developed over the past three decades by the Commission and other regulators. This guidance will likely reduce the time and costs that regulated markets will incur in providing the appropriate

information. The guidance also reduces the amount of time it takes Commission staff to analyze whether a new product or rule amendment is in compliance with the CEA. Some DCMs regularly provide the information outlined in appendix C, but others do not include enough information for Commission staff to determine whether the contract is in compliance with the CEA. Having all of the supporting information included in a new product submission or rule amendment reduces the resources Commission staff must expend to request such information from the exchange or to find independently.

Section 15(a) Factors

(1) Protection of market participants and the public. The information recommended in appendix C for inclusion in the new product or rule amendment submission provides insight and evidence of the DCM's research into the underlying cash market of the DCM's product. This should allow for a timely review by Commission staff of the DCM's supporting analysis and data to determine whether the contract is not readily susceptible to manipulation.

(2) Efficiency, competitiveness and financial integrity of futures markets. By providing guidance based on best practices regarding what a DCM should consider when developing a futures contract or amending the rules of an existing contract, the contracts listed by DCMs, as a whole, should be more reflective of the underlying cash market by promoting efficient pricing through convergence.

(3) Price discovery. The guidance provides the information a DCM should analyze to determine if its contract is designed in such a way to promote convergence at expiration, and thus promote the price discovery mechanism of the centralized market.

(4) Sound risk management practices. By following the best practices outlined in the guidance in appendix C, a DCM can minimize the susceptibility of a contract to manipulation or price distortion while it is developing the contract terms and conditions for its futures contract. As a result, the risks to the DCM's clearing house and market participants would also be minimized.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

5. Core Principle 4: Prevention of Market Disruption

§ 38.251 (General Requirements)

Section 38.251 requires that DCMs collect and evaluate data on individual traders' market activity on an ongoing basis, monitor and evaluate general market data, have the ability to conduct real-time monitoring of trading and comprehensive and accurate trade reconstructions, and monitor for violations of exchange-set position limits. Based upon comments, the Commission removed what were perceived as prescriptive elements from the proposed rule (including a requirement that DCMs have manual processes or automated alerts effective in detecting and preventing trading abuses) and included them in the guidance and acceptable practices in appendix B.

Summary of Comments and Discussion

Several commenters asserted that their current regulatory systems do not allow for effective real-time monitoring of position limits and that this regulation would impose additional costs.[583] Additionally, MGEX stated that the automated trading alert

[583] CME Comment Letter at 24-25 (Feb. 22, 2011), MGEX Comment Letter at 4 (Feb. 22, 2011), KCBT Comment Letter at 4 (Feb. 22, 2011), and ICE Comment Letter at 4 (Feb. 22, 2011).

requirement of proposed § 38.251 did not provide any real value and only imposed more burden and cost.[584]

The Commission notes that while § 38.251 requires that DCMs monitor for intraday position-limit violations it does not require that position limits necessarily be monitored in real-time. Instead, the rule requires that DCMs demonstrate the ability to comprehensively and accurately reconstruct daily trading activity for the purposes of detecting trading abuses and violations of exchange-set position limits, including those that may have occurred intraday. The acceptable practices under appendix B explains that while real-time monitoring is the most effective method, an acceptable program may monitor for intraday violations on a T + 1 basis. The flexibility afforded by the guidance should limit the cost of compliance given that T+1 monitoring is likely less costly than real-time monitoring.

In order to provide greater specificity to market participants, reduce costs, and maximize flexibility, the Commission is also converting the requirement that a DCM have an effective automated alerts regime to detect trading abuses from a rule to an acceptable practice so that a DCM will have added flexibility in meeting this requirement, as the Commission believes that automated trading alerts, though not necessarily in real time, are the most effective means of detecting market anomalies. The Commission is also removing provisions from the proposal dealing with the real-time monitoring of impairments to market liquidity and clarifying in the guidance and acceptable practices what must be included in real-time monitoring as compared to what may not need to be monitored in real-time.

Costs

[584] MGEX Comment Letter at 4 (Feb. 22, 2011).

While some DCMs already have the ability to monitor for intraday trading abuses and market activity, including position-limit violations as required in § 38.251, other DCMs may need to hire additional staff (even if the monitoring is done on a T+1 basis) and may need to install and maintain new or advanced systems with improved capabilities. Additional costs will vary based on the number of products a DCM offers and its trading volumes. However, the Commission notes that a DCM may be able to reduce the costs associated with this rule by using a unified monitoring system to jointly satisfy the requirements of § 38.251 and § 38.157 (Real-time market monitoring). Notwithstanding any related costs, § 38.251 brings DCMs into compliance with the statutory language of the Dodd-Frank Act, which requires that DCMs conduct real-time monitoring of trading activities and be able to reconstruct trading. The regulation does so by minimizing costs while abiding by the Dodd-Frank Act.

Benefits

The Dodd-Frank Act amended Core Principle 4 to emphasize that DCMs must take an active role not only in monitoring trading activities within their markets, but in preventing market disruptions. Rule 38.251 requires that DCMs have the proper tools to prevent manipulation or other disruptions. By requiring DCMs to prevent manipulation or other disruptions, the Commission is able to help ensure that market participants are able to execute trades at prices that are not subject to preventable market disruptions. Moreover, to help reduce the cost of compliance, the Commission is providing DCMs with flexibility in meeting the rule's requirements as set forth in guidance and acceptable practices.

§ 38.252 (Additional requirements for physical-delivery contracts)

Section 38.252 requires that DCMs monitor physical-delivery contracts' terms and conditions as they relate to the underlying commodity market and to the convergence between the contract price and the price of the underlying commodity, address conditions that interfere with convergence, and monitor the supply of the commodity used to satisfy the delivery requirements.[585]

Costs and Benefits

The Commission has a long history of monitoring for convergence and addressing issues of non-convergence.[586] The Commission notes that this surveillance requirement is currently in place and that DCMs are unlikely to incur any additional costs as a result of this codification of an existing practice. The rules adopted in this release ensure that market participants are better able to hedge their risk and that price discovery is enhanced by helping to detect disconnects between futures and underlying physical market prices. Close monitoring of physical-delivery contracts helps prevent the manipulation of prices, and the public benefits from futures prices that reflect actual market conditions because those prices often form the basis for transactions taking place in the physical market.

§ 38.253 (Additional requirements for cash-settled contracts)

Section 38.253 requires that for cash-settled contracts, a DCM must monitor the pricing of the index to which the contract will be settled and also monitor the continued appropriateness of the methodology for deriving the index. If a DCM's contract is settled

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[585] The Commission received comments from CME, MGEX, and KCBT stating that this rule is overly prescriptive. CME Comment Letter at 25 (Feb. 22, 2011), MGEX Comment Letter at 4-5 (Feb. 22, 2011), KCBT Comment Letter at 4 (Feb. 22, 2011). The Commission considered these comments in preparing this release and discusses the costs and benefits of the codification of rules in lieu of guidance and acceptable practices in further detail in section C(1) above.

[586] See, e.g., "Statement of the Agricultural Advisory Committee," October 29, 2009, available at: http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/aac102909_bruns.pdf.

by reference to the price of a contract or commodity traded in another venue, the DCM must have access to information on the activities of its traders in the reference market.

Summary of Comments and Discussion

CME commented that the Commission is uniquely situated to add regulatory value to the industry by reviewing for potential cross-venue rule violations, noting that the Commission is the central repository for position information delivered to it on a daily basis in a common format across all venues.[587] CME asserted that the Commission would be imposing an onerous burden on DCMs and their customers by requiring the reporting of information that the Commission already receives or will be receiving.[588] CME also stated that the alternative proposal, that the DCM enter into an information-sharing agreement with the other venue, also will result in additional costs to both entities, and that it may not be practical or prudent for a DCM to enter into such an agreement with the other venue.[589] CME noted that its rules already allow it to request such information from market participants on an as-needed basis.[590] Argus stated that the cost of monitoring the "availability and pricing" of the commodity making up a third-party index to which a contract is settled would be prohibitive.[591]

The Commission believes that a DCM must have the ability to determine whether a trader in its market is manipulating the instrument or index to which the DCM contract cash-settles. A DCM must be able to obtain information on its traders' activities in the underlying instrument or index. Nonetheless, the Commission believes the rule need not prescribe the specific methods to accomplish this, for example, by information-sharing

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[587] CME Comment Letter at 25-26 (Feb. 22, 2011).
[588] Id. at 26.
[589] Id.
[590] Id.
[591] Argus Comment Letter at 6-7 (Feb. 22, 2011).

agreements or by placing a reporting burden on traders who carry a position near contract settlement. Accordingly, the description of the methods for obtaining these data on traders' activity in an underlying index or instrument are set forth in the acceptable practices, rather than included in the rule. Also, the specific requirement that DCMs monitor the availability and pricing of the commodity making up the index has been removed from the rule.

Costs

DCMs have, as a part of the contract market designation process, long been required to perform this type of surveillance on cash-settled contracts, and thus are unlikely to incur substantial additional costs on these contracts. DCMs may, however, incur significant additional costs for collecting information on traders' activities in the underlying instrument or index. These costs cannot be quantified because they will vary according to the particular instrument or index. Moreover, no DCM provided the Commission with any quantification of the costs of compliance. In consideration of the comment received from CME, the Commission has attempted to minimize the costs that will be incurred by giving DCMs some flexibility in determining the size of positions and the dates for which position data is collected. This will sharply reduce the costs for DCMs that routinely have few traders that hold substantial positions near contract expirations.

Benefits

In certain markets, the settlement price is linked to prices established in another market. Linked markets are becoming more and more prevalent, and the interconnected nature of these markets may create incentives for traders to disrupt or manipulate prices

in the reference market in order to influence the prices in the linked market. Detecting and preventing this sort of manipulation requires information on traders' activities in the cash-settled contract and in, or related to, the index to which it is settled. This rule ensures that DCMs have the information and tools they need to accomplish their statutory duty to prevent manipulation and disruptions to the cash-settlement process and enhances the confidence of market participants and the public that these contracts are free of manipulation.

§ 38.254 (Ability to obtain information)

Section 38.254 requires DCMs to require that traders in their markets keep records, including records of their activity in the underlying commodity and related derivative markets and contracts. If its market has intermediaries, the DCM must either use a comprehensive large-trader reporting system or obtain position data from other sources in order to conduct an effective surveillance program.

Summary of Comments and Discussion

KCBT contended that it is unnecessary and burdensome for a DCM to require traders to keep such records.[592] Similarly, MGEX discussed the burden that the proposed rule would place on its traders as a result of the proposed record-keeping obligation, and noted that, for contracts not traded on the DCM, it is unclear what records a DCM must tell its traders to keep.[593]

The Commission notes that a trader's burden to keep such records is sound commercial practice, and that a trader of a reportable size is already required, under § 18.05 of the Commission's regulations, to keep records of such trades and to make

[592] KCBT Comment Letter at 5 (Feb. 22, 2011).
[593] MGEX Comment Letter at 5 (Feb. 22, 2011).

them available to the Commission upon request. In addition, the Commission has found trader records to be an invaluable tool in its market surveillance effort, and believes that the DCM, as an SRO, should have direct access to such information in order to fulfill its obligations under the DCM core principles, and in particular, Core Principle 4. The Commission is, however, providing in appendix B an acceptable practice for meeting the requirements of § 38.254(b) that allows the DCM to limit the duration and scope of the trader's obligations. For instance, in the acceptable practices, the Commission permits a DCM to restrict the record-keeping requirement to traders who are reportable to the DCM in its large-trader reporting system or who otherwise hold a substantial position. As an acceptable practice, the reportable level of a trader is at the discretion of the DCM, as long as the reportable level is consistent with an effective oversight program.

Costs

A trader's cost to keep such records should be minimal if, as expected, it is part of their normal business practice. Moreover, the Commission already imposes a similar requirement on large traders under its rule 18.05 (Maintenance of books and records). As a result, a trader's additional cost to provide records to the DCM, and the DCM's cost to request and process the records, will be low if, based upon the Commission's experience, such requests are infrequent and targeted to specific and significant market situations.[594]

Benefits

This rule ensures that DCMs have sufficient information in order to assess the potential for price manipulation, price distortions, and the disruption of the delivery or cash-settlement process as required by Core Principle 4. Detecting and preventing

[594] CME opposed the rule as proposed and recommended that the types of records the DCM should require traders to keep should be covered in acceptable practices. CME Comment Letter at 26 (Feb. 22, 2011).

manipulation requires information on large traders' positions in the relevant contracts and their activities in the underlying markets. Access to this information is vital to an effective surveillance program. Absent this information, the DCM may fail in its statutory duty to prevent manipulation and disruptions to the cash-settlement process.

§ 38.255 (Risk controls for trading)

Section 38.255 requires that DCMs establish and maintain risk control mechanisms to prevent or reduce the potential risk of price distortions and market disruptions, including, but not limited to, market restrictions that automatically pause or halt trading in market conditions prescribed by the DCM.[595] While the rule requires pauses and halts, the acceptable practices enumerate other additional types of risk controls that would also be permitted, giving wide discretion to the DCM to select among the listed controls, to create new ones that are most appropriate for their markets, and to choose the parameters for those selected. If equity products are traded on the DCM, then the acceptable practices for this rule include, to the extent practicable, coordination of such controls with those placed by national security exchanges.[596]

Summary of Comments and Discussion

ICE stated that a temporary price floor or ceiling can work better than a pause or halt since trading can continue uninterrupted, thereby offering the earliest opportunity for price reversal should the market deem a sudden large move to be an overreaction or

[595] The Commission received several comments stating that rule § 38.255 should not be prescriptive. See, e.g., CME Comment Letter at 26-27 (Feb. 22, 2011), KCBT Comment Letter at 5 (Feb. 22, 2011), ICE Comment Letter at 12 (Feb. 22, 2011), CFE Comment Letter at 3-4 (Feb. 22, 2011), NYSE Liffe Comment Letter at 11 (Feb. 22, 2011), ELX Comment Letter at 4 (Feb. 22, 2011), and MGEX Comment Letter at 5-6 (Feb. 22, 2011). The Commission considered these comments in preparing this release and discusses the costs and benefits of the codification of rules in lieu of guidance and acceptable practices in further detail in section C(1) above.

error.[597] ICE also stated that pauses and halts are not the only effective way to prevent market disruption, and that by being prescriptive, the Commission is freezing innovation in preventing market disruptions.[598]

In response to ICE and other commenters that question the necessity of pauses and halts over other forms of risk controls, the Commission notes that pauses and halts to trading have been effective in the past. The ability of DCMs to pause or halt trading in extraordinary circumstances and, importantly, to re-start trading through the appropriate re-opening procedures, will allow DCMs to mitigate the propagation of shocks that are of a systemic nature and to facilitate orderly markets. Furthermore, DCMs must ensure that such pauses and halts are effective for their specific order-routing and trading environment and are adapted to the specific types of products traded.

With respect to ICE's comment regarding innovation, the Commission notes that DCMs are not prohibited from implementing additional risk controls, such as temporary price floors or ceilings as ICE suggests, or any other appropriate risk control, including those not enumerated in the acceptable practices.

Costs

Although pauses and halts are not currently required by Commission regulation, many DCMs already have the types of risk controls that are required by § 38.255, as well as others that have been moved to acceptable practices.[599] There may be certain one-time costs of programming such controls where they are not already present as well as on-going costs to maintain and adjust such controls across time. Some DCMs have pauses

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[597] ICE Comment Letter at 12 (Feb. 22, 2011).
[598] Id.
[599] An FIA working group survey revealed that 66 percent of exchanges surveyed currently offer pre-trade risk controls at the exchange levels and that an additional 27 percent of respondents are planning to add such controls in the future. See http://www.futuresindustry.org/downloads/RC-survey.pdf at 27.

and halts only for stock index futures, while utilizing other risk controls for other contracts. For those DCMs, the costs of adding pause and halt functionality to the other contracts should be minimal since much of that technology would already exist. DCMs that do not currently utilize pauses and halts should be able to implement them with existing software, so that the cost should be relatively modest. As noted in the Pre-Trade Functionality Subcommittee of the CFTC Technology Advisory Committee report, the costs would largely be borne by the exchanges and would center around intellectual property, as many exchanges develop, own, and manage their own technology.[600] However, the exact costs associated with implementing risk controls were not described in verifiable detail in the Pre-Trade Functionality Subcommittee report and can vary greatly from one DCM to another. Additionally, the costs will depend on which specific risk controls will be implemented and the trading platform being used by the DCM. The Commission received no comments indicating that risk controls cannot be implemented in a cost-effective manner using commercially available technology.

As further noted in the Pre-Trade Functionality Subcommittee of the CFTC Technology Advisory Committee report, "[s]ome measure of standardization of pre-trade risk controls at the exchange level is the cheapest, most effective and most robust path to addressing the Commission's concern [for preserving market integrity]."[601] Congress specifically modified DCM Core Principle 4 to substitute the title "prevention

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[600] See "Recommendations on Pre-Trade Practices for Trading Firms, Clearing Firms and Exchanges involved in Direct Market Access," Pre-Trade Functionality Subcommittee of the CFTC Technology Advisory Committee ("TAC Subcommittee Recommendations"), (March 1, 2011) at 4, available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_ptfs2.pdf . The Commission notes that the subcommittee report was submitted to the Technology Advisory Committee and made available for public comment, but no final action has been taken by the full committee.

[601] See TAC Recommendations at 4, available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_ptfs2.pd.

of market disruptions" for the previous title of "monitoring of trading." The new rules on risk controls, which are designed to prevent market disruptions before they occur, bring the rules in line with the amended statute.

Benefits

The Commission anticipates that the benefits of this rule will be substantial. As noted in the DCM NPRM, risk controls such as automated trading pauses and halts can, among other things, allow time for participants to analyze the market impact of new information that may have caused a sudden market move, allow new orders to come into a market that has moved dramatically, and allow traders to assess and secure their capital needs in the face of potential margin calls.[602] Moreover, the Commission notes that pauses and halts are particularly intended to apply in the event of extraordinary price movements that may trigger or propagate systemic disruptions. Accordingly, the Commission notes that a DCM's ability to pause or halt trading in certain circumstances and, importantly, to re-start trading through the appropriate re-opening procedures will allow DCMs to mitigate the propagation of shocks that are of a systemic nature and to facilitate orderly markets. For these reasons, the Commission believes that pauses and halts are the most effective risk management tools to carry out this purpose and will facilitate orderly markets and prevent systemic disruptions. While the Commission is requiring pauses and halts in the rule, the Commission is enumerating other types of automated risk controls that may be implemented by DCMs in the acceptable practices in order to give DCMs greater discretion to select among the enumerated risk controls or to create new risk controls. The Commission believes that this combination of rules and

[602] 75 FR 80572, 80584, Dec. 22, 2010.

acceptable practices will facilitate orderly markets and mitigate systemic disruptions while maintaining a flexible environment that facilitates innovation.

§ 38.256 (Trade reconstruction), § 38.257 (Regulatory service provider), and § 38.258 (Additional sources for compliance)

Section 38.256 requires a DCM to have the ability to comprehensively and accurately reconstruct all trading on its trading facility. The requirement to have the ability to comprehensively and accurately reconstruct trading appears in the statute itself and has long been a part of the DCM requirements under former Core Principle 10. Section 38.257 requires a DCM to comply with the regulations in this subpart through a dedicated regulatory department, or by delegation of that function to a regulatory service provider.

The Commission eliminated proposed rule 38.258 (which required a DCM to adopt and enforce additional rules that are necessary to comply with this core principle), and replaced it with new § 38.258, which allows a DCM to refer to the guidance and acceptable practices in appendix B in order to demonstrate compliance with Core Principle 4.

The Commission received no comments discussing the costs or benefits of §§ 38.256, 35.257, and 38.258 and is adopting § 38.256 with a minor modification, § 35.257 as proposed, and § 38.258 as noted above. In addition, these rules do not contain any significant changes from existing DCM requirements, and thus it is unlikely that additional costs will be incurred.

Section 15(a) Factors (§§ 38.251-38.258)

(1) Protection of market participants and the public. These rules implementing Core Principle 4 reduce the likelihood that markets will be subject to manipulation or other disruptions and ensure that market participants are better able to hedge their risk by requiring that: DCMs properly monitor their markets; market participants keep adequate records; DCMs are able to adequately collect information on market activity, including special considerations for physical-delivery contracts and cash-settled contracts; and reasonable pre-trade risk controls are in place that facilitate orderly markets and prevent systemic disruptions that could harm market participants and the public. Close monitoring of physical-delivery contracts helps prevent the manipulation of prices, and the public benefits from futures prices that reflect actual market conditions because those prices often form the basis for transactions taking place in the physical market.

(2) Efficiency, competitiveness and financial integrity of futures markets. The rules for market monitoring and implementation of risk controls, including pauses and halts, help to facilitate orderly, efficient markets by requiring DCMs to establish and maintain risk control mechanisms that would be able to prevent or reduce the risks associated with a variety of market disruptions. By protecting against disruptions and market manipulation, the rules enhance competitiveness and promote the efficiency and financial integrity of DCM markets. Market mispricing that is due to disruptions or manipulation interferes with a market's efficiency by limiting its ability to reflect the value of the underlying commodity. Markets that are prone to disruption or manipulation have a severe competitive disadvantage to those without such problems. These rules are designed to address and mitigate such problems. Further, the rules are designed to prevent or mitigate extreme volatility or other market disruptions that can lead to

unwarranted margin calls and losses of capital, which could otherwise impair the financial integrity of the market and its participants.

(3) Price discovery. Manipulation or other market disruptions interfere with the discovery of a commodity's value in normal market circumstances. These rules are designed to detect and, where possible, prevent such market mispricing and to detect disconnects between futures and underlying physical market prices. In physical-delivery markets, such disconnects usually relate to market convergence. In cash-settled markets, such disconnects usually relate to the integrity of the index used to settle the futures contract. Under the new rules, DCMs will need to monitor contract terms and resolve conditions that are interfering with the price discovery process.

(4) Sound risk management practices. Sound risk management relies upon execution of hedge strategies at market prices that are free of manipulation or other preventable disruptions. These rules are designed to facilitate hedging at prices free of distortions that may be preventable by adequate controls.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

6. Core Principle 5: Position Limitations or Accountability

Core Principle 5 requires that DCMs, for each contract and as necessary and appropriate, adopt position limitation or position accountability, and that, for any contract that is subject to a position limitation established by the Commission in part 151 of the Commission's regulations,[603] DCMs must set the position limit at a level not higher than the position limitation established by the Commission.

Summary of Comments and Discussion

[603] See "Position Limits for Futures and Swaps," 76 FR 71626, Nov. 18, 2011.

The Commission received several comments pertaining to the Commission's codification of part 151 of its regulations. These comments were appropriately addressed in the relevant rulemaking for Position Limits for Futures and Swaps.[604]

7. Core Principle 6: Emergency Authority

§ 38.351 (Additional sources for compliance and Appendix B)

Rule 38.351 refers applicants and DCMs to appendix B to part 38 – "Guidance on, and Acceptable Practices in, Compliance With Core Principles" for purposes of demonstrating compliance with the requirements of Core Principle 6. The guidance for Core Principle 6 tracks the former guidance to previous Core Principle 6. As such, the costs and benefits of administering emergency procedures pursuant to current Core Principle 6 should be no different than the costs and benefits of administering emergency procedures prior to the Dodd-Frank Act. The Commission did not receive any comments discussing the costs or benefits of these provisions.

8. Core Principle 7: Availability of General Information

§ 38.401 (General Requirements)

Section 38.401(a) requires DCMs to have in place procedures for disclosing to market authorities, market participants, and the public accurate and relevant information pertaining to rules and regulations, contract terms and conditions, and operations. Section 38.401(b) requires that each DCM have procedures in place to ensure that, to the best of its knowledge, any information or communication with the Commission is accurate and complete. Section 38.401(c) requires DCMs to post such information on their websites concurrent with the filing of such information with the Commission.

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[604] Id.

Section 38.401(d) requires DCMs to update their rulebooks upon the effectiveness of a rule submission or certification.

Costs

The few requirements in § 38.401 that do not simply replicate the statutory language were derived from previous guidance and acceptable practices that reflect existing industry practices, and thus should impose no new costs on DCMs or market participants. For example, the accuracy requirement is unlikely to impose additional costs on market participants because the statute already contains an accuracy requirement; the rule simply adds additional context to the requirement. The requirements for a DCM to place information on its web site on the same business day as the filing of such information with the Commission and to post new or amended rules on the date of implementation are unlikely to result in additional costs to DCMs because similar requirements existed in the guidance and acceptable practices under the original Core Principle 7. No DCM commented on the costs imposed by this rule.

Benefits

Market authorities, market participants, and the public all benefit from access to accurate, relevant, and timely information pertaining to contract terms and conditions, new product listings, new or amended governance, trading and product rules, and other changes to information previously disclosed by the DCM. The disclosure of accurate information to the Commission will assist the Commission's oversight of the markets by enabling the Commission to evaluate a DCM's compliance with the core principles and to take prompt action to ensure transparent, fair, and orderly markets.

Prompt posting of information pertaining to new product listings, new rules, and rule amendments on the DCM's website will ensure that market participants and the public have sufficient notice and time to analyze proposed rule amendments, product listings/de-listings, and rule certifications in advance of their taking effect and to be able to plan their actions accordingly. Advance notice of rule amendments and certifications is consistent with the goal of Core Principle 7 to make pertinent information available to market participants and the public.

Section 15(a) factors

(1) Protection of market participants and the public. To protect market participants and the public, the Commission has comprehensive regulatory, surveillance, investigative, and enforcement programs. To support these programs, the Commission must have access to accurate, relevant, and timely information regarding contract terms and conditions, new product listings, new or amended governance, trading and product rules, and other changes to information previously disclosed by the DCM. Additionally, prompt posting of information pertaining to new product listings, new rules, and rule amendments on the DCM's website will ensure that market participants and the public have sufficient notice and time to analyze these changes and report any problems to the Commission in advance of the changes taking effect.

(2) Efficiency, competitiveness and financial integrity of futures markets. In order to promote efficient, competitive, and financially stable markets, the Commission must have access to accurate, relevant, and timely information regarding contract terms and conditions, new product listings, new or amended governance, trading and product rules, and other changes to information previously disclosed by the DCM. The Commission

must have notice of these changes in order to analyze their likely impact on the efficiency, competitiveness, and financial integrity of the futures markets and to take action as necessary.

(3) Price discovery. The disclosure of accurate information to the Commission will assist the Commission's oversight of the markets and protect market participants by enabling the Commission to evaluate a DCM's compliance with the core principles.

(4) Sound risk management practices. The disclosure of accurate information to the Commission will assist the Commission's oversight of the markets and protect market participants by enabling the Commission to evaluate a DCM's compliance with the core principles, including Core Principle 11 (Financial Integrity of Transactions). A detailed discussion of Core Principle 11 in light of the section 15(a) factors appears later in this release.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

9. Core Principle 8: Daily Publication of Trading Information

§ 38.451 (Reporting of trade information)

Core Principle 8 requires that a board of trade make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market. Section 38.451 refers a DCM to part 16 of the Commission's regulations in order to meet the compliance requirements of Core Principle 8. This rulemaking also revises § 16.01 with regards to the information a reporting market must record and publish by adding swaps and options on swaps. Also, §16.01 is revised to add the requirement that reporting markets also report to the

Commission information pertaining to "the total volume of block trades that are included in the total volume of trading."

Summary of Comments and Discussion

CME did not object to reporting block trades that are included in the daily volume of trading, but noted that this new requirement will require it to ascertain what systems changes will be necessary and how long such changes will take to implement.[605] CME did not provide any cost or time estimates.

The Commission believes that it is necessary for DCMs to report trade information; the regulation provides the reporting markets flexibility to make the necessary and appropriate changes to their systems in a cost-effective manner while providing transparency to the markets by means of basic summary trading information of that day's trading session.

Costs

The cost of reporting volume for swaps should be similar to the cost of reporting volume for futures and options. The Commission did not receive any comments that provide otherwise. Further, the Commission does not anticipate that DCMs that choose to list swaps will need to make any changes to systems beyond those needed to report prices and volume for any new contract. The requirement to publish the total volume of block trading at the end of the day will be an added cost for the DCM. This provision may require some changes to DCMs' current systems. However, because DCMs already have or will have to have systems in place to provide daily trading volumes under § 16.01, any costs to now include the reporting of blocks should be minimal. It is not

[605] CME Comment Letter at 29 (Feb. 22, 2011).

feasible to quantify the costs of necessary system changes, largely because it is unclear what system changes will be adopted by DCMs. The Commission did not receive any comments stating that the regulation imposes an unnecessary burden.

Benefits

The Commission allows DCMs significant flexibility in complying with this rule. As such, DCMs are free to design a system that provides the transparency required by part 16 in the most cost effective manner. This rule complies with the statute and provides transparency to the markets by requiring DCMs to publish end of day price and volume summary information to the public and to the Commission.

Section 15(a) Factors

(1) Protection of market participants and the public. The rule complies with Core Principle 8 by ensuring that volume and price information is publicly available on a daily basis. Market participants and the public will be able to make economic decisions based on accurate futures and swaps prices that are reported on a timely basis.

(2) Efficiency, competitiveness, and financial integrity of futures markets. The rule will promote the efficiency and competitiveness of futures markets by ensuring that volume and price data for futures, options, and swaps traded at all DCMs are publicly available. Competitiveness may be enhanced to the extent that market participants are able to compare prices of similar contracts at different DCMs.

(3) Price discovery. The rule promotes price discovery by ensuring that end of day trading data, including volume and prices, are disseminated to the public. An important benefit of price discovery is the availability of prices to market participants and the public who may use this information to inform their economic decisions.

(4) Sound risk management practices. The Commission has not identified any effects that this rule will have on sound risk management practices.

(5) Other public interest considerations. The rule provides post-trade transparency to the markets by requiring DCMs and SEFs to publish end of day trading data including volume and prices to show the activity that occurred during that day's trading session.

10. Core Principle 9: Execution of Transactions

§§ 38.501 – 38.506

The Commission received a number of comments pertaining to the costs and/or benefits of proposed §§ 38.501-38.506. As noted above, the Commission is not finalizing these provisions at this time, and expects and plans to take up the proposed rules under Core Principle 9 when it considers the final SEF rulemaking. Comments pertaining to these proposed rules, including those relative to costs and/or benefits, will be considered in such future rulemaking.

11. Core Principle 10: Trade Information

§ 38.551 (Audit Trail Required), § 38.552 (Elements of an Acceptable Audit Trail Program), and § 38.553 (Enforcement of Audit Trail Requirements)

Section 38.551 establishes the requirements of an acceptable audit trail program to help ensure that DCMs can monitor and investigate any customer or market abuses. Section 38.552 sets forth the four program areas that a DCM must address as part of an acceptable audit trail program, including original source documents, transaction history database, electronic analysis capability, and safe storage of all audit trail data. Section 38.553(a) establishes the elements of an effective audit trail enforcement program. Additionally, § 38.553(b) requires that an effective audit trail enforcement

program must enable the DCM to identify entities that are routinely non-compliant with the regulations under Core Principle 10 and to levy meaningful sanctions when such deficiencies are identified. The regulation prohibits DCMs from issuing more than one warning letter for the same violation within a rolling 12-month time period.

Summary of Comments

CME and MGEX argued that the requirement for enforcement of an audit trail program to annually audit all market participants would essentially require the exchange to review every participant who enters an order into the trading system, which would be onerous, costly, and unproductive.[606] MGEX suggested that DCMs should only be required to review a sample of market participants.[607]

Discussion

In response to comments that requiring exchanges to conduct annual audits of all members and market participants would be onerous and costly, the Commission is revising proposed § 38.553 to apply only to "members and persons and firms subject to designated contract market recordkeeping rules." With this change, the Commission limits the universe of entities that a DCM must audit for compliance with Core Principle 10. This revision addresses commenters' concerns by making the annual audit requirement less burdensome.

Additionally, this revision also responds to MGEX's comments that the Commission should allow DCMs to test for audit trail compliance by auditing only a sample of market participants. While the number of persons and entities subject to audit has been reduced in the final rule, the remaining population must still be audited annually

[606] CME Comment Letter at 33-34 (Feb. 22, 2011), MGEX Comment Letter at 7 (Feb. 22, 2011).
[607] MGEX Comment Letter at 7 (Feb. 22, 2011).

to ensure compliance. As explained above, this revision will decrease the burden on DCMs.

The Commission believes it is essential for DCMs to have complete and accurate access to trade information to facilitate trade reconstructions and thereby detect customer and market abuses. The Commission believes it is essential for DCMs to have complete and accurate access to trade information to facilitate trade reconstructions and thereby detect customer and market abuses. The Commission has determined that the audit trail requirements and the annual audits of members and entities subject to Commission or DCM recordkeeping rules are the best way to achieve its policy objectives, while providing DCMs with flexibility to achieve these objectives. The Commission has considered the comments raised related to the cost of ensuring that customer and market abuses can be detected, prosecuted, and ultimately discouraged, and believes that the benefits of the rule as finalized are substantial.

Costs

The costs associated with Core Principle 10 include the cost of developing and maintaining an electronic history transaction database to maintain a history of all orders and transactions entered into the trading system and electronic analysis capability to permit the exchange to reconstruct orders and trades. DCMs will also bear the cost of developing and implementing a program to collect and maintain original source documents for trades entered both manually and electronically into the trading system. Core Principle 10 compliance also imposes costs for developing and maintaining a safe storage system for all the trade data collected and ensuring that such data is readily accessible to exchange compliance staff. The Commission notes, however, that almost

all exchanges currently operating are in compliance with these regulations. Therefore, existing DCMs should have already established these programs and, as such, should have already borne the costs necessary to comply with these requirements.

These requirements were previously explained in the guidance and acceptable practices for Core Principle 10 – Trade Information. The Commission's RERs have frequently highlighted compliance with the guidance and acceptable practices in the discussion of an exchange's audit trail program. Specifically, past RERs have discussed exchanges' practices regarding use of an electronic history transaction database, electronic analysis capability, and safe storage systems. As such, the Commission is simply codifying these existing practices and regulations as rules.

DCMs will incur costs to ensure they employ appropriate resources to enforce Core Principle 10's requirements, including the ability to conduct annual compliance audits by hiring sufficient staff to review the information and having in place adequate technology to retrieve and store the information. It is not feasible to quantify the costs for appropriate resources for audit trail and Core Principle 10 enforcement because the factors necessary to determine what resources are "appropriate" vary widely from exchange to exchange, and the costs for each variable depend upon the particular circumstances of each exchange. For example, the number of participants who trade on a particular exchange varies widely and the number of participants who are members and persons and firms subject to Commission or DCM recordkeeping rules directly corresponds to the number of annual compliance audits a particular DCM will conduct to determine compliance with all audit trail requirements.

While the Commission is imposing new requirements that specify certain components that must be incorporated in audit trail reviews, the Commission notes that most exchanges already have such resources in place and conduct audit trail reviews in such a manner to comply with these new regulations due to the RER process and recent recommendations. What constitutes "appropriate resources" to oversee and enforce the audit trail requirements is addressed on an individualized basis in the specific RERs for each exchange. Importantly, no DCM provided the Commission with information related to the current cost of compliance and the estimated increase related to codification of existing practices.

Benefits

Core Principle 10 and the associated regulations promote the reliability, completeness, accuracy, and security of exchange order and trade data. The ability of DCMs to recover, review, and reconstruct trading transactions is imperative to monitor for potential customer and market abuses. The requirements of Core Principle 10 ensure the ability of DCMs to prosecute rule violations supported by evidence from audit trail data and order and trade information. This furthers the protection of market participants by requiring exchanges to have the ability to adequately conduct market surveillance and prosecute rule violations.

The requirement that exchanges issue no more than one warning letter for the same violation within a rolling twelve-month time period will ensure that instead of simply sending multiple warning letters, exchanges levy meaningful fines and sanctions to deter recidivist behavior and prevent future rule violations.

Section 15(a) Factors (§§ 38.551-38.553)

(1) Protection of market participants and the public. Sections 38.551-38.553 benefit the protection of market participants and the public by requiring that DCMs maintain all order and trade information so that rule violations that could harm market participants and the public may be detected, reconstructed, investigated, and prosecuted. A DCM cannot complete its surveillance and enforcement practices without such audit trail data collection and requirements. The absence of these regulations would result in an increased potential for violations to go undetected. Such requirements strengthen DCMs' market oversight capabilities and result in stronger protection of market participants and the general public from rule violations and market abuses.

(2) Efficiency, competitiveness, and financial integrity of futures markets. The regulations under Core Principle 10 implemented in §§ 38.551-38.553 promote efficiency and competitiveness by ensuring that DCMs can adequately monitor their markets for rule violations and effectively prosecute and deter such rule violations. These regulations strengthen market confidence by deterring such rule violations, thereby promoting efficient pricing and a competitive trading atmosphere.

(3) Price discovery. Sections 38.551-38.553 benefit the price discovery process of markets by allowing DCMs to detect and prosecute rule violations that impede market prices from accurately reflecting information pertaining to underlying fundamentals. Having a process by which to detect, reconstruct, investigate, and prosecute rule violations deters market participants from engaging in activities which harm the market's price discovery process.

(4) Sound risk management practices. The Commission has not identified any effects that this rule will have on sound risk management practices.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

12. Core Principle 11: Financial Integrity of Transactions

§§ 38.601 – 38.606

Section 38.601 provides that all transactions executed on or through a DCM, other than transactions in security futures products, must be cleared through a Commission-registered DCO. Section 38.602 provides that DCMs must adopt rules establishing minimum financial standards for both member FCMs and IBs and non-intermediated market participants. Section 38.603 provides that DCMs must adopt rules for the protection of customer funds.

Section 38.604 requires that a DCM must routinely receive and promptly review financial and related information from its members, and conduct ongoing financial surveillance of the risk created by the positions taken by an FCM's customers. Section 38.605 requires DCMs, as self-regulatory organizations, to comply with the standards of amended § 1.52 to ensure the financial integrity of intermediaries by establishing and carrying out an SRO program for the examination and financial supervision of intermediaries. Section 38.606 provides that DCMs may satisfy their financial surveillance responsibilities under §§ 38.604 and 38.605 by outsourcing such responsibilities to a regulatory service provider if certain requirements are met.

Summary of Comments and Discussion

KCBT commented that because its rules incorporate by reference the requirements of the CEA, the requirement to implement exchange rules that mirror Commission regulations is duplicative, unnecessary and burdensome.[608]

The Commission believes the establishment of independent financial integrity rules is important because it will provide evidence that: (i) each DCM has focused attention on the specific regulations promulgated under the CEA; and (ii) such regulations are appropriately implemented. Section 38.603 does not specify the exact rules to be implemented by each DCM, but sets forth the substance of what the rules of each DCM must address; therefore, a DCM would be unable to meet the requirements of the rule by incorporating the CEA requirements by reference.

Costs

Section 38.601 imposes no new costs on DCMs, as all transactions on a DCM are currently subject to mandatory clearing; this was required by the former core principle, before it was amended by the Dodd-Frank Act.

Section 38.602 imposes no new costs as all DCMs are currently required to have rules establishing minimum financial standards for member FCMs and IBs pursuant to Core Principle 11. The Commission will continue to review the financial standards that each DCM has established to be certain that the DCM is in compliance with the rule. The requirements of § 38.603 relating to the protection of customer funds are all existing requirements pursuant to former Designation Criterion 5(b) and have been found to be effective in monitoring and mitigating financial risk. By incorporating the substantive standards from former designation criteria that have already been implemented by registered DCMs, the Commission aims to minimize implementation costs. However, the

[608] KCBT Comment Letter at 7 (Feb. 22, 2011).

explicit requirement that DCMs adopt rules, as opposed to solely incorporating the requirements of the CEA by reference, will involve administrative costs on the part of DCMs, such as enacting the appropriate rules and building the understanding within its staff of those rules.

The requirements of § 38.604 also reflect requirements pursuant to former Designation Criterion 5(a). However, the rule does build on the foundation of historical compliance by DCMs by explicitly requiring intraday financial surveillance. The Commission believes that intraday surveillance is necessary to account for possible intraday risk build-up and to meet the requirements of the financial integrity core principle. Because DCOs currently conduct intraday monitoring, DCMs should already meet this requirement through the DCO(s) that provides their clearing services. As the Commission notes in the preamble, an arrangement between a DCO and a DCM, whereby the DCO is responsible to a DCM for the performance of certain functions, including this monitoring, will continue to be permitted by the Commission. Therefore, intraday financial surveillance should not impose new costs on DCMs.

DCMs will not need to expend significant additional resources to comply with § 38.605 as all DCMs have existing SRO programs in place and currently are in compliance with section 1.52, as well as the guidance that has now been incorporated into section 1.52 from Division of Trading and Markets Financial and Segregation Interpretations 4-1 and 4-2. Further, the JAC Agreement, as discussed above, is already in place and operating effectively.

Section 38.606 provides DCMs with the option of outsourcing their financial surveillance responsibilities if they would prefer not to do such surveillance in house.

Although §§ 38.604 and 38.605 impose the actual surveillance requirements, those DCMs electing to outsource such surveillance responsibilities will incur costs related to conducting due diligence of the regulatory service provider and making sure the DCM has adequate staff to monitor the provider. The Commission is unable to quantify such costs because the rule does not require a certain method of due diligence, and therefore the costs would vary based on the practices and choices of each DCM.

Benefits

Section 38.601 is a codification of the statutory requirement in Core Principle 11. Section 38.602 requires a DCM to establish and maintain minimum financial standards for market participants, which is essential to mitigating systemic risk. Implementing the requirements of the core principle, which requires that each DCM has rules to ensure the financial integrity of FCMs and IBs, achieves the Commission's regulatory objectives by ensuring the financial integrity of the transactions entered into by or through the facilities of the contract market, while also providing flexibility as to how to meet the requirements of the core principle.

Rule 38.603 implements the requirement of the core principle that DCMs establish and enforce rules to ensure the protection of customer funds. DCMs, as SROs, are well-positioned to undertake the responsibility of establishing such rules and ensuring the compliance of intermediaries with those rules. As a result, the requirements of § 38.603 enhance the protection of customers (who are both market participants and members of the public) from the losses incurred by fellow customers. This directly enhances the protection of market participants and the public, and promotes sound risk management. Moreover, by mitigating the loss of customer funds, which loss in turn

would damage all customers' confidence in the safety of the funds they post as collateral for cleared positions, these requirements mitigate systemic risk.

The intraday surveillance requirement in § 38.604 requires that a DCM continually survey each FCM's obligations created by its customers. Satisfaction of this requirement is necessary for a DCM to meet the requirements of the core principle to have rules ensuring the financial integrity of market participants, as well as the protection of customer funds. By conducting intraday surveillance and acting on the results of the surveillance, DCMs will be able to address intraday risks before they grow larger and therefore avoid losses to DCOs carrying FCMs or customers.

For section 38.605, existing benefits include avoiding duplicative review of members, as well as ensuring the financial integrity of FCMs and IBs, protecting customer funds and contributing to market confidence. In addition, because § 38.606 provides a DCM with options, it is more efficient and cost-effective as DCMs can choose whether to allocate their own resources to this surveillance or to use a regulatory service provider.

Section 15(a) Factors (§§ 38.601 – 38.606)

(1) Protection of market participants and the public. The rules protect market participants and the public by ensuring the financial integrity of DCM transactions via clearing of all transactions on a DCM, financial surveillance of members and minimum standards for members. The protection of customer funds rules protect customers from the losses incurred by either other market participants or fellow customers, thereby strengthening the financial integrity of the markets and decreasing potential systemic risks.

(2) Efficiency, competitiveness and financial integrity of futures markets. Since most of these rules codify pre-existing requirements, DCMs are already in compliance. As a result, the rules do not require significant changes (i.e., costs), and therefore have minimal effect on the competitiveness of futures markets. The addition of rules requiring intraday financial surveillance will benefit the financial integrity of the markets by requiring DCMs to have procedures that will foster DCMs addressing intraday risks before they grow larger, thereby avoiding losses to DCOs carrying FCMs or customers.

(3) Price discovery. The Commission has not identified any effects that this rule will have on price discovery.

(4) Sound risk management practices. The rules requiring the establishment of minimum financial standards for DCM market participants promote sound risk management practices by ensuring that market participants have a certain level of sophistication and resources, which in turn, mitigates systemic risk.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

§ 38.607 (Direct Access)

Section 38.607 requires a DCM that allows customers direct access to its contract market to implement certain direct access controls and procedures (such as automated pre-trade controls) in order to provide member FCMs with tools to manage their financial risk.

Costs

As discussed in the preamble, a recent Futures Industry Association ("FIA") report stated that the majority of exchanges have policies and tools in place that comply

with the recommendation that mandatory pre-trade controls be set at the exchange level.[609] As a result, these requirements will not impose significant costs on a majority of DCMs. Those DCMs that do not have controls and procedures in place, but do allow customers direct access to the contract market, will incur costs in implementing these controls and procedures, and FCMs will incur costs in utilizing the controls and procedures. The Commission is unable to quantify such costs because the rule does not require a certain set of controls and procedures, and therefore the costs would vary based on the controls adopted by the individual DCM. In addition, such costs would also vary depending on the DCM's existing infrastructure, which varies markedly across exchanges. Moreover, commenters did not discuss the costs of this provision.

Benefits

The requirements of this rule will enable an FCM to protect itself when a customer has direct access to a DCM and completes a trade before an FCM's systems have an opportunity to prevent the execution of such trade, thereby avoiding losses that could extend to customers or the DCO from trades that would exceed the parameters set by the FCM on the DCM. Further, as discussed in the preamble, the benefits of risk controls at the FCM, DCO and DCM level, discussed above, have been recognized both domestically and internationally.

Section 15(a) Factors

(1) Protection of market participants and the public. The final rule promotes the protection of market participants and the public because it enables an FCM to protect

[609] See FIA report on "Market Access Risk Management Recommendations" (April 2010), available at: http://www.futuresindustry.org/downloads/Market_Access-6.pdf.

itself from its customers with direct access to the DCM, thereby preventing customers from undertaking risks that could bankrupt an FCM.

(2) Efficiency, competitiveness and financial integrity of futures markets. Automated controls will permit an FCM to enforce limitations on its customers' trading via direct access, which will serve to protect all market participants, which will also promote the efficient, competitive, and financial integrity of futures markets.

(3) Price discovery. The Commission has not identified any effects that this rule will have on price discovery.

(4) Sound risk management practices. Without the aid of controls at the DCM-level, an FCM will be unable to protect itself from its customers with direct access to the DCM. Therefore, the final rule serves sound risk management practices by enabling FCMs to manage risk.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

13. Core Principle 12: Protection of Markets and Market Participants

Section 38.651 provides that a DCM must have and enforce rules that are designed to promote fair and equitable trading and to protect the market and market participants from abusive practices including fraudulent, noncompetitive or unfair actions, committed by any party.

Costs and Benefits

Section § 38.651 specifies DCMs' obligations under Core Principle 12 relating to their compliance with Core Principles 2, 4 and 9, and the associated regulations.

Accordingly, § 38.651 does not impose any additional costs beyond those discussed under each of the respective Core Principles 2, 4 and 9.

14. Core Principle 13: Disciplinary Procedures

Core Principle 13 consists of a series of rules that, among other things, seek to ensure a fair, prompt, and effective disciplinary program.[610] A more detailed description of the Core Principle 13 rules themselves is contained in the preamble.

§ 38.701 (Enforcement Staff)

Rule 38.701 requires that a DCM must establish and maintain sufficient enforcement staff and resources to effectively and promptly prosecute possible rule violations.

Costs

The obligations imposed by § 38.701 are not new; rather, the requirements for DCMs to ensure adequate staff and resources stem from recent RERs, in which Commission staff recommended that DCMs increase their compliance staff levels and monitor the size of their staff and increase the number of staff as appropriate.[611] Accordingly, the Commission does not anticipate that this provision will impose additional costs on DCMs.

Benefits

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[610] CME and MGEX stated that a number of the rules implementing Core Principle 13 are overly prescriptive. See CME Comment Letter at 35-36 (Feb. 22, 2011) and MGEX Comment Letter at 9 (Feb. 22, 2011). The Commission considered these comments in preparing this release and discusses the costs and benefits of the codification of rules in lieu of guidance and acceptable practices in further detail in section C(1) above.

[611] See Rule Enforcement Review of the Minneapolis Grain Exchange (Aug. 27, 2009), Rule Enforcement Review of ICE Futures U.S. (Feb. 2, 2010), and Rule Enforcement Review of the Chicago Board of Trade and the Chicago Mercantile Exchange (Sept. 13, 2010) for findings and recommendations pertaining to the adequate staff size of DCM compliance departments.

The Commission believes that adequate enforcement staff and resources are essential to the effective performance of a DCM's disciplinary program. Without an effective disciplinary program, a DCM will be unable to effectively and promptly investigate and adjudicate potential rule violations and deter future violations. Rule 38.701 ensures that DCMs monitor the size of their staff and increase the number of staff appropriately as trading volume increases, new responsibilities are assigned to compliance staff, or internal reviews demonstrate that work is not completed in an effective or timely manner. Rule 38.701 also ensures the independence of enforcement staff and promotes disciplinary procedures that are free of potential conflicts of interest by providing that a DCM's enforcement staff may not include members of the exchange or persons whose interests conflict with their enforcement duties.

§ 38.702 (Disciplinary Panels)

Rule 38.702 requires DCMs to have one or more "review panels, without imposing a specific requirement for DCMs to maintain a "review panel" and a "hearing panel."

Costs

The requirement in the rule to establish disciplinary panels reflects industry practices that have already been adopted by most DCMs. Accordingly, the Commission anticipates that § 38.702 will not impose additional cost burdens on most DCMs. To the extent that the rule does impose costs on DCMs, the Commission notes that since disciplinary panel members are typically unpaid, any potential costs associated with § 38.702 would be limited to administrative costs associated with establishing the disciplinary panel, which are likely to vary by DCM. Finally, as described above, in

response to concerns raised by commenters, the Commission has removed the proposed requirement to maintain distinct hearing panels and review panels, thereby reducing the burden associated with the proposed rule.

Benefits

Rule 38.702 requires DCMs to establish one or more disciplinary panels authorized to fulfill their obligations under the part 38 rules, including, among other things, to issue notices of charges, conduct hearings, render written decisions, and impose disciplinary sanctions. These functions are critical components of a DCM's disciplinary program and will deter violations of DCM rules, prevent recidivist behavior, protect respondents by requiring procedural safeguards to ensure fairness for all respondents in disciplinary actions, and protect customers by requiring full customer restitution in any disciplinary matter where customer harm is demonstrated.

In addition to providing these numerous benefits, § 38.702 permits flexibility in the structure of DCMs' disciplinary bodies but protects against conflicts of interest by ensuring that the same individual is not invested with the authority to both issue and adjudicate charges in the same manner.

§ 38.703-38.711 and Guidance

Rules 38.703-38.711, and the accompanying guidance, seek to ensure a fair, prompt, and effective disciplinary program by, among other things, requiring a notice of charges and providing respondents with a right to representation, a reasonable period of time to file an answer to charges, and the right to a fair hearing. The rules also outline procedures for rendering disciplinary decisions and issuing disciplinary sanctions and warning letters. In response to comments requesting greater flexibility, the Commission

is also converting several proposed rules into guidance in order to reduce potential incremental costs resulting from the final rules. This guidance will cover notices of charges, the admission or failure to deny charges, settlement offers, hearings, rights to appeal, summary fines, and emergency disciplinary sanctions.

Summary of Comments and Discussion

The Commission did not receive any specific comments discussing costs or benefits of proposed §§ 38.703 – 38.716. However, several commenters made general requests for greater flexibility across all core principles. Accordingly, the Commission has modified certain aspects of the proposed rules under Core Principle 13 where it believes that flexibility can reasonably be afforded. To that end, the Commission is converting the following proposed rules, in their entirety, to guidance: proposed § 38.707 (Admission or failure to deny charges); proposed § 38.709 (Settlement offers); proposed § 38.712 (Right to appeal); and proposed § 38.716 (Emergency disciplinary actions). In addition, the Commission is moving the following specific requirements to guidance: the requirements under paragraphs (a) and (b) of proposed § 38.704, which allowed, but did not require, a DCM to issue rules regarding failures to request a hearing and expressly answer or deny a charge; the provision under paragraph (b) of proposed § 38.710, which provided that the DCM's rules may provide that a sanction may be summarily imposed upon any person whose actions impede the progress of a hearing; and the provisions under proposed § 38.715 that permitted, but did not require, a DCM to adopt a summary fine schedule.

The Commission is also removing the following proposed provisions from the final rules: paragraphs (a) and (b) under proposed § 38.703 regarding the review of

investigation reports when additional evidence is needed or no reasonable basis exists for finding a violation; the section of proposed § 38.708 which was optional, allowing a DCM's rule to provide that, except for good cause, a hearing must be concerned only with those charges denied or sanctions set by the panel for which a hearing has been requested; and the optional rule under proposed § 38.710(a)(7) which, in certain cases, allowed for the cost of transcribing the record of the hearing to be borne by the respondent.

Costs (§ 38.703-38.712 and Guidance)

While § 38.701 and § 38.702 impose specific requirements on DCMs to have sufficient enforcement staff and resources and to establish disciplinary panels, the remainder of the Core Principle 13 regulations simply outline the policies and procedures that a DCM's disciplinary program must follow. The Commission notes that these Core Principle 13 regulations merely reflect disciplinary concepts formerly found in Designation Criterion 6, part 8 of the Commission's regulations,[612] and the guidance and acceptable practices for former Core Principle 2. Accordingly, existing exchanges generally have already established disciplinary programs and, as such, have already expended the fees and costs necessary to comply with the requirements under §§ 38.703–38.712.

As discussed in the preamble, many of the new requirements applicable to DCMs with respect to their disciplinary procedures were derived from findings and recommendations made by Commission staff through RERs.[613] These recommendations represent what the Commission staff believes are best practices and are typically adopted

[612] Exchange Procedures for Disciplinary, Summary, and Membership Denial Actions.
[613] For example, the requirements in regulation 38.708 (Decisions) and regulation 38.710 (Disciplinary Sanctions) are based on findings and recommendations in recent RERs.

by DCMs as the standard form of compliance. Therefore, while the codification of certain disciplinary requirements may be new, Commission staff has already expressed these expectations to the industry through RERs.

The exact incremental costs incurred by DCMs to comply with the specific requirements of final rules under Core Principle 13 cannot be ascertained since they will vary depending on the DCM's current disciplinary program. To ensure the effectiveness of their disciplinary programs and provide procedural safeguards to potential respondents, most DCMs already have disciplinary rules and procedures that are similar to those required by the rules, even though they were not previously required to do so by Commission regulation. Therefore, as a practical matter, the rules may likely require DCMs to amend existing disciplinary rules and procedures rather than creating them anew. Accordingly, costs would likely be limited to the resources allocated to amending existing rules and procedures to ensure compliance with the final rules.

As described above, in response to commenters' request for greater flexibility, the Commission has sought to reduce any incremental costs imposed by the final rules by modifying certain rules where it believes that flexibility can reasonably be afforded and the overall burden on DCMs can be reduced. As described above, the Commission is moving numerous proposed regulations from rules to guidance, as well as removing certain provisions in their entirety. Finally, the Commission expects the following additional modifications to the proposed rules to also reduce the costs imposed by the rules on market participants: (1) The rules regarding a respondent's answer to a notice of charges, outlined in paragraphs (a), (b), and (c) of proposed § 38.706, are being replaced with a requirement that any rules adopted pursuant to this rule be "fair, equitable, and

publically available;" (2) Proposed § 38.714 is being modified so that it does not require customer restitution if the amount of restitution, or the recipient, cannot be reasonably determined.

Benefits

The regulations under Core Principle 13 protect market participants and the public by ensuring that exchanges will discipline, suspend or terminate the activities of members or market participants found to have committed rule violations. To that end, the rules will ensure that DCMs maintain fair, prompt, and effective disciplinary programs. The rules will deter violations of DCM rules by requiring disciplinary sanctions sufficient to deter recidivism under§ 38.710 and by restricting repeat warning letters in § 38.711. The rules protect respondents by requiring procedural safeguards to ensure fairness for respondents. These include an adequate notice of charges under § 38.703, the right to representation in § 38.704, a reasonable period of time to file an answer to charges under § 38.705, right to a hearing under § 38.707, and a prompt written decision under § 38.708, among others. Finally, the rules protect customers by requiring restitution where customer harm is demonstrated in § 38.710.

The guidance provisions regarding settlement offers and § 38.708 (Decisions) were based on the Commission's recommendation that DCM disciplinary committees improve the documentation of their disciplinary decisions. As discussed in the DCM NPRM, the Commission believes that improved written documentation yields the following benefits: (1) Disciplinary panels will be required to focus their analysis more carefully in order to articulate the rationale for their decisions; (2) DCM enforcement staff will gain a better understanding of the evidentiary expectations to which different

disciplinary panels adhere; (3) DCM enforcement staff and respondents will both have an improved record to base any appeals they may wish to file; and (4) Improved review of the DCMs' disciplinary program by the Commission.

Section § 38.710 (Disciplinary Sanctions), which provides that all disciplinary penalties imposed by a DCM or its disciplinary panels must be commensurate with the violations committed, and be sufficient to deter recidivist activity, and § 38.711 (Warning Letters), which prohibits a DCM from issuing more than one warning letter in a rolling 12 month period, are also examples of recommendations made by the Commission in RERs. As discussed in the DCM NPRM, these reflected DMO staff's concern regarding the adequacy of sanctions.

Section 15(a) factors (§ 38.701-38.712 and Guidance)

(1) Protection of market participants and the public. The regulations and guidance under Core Principle 13 benefit the protection of market participants and the public by ensuring that exchanges maintain sufficient enforcement staff and resources through § 38.701 and will discipline, suspend or terminate the activities of members or market participants found to have committed rule violations. The regulations require that DCMs maintain fair, prompt, and effective disciplinary programs to ensure fairness for all respondents in disciplinary actions. Additionally, by requiring that DCMs levy meaningful sanctions against persons and entities that violate DCM rules under §§ 38.710 and 38.711, the regulations seek to promote the effectiveness of disciplinary sanctions and deter recidivist behavior. Finally, to compensate customers who suffer harm, the rules require full customer restitution in any disciplinary matter where customer harm was demonstrated

and where the amount of restitution and the recipient can be reasonably determined under § 38.710.

(2) Efficiency, competitiveness and financial integrity of futures markets. The regulations under Core Principle 13 promote the financial integrity of the futures markets by ensuring that individuals and entities that violate the rules of a DCM are appropriately sanctioned, such sanctions are effective and discourage recidivist activity, and customers who are harmed received full restitution under §§ 38.710 and 38.711.

(3) Price discovery. The Commission has not identified any effects that these rules will have on price discovery other than those identified above.

(4) Sound risk management practices. The Commission has not identified any effects that these rules will have on sound risk management practices, other than those identified above.

(5) Other public interest considerations. The regulations under Core Principle 13 promote public interest considerations, such as market integrity and customer protection, by establishing an enforcement program through which DCMs can effectively prosecute members and market participants who engage in abusive trading practices or violate other DCM rules.

15. Core Principle 14: Dispute Resolution

The new guidance for Core Principle 14 is essentially identical to the prior guidance to former Core Principle 13. No comments were provided related to the costs of Core Principle 14. Therefore, the costs and benefits should be no different than the costs and benefits of administering a dispute resolution program under former Core Principle 13 prior to enactment of the Dodd Frank Act.

16. Core Principle 18: Recordkeeping

§ 38.951 (Additional sources for compliance)

Section 38.951 requires DCMs to maintain records, including trade records and investigatory and disciplinary files, in accordance with Commission regulations, § 1.31, and in accordance with part 45 of the Commission's regulations with respect to swap transactions.

Costs

The Commission did not receive any comments related to the costs of this core principle. Although § 38.951 incorporates by reference the requirements of existing § 1.31 and part 45, it does not impose any additional burden or costs to which DCMs are not already subject under current regulations. Regulation 38.951 merely references recordkeeping obligations to which DCMs have always been subject under § 1.31 and to which DCMs are required to comply with respect to swap transactions under part 45. Accordingly, DCMs will not bear any new costs solely due to § 38.951.

Benefits

Section § 38.951 enables the Commission to obtain the books and records of DCMs, which is essential to carrying out the Commission's regulatory functions, including trade practice and market surveillance, regulatory examinations, and enforcement examinations. Furthermore, such books and records assist the Commission in prosecuting violations of the CEA and Commission regulations.

17. Core Principle 19: Antitrust Considerations

The guidance for Core Principle 19 is nearly identical to the guidance for former Core Principle 18 and therefore the costs and benefits of requiring DCMs to operate

according to accepted antitrust law should be no different than the costs and benefits associated with the pre-existing guidance, prior to the enactment of the Dodd Frank Act.

18. Core Principle 20: System Safeguards

§ 38.1051 (General requirements)

Section 38.1051 establishes system safeguards requirements for all DCMs, pursuant to new Core Principle 20 added under the Dodd-Frank Act. The rules under § 38.1051(a) and (b) require a DCM's program of risk analysis and oversight to address six categories of risk analysis and oversight and to follow generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of automated systems. Section 38.1051(c) specifically requires each DCM to maintain a business continuity-disaster recovery ("BC-DR") plan and BC-DR resources sufficient to enable resumption of trading and of all of the responsibilities and obligations of the DCM during the next business day following any disruption of its operations. Section 38.1051(d) specifies the requirement to be able to resume trading and clearing during the next business day following a disruption for DCMs that are not determined to be a critical financial market. The rules also require each DCM to notify Commission staff of various system security-related events under § 38.1051(e) and (f), to provide relevant documents to the Commission in § 38.1051(g), and to conduct regular, periodic, objective testing and review of automated systems under § 38.1051(h). Finally, the rules under § 38.1051(i) require each DCM to coordinate its BC-DR plan with its members and market participants .

Summary of Comments

CME stated that the requirement for notice of all systems malfunctions is overly broad and would require onerous reporting of mundane and trivial incidents, and that the Commission should limit required reporting only to material system failures.[614] CME also stated that the requirement that DCMs provide the Commission with timely advance notice of all planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems is an "extremely onerous burden for DCMs" and that the requirement adds "significant costs that are not at all commensurate with any value created."[615] CME claimed that any change to a system could conceivably impact the operation of the system, and that it would be inefficient and unproductive to report every planned change to their automated systems.[616] Finally, CME stated that the requirement that DCMs provide timely advance notice of all planned changes to the DCM's program of risk analysis and oversight is overly broad and is neither necessary nor productive.[617]

Discussion

In response to CME's concerns that the rule would require reporting of insignificant system events, the Commission is adopting final rules that require reporting only of significant system malfunctions and advance notification only of material system changes.

Costs

§ 38.1051(a) and (b)

[614] CME Comment Letter at 36-37 (Feb. 22, 2011).
[615] Id.
[616] Id.
[617] Id.

The Commission believes that DCMs generally will not incur significant additional costs to achieve compliance with the requirements described in § 38.1051(a) and (b) because from the time Core Principle 20 went into effect, all DCMs would need to have a program addressing all six categories of risk analysis and oversight. Former Core Principle 9 and Designation Criteria 4 provided for essentially the same requirements which reflect activities that would normally be conducted by the DCM in the course of following industry standards, guidelines, and best practices for the management and operation of automated systems. Additionally, the requirement to maintain a program of risk analysis and oversight appears in Core Principle 20 itself and was not the product of Commission discretion.

§ 38.1051(c)

The Commission believes that DCMs generally will not incur significant additional costs to achieve compliance with the requirements described in § 38.1051(c). The requirement to maintain a business continuity-disaster recovery plan, business continuity disaster recovery resources, emergency procedures, and backup facilities appears in the core principle itself and was not the product of Commission discretion. Additionally, the requirements in § 38.1051(c) reflect industry best practices; an exchange without the ability to resume operations shortly after a disastrous event, which by definition implies that they will not in that timeframe be able to operate out of their production environment, cannot expect to retain its customer base. In the event that an existing DCM is determined by the Commission to be a "critical financial market," substantial additional initial and ongoing costs could be incurred due to the more stringent requirements in this regard, set forth in § 40.9. The Commission expects to

notify a DCM of its consideration of the DCM's status as a critical financial market sufficiently in advance of any formal designation as such; further, the Commission believes that any DCM subject to this designation would be generating sufficient volume to reasonably support additional costs incurred.

§ 38.1051(d)

The Commission does not believe that any additional material costs will be incurred by DCMs in complying with the requirements listed in § 38.1051(d), as DCMs covered by this provision are already in compliance with its requirements.

§ 38.1051(e)

The Commission does not believe that any material costs will be incurred by DCMs in complying with the notification requirements listed in § 38.1051(e). Given the general operating stability of the automated systems at existing DCMs, notification to Commission staff, either via e-mail or telephone, would be fairly infrequent and could easily be combined with notifications distributed to market participants. Several DCMs have automated notification systems; adding an e-mail address to these systems would not impose additional costs on DCMs. Minimal additional cost due to DCM staff time could be incurred in follow-up activities, including completing a systems outage notification template developed by Commission staff. However, this template closely follows standard technical post-mortem reporting procedures, and is not expected to require more than one hour to complete, at a cost of about $52. Additionally, the Commission notes that it is reducing the burden of this provision by revising the proposed rule to provide that DCMs must only promptly advise the Commission of all significant system malfunctions, rather than all system malfunctions.

§ 39.1051(f)

The Commission does not believe that any significant material costs will be incurred by existing DCMs or applicants in complying with the notification requirements listed in § 38.1051(f). Commission staff has developed notification templates for the notice requirements contained in both (f)(1) and (2); these templates have been designed to minimize additional work for DCM staff. As the templates largely follow guidelines for best practices in automated systems management and capacity planning, Commission staff believes that each notification will require no more than two hours of DCM staff time (at a cost of about $104). Commission notification of planned changes to a DCM's program of risk analysis and oversight should also not impose additional costs on DCMs, as copies of documents developed by DCM staff for change planning purposes are expected to be sufficient in meeting this requirement. Additionally, the Commission notes that it is reducing the burden of this provision on DCMs by revising the proposed rule to provide that, with respect to planned changes to automated systems or risk analysis and oversight programs, a DCM must only provide timely advance notification of material changes, rather than of all changes.

§ 38.1051(g)

The Commission does not believe that any significant costs will be incurred by existing DCMs or applicants in complying with the requirements listed in § 38.1051(g), as these documents and procedures can be provided electronically with minimal additional DCM staff effort, and would be produced by the DCM in the course of following industry standards, guidelines and best practices for the management and operation of automated systems. If the documents are available electronically, the

request can likely be met in under 15 minutes. Hardcopy responses would likely require no more than 30 minutes of DCM staff time.

§ 38.1051(h)

The Commission does not believe that any significant costs will be incurred by existing DCMs in complying with the requirements listed in § 38.1051(h), as all DCMs should currently be performing this testing and review in the course of following industry standards, guidelines and best practices for the management and operation of automated systems.

§ 38.1051(i)

The Commission does not believe that any significant costs will be incurred by existing DCMs in complying with the requirements listed in § 38.1051(i), as all DCMs should meet the requirements of this provision in the course of following industry standards (including industry-wide tests conducted at least annually and sponsored by the Futures Industry Association ("FIA")), guidelines and best practices for the management and operation of automated systems. Further, compliance with sections (1) and (3) would generally result from the development of contingency and disaster recovery plans following generally accepted best practices and standards. Finally, industry-wide testing currently conducted on an annual basis would result in substantial compliance with part (2) of this section.

Benefits

Sophisticated computer systems are crucial to a DCM's ability to meet its obligations and responsibilities. Safeguarding the reliability, security, and capacity of such systems is essential to mitigate systemic risk for the nation's financial sector as a

whole. The ability of DCMs to recover and resume trading promptly in the event of a disruption of their operations is highly important to the U.S. economy. Ensuring the resilience of the automated systems of DCMs is a vitally important part of the Commission's mission and will be crucial to the robust and transparent systemic risk management framework established by the Dodd- Frank Act. DCM compliance with generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of automated systems can reduce the frequency and severity of automated system security breaches or functional failures, thereby augmenting efforts to mitigate systemic risk. Notice to the Commission concerning systems malfunctions, systems security incidents, or any events leading to the activation of a DCM's business continuity-disaster recovery (''BC–DR'') plan will assist the Commission's oversight and its ability to assess systemic risk levels. It would present unacceptable risks to the U.S. financial system if futures and swaps markets that comprise critical components of the world financial system were to become unavailable for an extended period of time for any reason. Adequate system safeguards are crucial to mitigate such risks and this regulation will ensure such safeguards are in place.

Section 15(a) Factors

(1) Protection of market participants and the public. Because automated systems play a central and critical role in today's electronic financial market environment, oversight of core principle compliance by DCMs with respect to automated systems is an essential part of effective oversight of both futures and swaps markets. Timely reporting to the Commission of material system malfunctions, planned changes to automated systems, and planned changes to programs of risk analysis and oversight will facilitate the

Commission's oversight of futures and swaps markets, augment the Commission's efforts to monitor systemic risk, and will further the protection of market participants and the public by helping to ensure that automated systems are available, reliable, secure, have adequate scalable capacity, and are effectively overseen.

(2) Efficiency, competitiveness, and financial integrity of futures markets. Sophisticated computer systems are crucial to a DCM's ability to meet its obligations and responsibilities. Safeguarding the reliability, security, and capacity of such systems is also essential to mitigation of system risk for the nation's financial sector as a whole. This is particularly true in light of the fact that the over-the-counter swaps market is estimated to have in excess of $600 trillion in outstanding contracts. The ability of DCMs to recover and resume trading promptly in the event of a disruption of their operations is highly important to the U.S. economy. Ensuring the resilience of the automated systems of DCMs is a critical part of the Commission's mission, and will be crucial to the robust and transparent systemic risk management framework established by the Dodd-Frank Act. Notice to the Commission concerning systems malfunctions, systems security incidents, or any events leading to the activation of a DCM's business continuity-disaster recovery plan will assist the Commission's oversight and its ability to assess systemic risk levels. It would present unacceptable risks to the U.S. financial system if futures and swaps markets that comprise critical components of the world financial system were to become unavailable for an extended period of time for any reason, and adequate system safeguards and timely notice to the Commission regarding the status of those safeguards are crucial to mitigation of such risks.

(3) Price discovery. The reliable function of sophisticated computer systems and networks is vital to the fulfillment of a DCM's duties and obligations, a crucial ingredient of adequate regulatory oversight, and central to the robust, conservative, and transparent risk management framework promulgated by the Dodd-Frank Act. Following generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of automated systems will reduce the incidence and severity of automated system security breaches and functional failures, thereby providing reliable and available venues for price discovery.

(4) Sound risk management practices. Reliably functioning computer systems and networks are crucial to comprehensive risk management, and prompt notice to the Commission concerning systems malfunctions, systems security incidents, or any events leading to the activation of a DCM's business continuity-disaster recovery plan will assist the Commission in its oversight role, and will bolster its ability to assess systemic risk levels. Adequate system safeguards and timely notice to the Commission regarding the status of those safeguards are crucial to mitigation of potential systemic risks.

(5) Other public interest considerations. The American economy and the American public depend upon the availability of reliable and secure markets for price discovery, hedging, and speculation. Ensuring the adequate safeguarding and the reliability, security, and capacity of the systems supporting these market functions is a core focus in the Commission's role in monitoring and assessing the level of systemic risk, and is central to its fulfillment of responsibilities given to it by the Dodd-Frank Act.

19. Core Principle 21: Financial Resources

§ 38.1101 (Financial Resources)

Section 38.1101(a) requires DCMs to maintain and calculate sufficient financial resources to cover operating costs for at least one year, calculated on a rolling basis, at all times, and requires any entity operating as both a DCM and a DCO to comply with both the DCM and DCO financial resources requirements.

Under section 38.1101(b), financial resources available to DCMs to satisfy the applicable financial resources requirements would include the DCM's own capital (assets in excess of liabilities) and any other financial resource deemed acceptable by the Commission.

Sections 38.1101(c), (d), and (f) require each DCM, no less frequently than at the end of each fiscal quarter, to calculate the financial resources it needs to meet the requirements of § 38.1101(a) and the current market value of each financial resource and report this information to the Commission within a specified timeframe. Section 38.1101(e) requires DCMs to maintain unencumbered liquid financial assets, such as cash or highly liquid securities, equal to at least six months' operating costs, or a committed line of credit or similar facility.

Summary of Comments

GreenX stated that the proposed rules implementing Core Principle 21 could effectively require DCMs to maintain financial resources in excess of one year's operating costs.[618] GreenX suggested modifying the rule so that the proposed six month liquidity requirement be explicitly included in the financial resources required to cover a DCM's operating costs for at least one year, or alternatively, requested that the Commission perform a cost benefit analysis of the proposed rule as written.[619]

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[618] GreenX Comment Letter at 14-15 (Feb. 22, 2011).
[619] Id. at 17-18.

GreenX also stated that revising the proposed rule to permit DCMs to include committed lines of credit as an acceptable financial resource would permit a DCM to reduce its operating costs by avoiding the need to incur unnecessary interest charges, while still ensuring that it has adequate funds available to pay its operating expenses.[620] Several commenters requested an extended deadline for filing the financial reports required as a result of § 38.1101(f). CME stated that the proposed 17 day filing deadline is not feasible and that instead, the requirement should be consistent with the SEC's reporting requirements.[621] Similarly, GreenX stated that it has procedures in place to comply with the SEC's requirements and that the proposed requirements in this rule would require new programming and resources.[622] GreenX recommended extending the reporting deadline to 30 calendar days, noting that this is still more burdensome than the requirements imposed by the SEC on national securities exchanges.[623] The Commission received no comments discussing the costs and benefits of §§ 38.1101(b) and 38.1101(d).

Discussion

As discussed in the preamble, the rule does not require each DCM to maintain eighteen months of financial resources, but, rather, requires each DCM to have at least twelve months of financial resources, including six months of liquid financial resources. Each DCM has the discretion to determine how to meet this requirement (*e.g.*, six months of illiquid financial resources combined with six months of liquid ones, twelve months of illiquid financial resources with a line of credit covering six months' worth of financial resources, or twelve months of illiquid financial resources and six months of liquid ones).

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[620] Id. at 16.
[621] CME Comment Letter at 38 (Feb. 22, 2011).
[622] GreenX Comment Letter at 20 (Feb. 22, 2011).
[623] Id.

There are similar proposed financial resources rules in the rulemakings for each type of registered entity (*i.e.,* SEFs, SDRs, and DCOs).

The provision in the rule text stating that acceptable financial resources include a DCM's own capital and "any other financial resource deemed acceptable by the Commission" was meant to capture other types of resources on a case-by-case basis and provide flexibility to both DCMs and the Commission. Accordingly, the Commission has revised the rule text to state that a DCM's own capital means its assets minus its liabilities calculated in accordance with GAAP. The Commission believes that if a certain financial resource is deemed to be an asset under GAAP, it is appropriate for inclusion in the calculation for this rule. To the extent a certain financial resource is not considered an asset under GAAP, but based upon the facts and circumstances a DCM believes that the particular asset should be so considered, Commission staff will work with the DCM to determine whether such resource is acceptable.

The Commission is persuaded that the proposed 17 business day filing deadline may be overly burdensome. The SEC requires its quarterly reports on Form 10-Q to be filed with the SEC 40 calendar days after the end of the fiscal quarter for accelerated filers and 45 calendar days after the end of the fiscal quarter for all other SEC-registered entities. The SEC requires annual reports on Form 10-K to be filed with the SEC 60 calendar days after the end of the fiscal year for large accelerated filers, 75 calendar days for other accelerated filers and 90 calendar days for non-accelerated filers. Accordingly, the Commission is extending the 17 business day proposed filing deadline to 40 calendar days for the required reports for the first three quarters. This will harmonize the Commission's regulations with the SEC's requirements for its Form 10-Q. Similarly, the

Commission has extended the filing deadline to 60 days for the fourth quarter report to harmonize with the SEC deadlines for the Form 10-K. The Commission does not believe that annual submissions are sufficient. The Commission believes that prudent financial management requires DCMs to prepare and review financial reports more frequently than annually, and expects that DCMs currently are reviewing their finances on at least a quarterly basis.

Costs

This is a new core principle for DCMs, so the requirement to maintain and calculate the financial resources necessary to meet the requirements of this rule may require an outlay of resources to achieve compliance. However, the Commission has required recent DCM registrants pursuant to their designation order to calculate and maintain a certain level of financial resources and therefore some DCMs are already generally in compliance with this requirement.

The Commission expects that most, if not all, DCMs already calculate and prepare financial statements quarterly. Accordingly, the Commission does not believe that the calculation of the financial resources required to meet the requirements of this core principle imposes a significant burden on DCMs. Extrapolation from the prepared financial statements should be relatively straightforward, but will require some resources on the part of DCMs, potentially including staff and technology resources to calculate, monitor, and report financial resources. Given the staffing and operational differences among DCMs, the Commission is unable to accurately estimate or quantify the additional costs DCMs may incur to comply with the new financial resource rules, and no information was provided in the comments in response to the NPRM. The proposed

regulation imposes additional costs on the Commission as staff will be required to review the filings received from DCMs. However, once the first couple of filings have been received and reviewed, Commission staff will be familiarized with the financial resources of each DCM and the Commission expects that the review will become increasingly more efficient.

Benefits

A DCM is obligated to ensure that trading occurs in a liquid, fair, and financially secure trading facility. In order to fulfill its responsibilities, a DCM must have appropriate minimum financial resources on hand and on an ongoing basis to sustain operations for a reasonable period of time. This includes a DCM having sufficient resources to allow it to close out trading in a manner not disruptive to the market, if necessary. The Commission believes that the benefits of the rule requiring six months' worth of unencumbered liquid financial assets are substantial. Specifically, this provision would give a DCM time to liquidate the remaining financial assets it would need to continue operating for the last six months of the required one year period. If a DCM does not have six months' worth of unencumbered liquid financial assets, it would be allowed to use a committed line of credit or similar facility to satisfy the requirement. If a DCM does not have the liquidity required under § 38.1101(e), it is not achieving the goal of the core principle, as it will be unable to pay its creditors. Liquidity is implicit in the core principle requirement that the financial resources be adequate. Additionally, the rules ensure that the Commission can be certain that DCMs are in compliance with the core principle as required by the Dodd-Frank Act. In addition, the reporting requirements will

facilitate the Commission's oversight role of ensuring DCMs maintain sufficient financial resources, as required by the core principle.

Section 15(a) Factors

(1) Protection of market participants and the public. As discussed herein, these rules implement the requirements of new Core Principle 21 pursuant to the Dodd-Frank Act. These requirements will enable a DCM to fulfill its responsibilities of ensuring that trading occurs in a liquid, fair, and financially secure trading facility by maintaining appropriate minimum financial resources on hand and on an ongoing basis to sustain operations for a reasonable period of time. As discussed, as a result of these requirements, DCMs will also have the financial resources necessary to close out trading in a manner not disruptive to the market. By establishing uniform standards that further the goals of avoiding market disruptions, financial losses, and systemic problems that could arise from a DCM's failure to maintain adequate financial resources, these rules will protect market participants and the public.

(2) Efficiency, competitiveness and financial integrity of futures markets. The rules also promote the financial integrity of the futures markets by requiring DCMs to have adequate operating resources (i.e., operating resources sufficient to fund both current operations and ensure operations of sufficient length in the future), and preventing those DCMs that lack these resources from expanding in ways that may ultimately harm the broader financial market (i.e., confining the operations of DCMs to levels their financial resources can support).

(3) Price discovery. The Commission has not identified any effects that this rule will have on price discovery.

(4) Sound risk management practices. By setting specific standards with respect to how DCMs should assess and monitor the adequacy of their financial resources, the rules promote sound risk management practices and further the goal of minimizing systemic risk.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

20. Core Principle 23: Securities and Exchange Commission

The Dodd-Frank Act added new Core Principle 23, requiring that DCMs keep any records relating to swaps defined in CEA section 1a(47)(A)(v), as amended by the Dodd-Frank Act, open to inspection and examination by the SEC. Consistent with the text of the core principle, the Commission is adopting guidance that provides that each DCM should have arrangements and resources for collecting and maintaining accurate records pertaining to any swap agreements defined in section 1a(47)(A)(v) of the amended CEA, and should leave them open to inspection and examination for a period of five years. The Commission did not receive any comments discussing the costs or benefits of this provision.

Costs

Core Principle 23 requires DCMs to keep records relating only to security-based swaps open to inspection and examination by the SEC. The accompanying guidance simply tracks the language of the Core Principle and does not impose any additional substantive requirements on DCMs. The five-year period is unlikely to impose significant costs on market participants because the core principle already requires DCMs to keep records relating to certain swaps open to inspection and examination by the SEC;

the guidance simply provides additional information with respect to the duration of the obligation imposed by the core principle. The Commission believes the five-year retention period is reasonable and reflects industry standards; the recordkeeping requirement under Core Principle 18 extends for a period of five years and the SEC's relevant recordkeeping requirements typically extend for a period of five years as well. Additionally, the requirement only applies to security-based swaps.

Benefits

The Dodd-Frank Act was intended to establish a comprehensive, new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system. In order to perform effective oversight and ensure the goals of Dodd-Frank are realized, the regulatory agencies charged with overseeing the swaps market must have access to accurate information regarding swap transactions. The SEC shares jurisdiction over the regulation of the swaps markets with the Commission and must have access to accurate records relating to swaps in order to effectively oversee those markets.

Section 15(a) Factors

(1) Protection of market participants and the public. To protect market participants and the public, the SEC has comprehensive regulatory, surveillance, investigative, and enforcement programs. To support these programs, the SEC must have access to accurate information regarding swap agreements. Section 38.1201 and the accompanying guidance ensure that DCMs keep accurate records relating to certain swaps open to inspection and examination by the SEC for a sufficient period of time of five years.

(2) Efficiency, competitiveness and financial integrity of futures markets. The SEC has comprehensive regulatory programs designed to promote efficient, competitive, and financially stable markets. In order to support these programs, the SEC must have access to accurate information regarding swap agreements. Section 38.1201 and the accompanying guidance ensure that DCMs keep accurate records relating to certain swaps open to inspection and examination by the SEC for a sufficient period of time of five years.

(3) Price discovery. The Commission has not identified any effects that this rule will have on price discovery.

(4) Sound risk management practices. The Commission has not identified any effects that this rule will have on sound risk management practices.

(5) Other public interest considerations. The Commission has not identified any effects that this rule will have on other public interest considerations.

IV. Text of Final Rules

List of Subjects

17 CFR Part 1

Commodity futures, Designated contract markets, Minimum financial requirements for intermediaries, Reporting and recordkeeping requirements.

17 CFR Part 16

Commodity futures, Reporting and Recordkeeping requirements

17 CFR Part 38

Block transaction, Commodity futures, Designated contract markets, Reporting and Recordkeeping requirements, Transactions off the centralized market.

For the reasons stated in the preamble, and under the authority of 7 U.S.C. 1, et seq., the Commodity Futures Trading Commission proposes to amend 17 CFR parts 1, 16 and 38 as follows:

PART 1- GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. Revise the authority citation for part 1 to read as follows:

Authority: 7 U.S.C. 1a, 2, 2a, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a-1, 7a-2, 7b, 7b-3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

2. Revise § 1.52 to read as follows:

§ 1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements.

(a) Each self-regulatory organization must adopt rules prescribing minimum financial and related reporting requirements for members who are registered futures commission merchants, registered retail foreign exchange dealers, or registered introducing brokers. The self-regulatory minimum financial and related reporting requirements must be the same as, or more stringent than, the requirements contained in §§1.10 and 1.17 of this chapter, for futures commission merchants and introducing brokers, and §§ 5.7 and 5.12 of this chapter for retail foreign exchange dealers; provided, however, a self-regulatory organization may permit its member registrants that are registered with the Securities and Exchange Commission as securities brokers or dealers to file (in accordance with §

1.10(h) of this chapter) a copy of their Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II, Part IIA, or Part II CSE, in lieu of Form 1–FR. The definition of adjusted net capital must be the same as that prescribed in § 1.17(c) of this chapter for futures commission merchants and introducing brokers, and § 5.7(b)(2) of this chapter for futures commission merchants offering or engaging in retail forex transactions and for retail foreign exchange dealers.

(b) Each self-regulatory organization must establish and operate a supervisory program for the purpose of assessing whether each member registrant is in compliance with the applicable self-regulatory organization and Commission rules and regulations governing minimum net capital and related financial requirements, the obligation to segregate customer funds, financial reporting requirements, recordkeeping requirements, and sales practice and other compliance requirements. The supervisory program also must address the following elements:

(1) Adequate levels and independence of audit staff. A self-regulatory organization must maintain staff of an adequate size, training, and experience to effectively implement a supervisory program. Staff of the self-regulatory organization, including officers, directors and supervising committee members, must maintain independent judgment and its actions must not impair its independence nor appear to impair its independence in matters related to the supervisory program. The self-regulatory organization must provide annual ethics training to all staff with responsibilities for the supervisory program.

(2) Ongoing surveillance. A self-regulatory organization's ongoing surveillance of member registrants must include the review and analysis of financial reports and

regulatory notices filed by member registrants with the designated self-regulatory organization.

(3) High-risk firms. A self-regulatory organization's supervisory program must include procedures for identifying member registrants that are determined to pose a high degree of potential financial risk, including the potential risk of loss of customer funds. High-risk member registrants must include firms experiencing financial or operational difficulties, failing to meet segregation or net capital requirements, failing to maintain current books and records, or experiencing material inadequacies in internal controls. Enhanced monitoring for high risk firms should include, as appropriate, daily review of net capital, segregation, and secured calculations, to assess compliance with self-regulatory and Commission requirements.

(4) On-site examinations. (i) A self-regulatory organization must conduct routine periodic on-site examinations of member registrants. Member futures commission merchants and retail foreign exchange dealers must be subject to on-site examinations no less frequently than once every eighteen months. A self-regulatory organization may establish a risk-based method of establishing the scope of each on-site examination, provided however, that the scope of each on-site examination of a futures commission merchant or retail foreign exchange dealer must include an assessment of whether the registrant is in compliance with applicable Commission and self-regulatory organization minimum capital and customer fund protection requirements, recordkeeping, and reporting requirements.

(ii) A self-regulatory organization must establish the frequency of on-site examinations of member introducing brokers that do not operate pursuant to guarantee agreements with

futures commission merchants or retail foreign exchange dealers using a risk-based approach, provided however, that each introducing broker is subject to an on-site examination no less frequently than once every three years.

(iii) A self-regulatory organization must conduct on-site examinations of member registrants in accordance with uniform audit programs and procedures that have been submitted to the Commission.

(5) Adequate documentation. A self-regulatory organization must adequately document all aspects of the operation of the supervisory program, including the conduct of risk-based scope setting and the risk-based surveillance of high-risk member registrants, and the imposition of remedial and punitive action(s) for material violations.

(c) Any two or more self-regulatory organizations may file with the Commission a plan for delegating to a designated self-regulatory organization, for any registered futures commission merchant, retail foreign exchange dealer, or introducing broker that is a member of more than one such self-regulatory organization, the responsibility of:

(1) Monitoring and auditing for compliance with the minimum financial and related reporting requirements adopted by such self-regulatory organizations and the Commission in accordance with paragraphs (a) and (b) of this section; and

(2) Receiving the financial reports necessitated by such minimum financial and related reporting requirements.

(d) Any plan filed under this section may contain provisions for the allocation of expenses reasonably incurred by the designated self-regulatory organization among the self-regulatory organizations participating in such a plan.

(e) A plan's designated self-regulatory organization must report to:

(1) That plan's other self-regulatory organizations any violation of such other self-regulatory organizations' rules and regulations for which the responsibility to monitor, audit or examine has been delegated to such designated self-regulatory organization under this section; and

(2) The Commission any violation of a self-regulatory organization's rules and regulations or any violation of the Commission's regulations for which the responsibility to monitor, audit or examine has been delegated to such designated self-regulatory organization under this section.

(f) The self-regulatory organizations may, among themselves, establish programs to provide access to any necessary financial or related information.

(g) After appropriate notice and opportunity for comment, the Commission may, by written notice, approve such a plan, or any part of the plan, if it finds that the plan, or any part of it:

(1) Is necessary or appropriate to serve the public interest;

(2) Is for the protection and in the interest of customers;

(3) Reduces multiple monitoring and multiple auditing for compliance with the minimum financial rules of the self-regulatory organizations submitting the plan of any futures commission merchant, retail foreign exchange dealer, or introducing broker that is a member of more than one self-regulatory organization;

(4) Reduces multiple reporting of the financial information necessitated by such minimum financial and related reporting requirements by any futures commission merchant, retail foreign exchange dealer, or introducing broker that is a member of more than one self-regulatory organization;

(5) Fosters cooperation and coordination among the self-regulatory organizations; and

(6) Does not hinder the development of a registered futures association under section 17 of the Act.

(h) After the Commission has approved a plan, or part thereof, under §1.52(g), a self-regulatory organization relieved of responsibility must notify each of its members that are subject to such a plan:

(1) Of the limited nature of its responsibility for such a member's compliance with its minimum financial and related reporting requirements; and

(2) Of the identity of the designated self-regulatory organization that has been delegated responsibility for such a member.

(i) The Commission may at any time, after appropriate notice and opportunity for hearing, withdraw its approval of any plan, or part thereof, established under this section, if such plan, or part thereof, ceases to adequately effectuate the purposes of section 4f(b) of the Act or of this section.

(j) Whenever a registered futures commission merchant, a registered retail foreign exchange dealer, or a registered introducing broker holding membership in a self-regulatory organization ceases to be a member in good standing of that self-regulatory organization, such self-regulatory organization must, on the same day that event takes place, give electronic notice of that event to the Commission at its Washington, D.C., headquarters and send a copy of that notification to such futures commission merchant, retail foreign exchange dealer, or introducing broker.

(k) Nothing in this section shall preclude the Commission from examining any futures commission merchant, retail foreign exchange dealer, or introducing broker for

compliance with the minimum financial and related reporting requirements to which such futures commission merchant, retail foreign exchange dealer, or introducing broker is subject.

(l) In the event a plan is not filed and/or approved for each registered futures commission merchant, retail foreign exchange dealer, or introducing broker that is a member of more than one self-regulatory organization, the Commission may design and, after notice and opportunity for comment, approve a plan for those futures commission merchants, retail foreign exchange dealers, or introducing brokers that are not the subject of an approved plan (under paragraph (g) of this section), delegating to a designated self-regulatory organization the responsibilities described in paragraph (c) of this section.

PART 16-REPORTS BY CONTRACT MARKETS AND SWAP EXECUTION FACILITIES

3. The authority citation for part 16 is revised to read as follows:

Authority: 7 U.S.C. 2, 6a, 6c, 6g, 6i, and 7, and 7b-3, as amended by Pub. L. 111-203, 124 Stat. 1376.

4. The heading for part 16 is revised to read as set forth above.

5. Revise § 16.01 to read as follows:

§ 16.01 Publication of market data on futures, swaps and options thereon: trading volume, open contracts, prices, and critical dates.

(a) Trading volume and open contracts. (1) Each reporting market, as defined in part 15 of this chapter, must separately record for each business day the information prescribed in paragraphs (a)(2)(i) through (vi) of this section for each of the following contract categories:

(i) For futures, by commodity and by futures expiration date;

(ii) For options, by underlying futures contracts for options on futures contracts or by underlying physical for options on physicals, and by put, by call, by expiration date and by strike price;

(iii) For swaps or class of swaps, by product type and by term life of the swap; and

(iv) For options on swaps or classes of options on swaps, by underlying swap contracts for options on swap contracts or by underlying physical for options on swaps on physicals, and by put, by call, by expiration date and by strike price.

(2) Each reporting market must record for each trading session the following trading volume and open interest summary data:

(i) The option delta, where a delta system is used;

(ii) The total gross open contracts for futures, excluding those contracts against which delivery notices have been stopped;

(iii) For futures products that specify delivery, open contracts against which delivery notices have been issued on that business day;

(iv) The total volume of trading, excluding transfer trades or office trades:

(A) For swaps and options on swaps, trading volume shall be reported in terms of the number of contracts traded for standard-sized contracts (i.e., contracts with a set contract size for all transactions) or in terms of notional value for non-standard-sized contracts (i.e., contracts whose contract size is not set and can vary for each transaction).

(v) The total volume of futures/options/swaps/swaptions exchanged for commodities or for derivatives positions that are included in the total volume of trading; and

(vi) The total volume of block trades included in the total volume of trading.

(b) Prices. (1) Each reporting market must record the following contract types separately

(i) For futures, by commodity and by futures expiration;

(ii) For options, by underlying futures contracts for options on futures contracts or by underlying physical for options on physicals, and by put, by call, by expiration date and by strike price;

(iii) For swaps, by product type and contract month or term life of the swap; and

(iv) For options on swaps or classes of options on swaps, by underlying swap contracts for options on swap contracts or by underlying physical for options on swaps on physicals, and by put, by call, by expiration date and by strike price.

(2) Each reporting market must record for the trading session and for the opening and closing periods of trading as determined by each reporting market:

(i) The opening and closing prices of each futures, option, swap or swaption;

(ii) The price that is used for settlement purposes, if different from the closing price; and

(iii) The lowest price of a sale or offer, whichever is lower, and the highest price of a sale or bid, whichever is higher, that the reporting market reasonably determines accurately reflects market conditions. Bids and offers vacated or withdrawn shall not be used in making this determination. A bid is vacated if followed by a higher bid or price and an offer is vacated if followed by a lower offer or price.

(3) If there are no transactions, bids, or offers during the opening or closing periods, the reporting market may record as appropriate:

(i) The first price (in lieu of opening price data) or the last price (in lieu of closing price data) occurring during the trading session, clearly indicating that such prices are the first and last prices; or

(ii) Nominal opening or nominal closing prices that the reporting market reasonably determines to accurately reflect market conditions, clearly indicating that such prices are nominal.

(4) Additional information. Each reporting market must record the following information with respect to transactions in commodity futures, commodity options, swaps or options on swaps on that reporting market:

(i) The method used by the reporting market in determining nominal prices and settlement prices; and

(ii) If discretion is used by the reporting market in determining the opening and/or closing ranges or the settlement prices, an explanation that certain discretion may be employed by the reporting market and a description of the manner in which that discretion may be employed. Discretionary authority must be noted explicitly in each case in which it is applied (for example, by use of an asterisk or footnote).

(c) Critical dates. Each reporting market must report to the Commission, for each futures contract, the first notice date and the last trading date, and for each option contract, the expiration date in accordance with paragraph (d) of this section.

(d) Form, manner and time of filing reports. Unless otherwise approved by the Commission or its designee, reporting markets must submit to the Commission the information specified in paragraphs (a), (b), and (c) of this section as follows:

(1) Using the format, coding structure and electronic data transmission procedures approved in writing by the Commission or its designee; provided however, that the information must be made available to the Commission or its designee in hard copy upon request;

(2) When each such form of the data is first available, but not later than 7:00 a.m. on the business day following the day to which the information pertains for the delta factor and settlement price and not later than 12:00 p.m. for the remainder of the information. Unless otherwise specified by the Commission or its designee, the stated time is U.S. eastern standard time for information concerning markets located in that time zone, and U.S. central time for information concerning all other markets; and

(3) For information on reports to the Commission for swap or options on swap contracts, refer to part 20 of this chapter.

(e) Publication of recorded information. (1) Reporting markets must make the information in paragraph (a) of this section readily available to the news media and the general public without charge, in a format that readily enables the consideration of such data, no later than the business day following the day to which the information pertains. The information in paragraphs (a)(2)(iv) through (vi) of this section shall be made readily available in a format that presents the information together.

(2) Reporting markets must make the information in paragraphs (b)(2) and (3) of this section readily available to the news media and the general public, and the information in paragraph (b)(4)(ii) of this section readily available to the general public, in a format that readily enables the consideration of such data, no later than the business day following the day to which the information pertains. Information in paragraph (b)(4)(i) of this section must be made available in the registered entity's rulebook, which is publicly accessible on its website.

PART 38 – DESIGNATED CONTRACT MARKETS

6. The authority citation for part 38 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6c, 6d, 6e, 6f, 6g, 6i, 6j, 6k, 6l, 6m, 6n, 7, 7a-2, 7b, 7b-1, 7b-3, 8, 9, 15, and 21, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

7. Designate existing §§ 38.1 through 38.6 as subpart A under the following subpart heading:

Subpart A – General Provisions

* * * * *

§ 38.1 [Amended]

8. Amend § 38.1 by removing the reference "Parts 36 or 37 of this chapter" and adding in its place the reference "parts 37 or 49 of this chapter."

9. Revise § 38.2 to read as follows:

§ 38.2 Exempt provisions.

A designated contract market, the designated contract market's operator and transactions traded on or through a designated contract market under section 5 of the Act shall comply with all applicable regulations under Title 17 of the Code of Federal Regulations, except for the requirements of § 1.35(e)-(j), § 1.39(b), § 1.44, § 1.53, § 1.54, § 1.59(b)-(c), § 1.62, § 1.63(a)-(b) and (d)-(f), § 1.64, §1.69, part 8, §100.1, § 155.2, and Part 156.

10. Revise § 38.3 to read as follows:

§ 38.3 Procedures for designation.

(a) Application procedures. (1) A board of trade seeking designation as a contract market must file electronically, in a format and manner specified by the Secretary of the Commission, the Form DCM provided in appendix A of this part, with the Secretary of the Commission at its Washington, D.C. headquarters at submissions@cftc.gov and the

Division of Market Oversight at DMOSubmissions@cftc.gov. The Commission will review the application for designation as a contract market pursuant to the 180-day timeframe and procedures specified in section 6(a) of the Act. The Commission shall approve or deny the application or, if deemed appropriate, designate the applicant as a contract market subject to conditions.

(2) The application must include information sufficient to demonstrate compliance with the core principles specified in section 5(d) of the Act. Form DCM consists of instructions, general questions and a list of exhibits (documents, information and evidence) required by the Commission in order to determine whether an applicant is able to comply with the core principles. An application will not be considered to be materially complete unless the applicant has submitted, at a minimum, the exhibits required in Form DCM. If the application is not materially complete, the Commission shall notify the applicant that the application will not be deemed to have been submitted for purposes of starting the 180-day review period set forth in paragraph (a)(1) of this section.

(3) The applicant must identify with particularity any information in the application that will be subject to a request for confidential treatment pursuant to § 145.9 of this chapter.

(4) Section 40.8 of this chapter sets forth those sections of the application that will be made publicly available, notwithstanding a request for confidential treatment pursuant to § 145.9 of this chapter.

(5) If any information contained in the application or in any exhibit is or becomes inaccurate for any reason, an amendment to the application or a submission filed under part 40 of this chapter must be filed promptly correcting such information.

(b) Reinstatement of dormant designation. Before listing or relisting products for trading, a dormant designated contract market as defined in § 40.1 of this chapter must reinstate its designation under the procedures of paragraphs (a)(1) and (a)(2) of this section; provided, however, that an application for reinstatement may rely upon previously submitted materials that still pertain to, and accurately describe, current conditions.

(c) Delegation of authority. (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, upon consultation with the General Counsel or the General Counsel's designee, authority to notify the applicant seeking designation under section 6(a) of the Act that the application is materially incomplete and the running of the 180-day period is stayed.

(2) The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph.

(3) Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in paragraph (c)(1) of this section.

(d) Request for transfer of designation. (1) Request for transfer of designation, listed contracts and open interest. A designated contract market that wants to request the transfer of its designation from its current legal entity to a new legal entity, as a result of a corporate reorganization or otherwise, must file a request with the Commission for approval to transfer the designation, listed contracts and positions comprising all associated open interest. Such request must be filed electronically, in a format and manner specified by the Secretary of the Commission, with the Secretary of the

Commission at its Washington, D.C. headquarters at submissions@cftc.gov and the Division of Market Oversight at DMOSubmissions@cftc.gov.

(2) Timing of submission. The request must be filed no later than three months prior to the anticipated corporate change; provided that the designated contract market may file a request with the Commission later than three months prior to the anticipated corporate change if the designated contract market does not know and reasonably could not have known of the anticipated change three months prior to the anticipated corporate change. In such event, the designated contract market shall be required to immediately file the request with the Commission as soon as it knows of such change, with an explanation as to the timing of the request.

(3) Required information. The request shall include the following:

(i) The underlying agreement that governs the corporate change;

(ii) A narrative description of the corporate change, including the reason for the change and its impact on the designated contract market, including its governance and operations, and its impact on the rights and obligations of market participants holding the open interest positions;

(iii) A discussion of the transferee's ability to comply with the Act, including the core principles applicable to designated contract markets, and the Commission's regulations thereunder;

(iv) The governing documents of the transferee including, but not limited to, articles of incorporation and bylaws;

(v) The transferee's rules marked to show changes from the current rules of the designated contract market;

(vi) A list of contracts, agreements, transactions or swaps for which the designated contract market requests transfer of open interest;

(vii) A representation by the transferee that it:

(A) Will be the surviving legal entity and successor-in-interest to the transferor designated contract market and will retain and assume, without limitation, all the assets and liabilities of the transferor;

(B) Will assume responsibility for complying with all applicable provisions of the Act and the Commission's regulations thereunder, including part 38 and Appendices thereto;

(C) Will assume, maintain and enforce all rules implementing and complying with these core principles, including the adoption of the transferor's rulebook, as amended in the request, and that any such amendments will be submitted to the Commission pursuant to section 5c(c) of the Act and part 40 of the Commission's regulations; and

(D) Will comply with all self-regulatory responsibilities except if otherwise indicated in the request, and will maintain and enforce all self-regulatory programs.

(viii) A representation by the transferee that upon the transfer:

(A) All open interest in all contracts listed on the transferor will be transferred to and represent equivalent open interest in all such contracts listed on the transferee;

(B) It will assume responsibility for and maintain compliance with the core principles for all contracts previously listed for trading through the transferor, whether by certification or approval; and

(C) That none of the proposed rule changes will affect the rights and obligations of any market participant with open positions transferred to it and that the proposed rule changes do not modify the manner in which such contracts are settled or cleared.

(ix) A representation by the transferee that market participants will be notified of all changes to the transferor's rulebook prior to the transfer and will be further notified of the concurrent transfer of the contract market designation, and the related transfer of all listed contracts and all associated open interest, to the transferee upon Commission approval and issuance of an order permitting this transfer.

(4) Commission determination. The Commission will review a request as soon as practicable and such request will be approved or denied pursuant to a Commission order and based on the Commission's determination as to the transferee's ability to continue to operate the designated contract market in compliance with the Act and the Commission's regulations thereunder.

(e) Request for withdrawal of application for designation. An applicant for designation may withdraw its application submitted pursuant to paragraphs (a)(1) and (a)(2) of this section by filing such a request with the Commission. Such request must be filed electronically, in a format and manner specified by the Secretary of the Commission, with the Secretary of the Commission at its Washington, D.C. headquarters, at submissions@cftc.gov, and the Division of Market Oversight, at DMOSubmissions@cftc.gov. Withdrawal of an application for designation shall not affect any action taken or to be taken by the Commission based upon actions, activities or events occurring during the time that the application for designation was pending with the Commission.

(f) Request for vacation of designation. A designated contract market may vacate its designation under section 7 of the Act by filing a request electronically, in a format and manner specified by the Secretary of the Commission, with the Secretary of the

Commission at its Washington, D.C. headquarters at submissions@cftc.gov and the Division of Market Oversight at DMOSubmissions@cftc.gov. Vacation of designation shall not affect any action taken or to be taken by the Commission based upon actions, activities or events occurring during the time that the facility was designated by the Commission.

11. In § 38.4, revise paragraphs (a) and (b) to read as follows:

§ 38.4 Procedures for listing products and implementing designated contract market rules.

(a) Request for Commission approval of rules and products. (1) An applicant for designation, or a designated contract market, may request that the Commission approve under section 5c(c) of the Act, any or all of its rules and contract terms and conditions, and subsequent amendments thereto, prior to their implementation or, notwithstanding the provisions of section 5c(c)(4) of the Act, at any time thereafter, under the procedures of §§ 40.3 or 40.5 of this chapter, as applicable. A designated contract market may label a future, swap or options product in its rules as "Listed for trading pursuant to Commission approval," if the future, swap or options product and its terms or conditions have been approved by the Commission, and it may label as "Approved by the Commission" only those rules that have been so approved.

(2) Notwithstanding the timeline under §§ 40.3(c) and 40.5(c) of this chapter, the operating rules, and terms and conditions of futures, swaps and option products that have been submitted for Commission approval at the same time as an application for contract market designation or an application under § 38.3(b) of this part to reinstate the designation of a dormant designated contract market, as defined in § 40.1 of this chapter,

or while one of the foregoing is pending, will be deemed approved by the Commission no earlier than when the facility is deemed to be designated or reinstated.

(b) Self-certification of rules and products. Rules of a designated contract market and subsequent amendments thereto, including both operational rules and the terms or conditions of futures, swaps and option products listed for trading on the facility, not voluntarily submitted for prior Commission approval pursuant to paragraph (a) of this section, must be submitted to the Commission with a certification that the rule, rule amendment or futures, swap or options product complies with the Act or rules thereunder pursuant to the procedures of § 40.6 of this chapter, as applicable. Provided, however, any rule or rule amendment that would, for a delivery month having open interest, materially change a term or condition of a swap or a contract for future delivery in an agricultural commodity enumerated in section 1a(9) of the Act, or of an option on such contract or commodity, must be submitted to the Commission prior to its implementation for review and approval under § 40.4 of this chapter.

12. Revise § 38.5 to read as follows:

§ 38.5 Information relating to contract market compliance.

(a) Requests for information. Upon request by the Commission, a designated contract market must file with the Commission information related to its business as a designated contract market, including information relating to data entry and trade details, in the form and manner and within the time specified by the Commission in its request.

(b) Demonstration of compliance. Upon request by the Commission, a designated contract market must file with the Commission a written demonstration, containing supporting data, information and documents, in the form and manner and within the time

specified by the Commission, that the designated contract market is in compliance with one or more core principles as specified in the request, or that is requested by the Commission to show that the designated contract market satisfies its obligations under the Act.

(c) Equity interest transfers.

(1) Equity interest transfer notification. A designated contract market shall file with the Commission a notification of each transaction that the designated contract market enters into involving the transfer of ten percent or more of the equity interest in the designated contract market.

(2) Timing of Notification. The equity transfer notice described in paragraph (1) shall be filed electronically with the Secretary of the Commission at its Washington, D.C. headquarters at submissions@cftc.gov and the Division of Market Oversight at DMOSubmissions@cftc.gov, at the earliest possible time but in no event later than the open of business ten business days following the date upon which the designated contract market enters into a firm obligation to transfer the equity interest.

(3) Rule filing. Notwithstanding the foregoing, any aspect of an equity interest transfer described in paragraph (1) that necessitates the filing of a rule as defined in part 40 of this chapter shall comply with the requirements of 5c(c) of the Act and part 40 of this chapter, and all other applicable Commission regulations.

(d) Delegation of authority. The Commission hereby delegates, until it orders otherwise, the authority set forth in paragraph (b) of this section to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time. The Director may submit to the Commission for its

consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

13. Add § 38.7 to subpart A to read as follows:

§ 38.7 Prohibited use of data collected for regulatory purposes.

A designated contract market may not use for business or marketing purposes any proprietary data or personal information it collects or receives, from or on behalf of any person, for the purpose of fulfilling its regulatory obligations; provided however, that a designated contract market may use such data or information for business or marketing purposes if the person from whom it collects or receives such data or information clearly consents to the designated contract market's use of such data or information in such manner. A designated contract market, where necessary, for regulatory purposes, may share such data or information with one or more designated contract markets or swap execution facilities registered with the Commission. A designated contract market may not condition access to its trading facility on a market participant's consent to the use of proprietary data or personal information for business or marketing purposes.

14. Add § 38.8 to subpart A to read as follows:

§ 38.8 Listing of swaps on a designated contract market.

(a) A designated contract market that lists for the first time a swap contract for trading on its contract market must, either prior to or at the time of such listing, file with the Commission a written demonstration detailing how the designated contract market is addressing its self-regulatory obligations and is fulfilling its statutory and regulatory obligations with respect to swap transactions.

(b) (1) Prior to listing swaps for trading on or through a designated contract market, each designated contract market must obtain from the Commission a unique, alphanumeric code assigned to the designated contract market by the Commission for the purpose of identifying the designated contract market with respect to unique swap identifier creation.

(2) Each designated contract market must generate and assign a unique swap identifier at, or as soon as technologically practicable following, the time of execution of the swap, in a manner consistent with the requirements of part 45.

15. Add § 38.9 to subpart A to read as follows:

§ 38.9 Boards of trade operating both a designated contract market and a swap execution facility.

(a) A board of trade that operates a designated contract market and that intends to also operate a swap execution facility must separately register, pursuant to the swap execution facility registration requirements set forth in part 37 of this chapter, and on an ongoing basis, comply with the core principles under section 5h of the Act, and the swap execution facility rules under part 37 of this chapter.

(b) A board of trade that operates both a designated contract market and a swap execution facility, and that uses the same electronic trade execution system for executing and trading swaps that it uses in its capacity as a designated contract market, must clearly identify to market participants for each swap whether the execution or trading of such swap is taking place on the designated contract market or on the swap execution facility.

16. Add § 38.10 to subpart A to read as follows:

§ 38.10 Reporting of swaps traded on a designated contract market.

With respect to swaps traded on and/or pursuant to the rules of a designated contract market, each designated contract market must maintain and report specified swap data as provided under parts 43 and 45 of this chapter.

17. Add subparts B through X to read as follows:

Subpart B – Designation as Contract Market

Sec.

38.100 Core Principle 1.

Subpart C – Compliance with Rules.

38.150 Core Principle 2.

38.151 Access requirements.

38.152 Abusive trading practices prohibited.

38.153 Capacity to detect and investigate rule violations.

38.154 Regulatory services provided by a third party.

38.155 Compliance staff and resources.

38.156 Automated trade surveillance system.

38.157 Real-time market monitoring.

38.158 Investigations and investigation reports.

38.159 Ability to obtain information.

38.160 Additional sources for compliance.

Subpart D – Contracts Not Readily Subject to Manipulation

38.200 Core Principle 3.

38.201 Additional sources for compliance.

Subpart E – Prevention of Market Disruption

38.250 Core Principle 4.

38.251 General requirements.

38.252 Additional requirements for physical-delivery contracts.

38.253 Additional requirements for cash-settled contracts.

38.254 Ability to obtain information.

38.255 Risk controls for trading.

38.256 Trade reconstruction.

38.257 Regulatory service provider.

38.258 Additional sources for compliance.

Subpart F – Position Limitations or Accountability

38.300 Core Principle 5.

38.301 Position limitations and accountability.

Subpart G – Emergency Authority

38.350 Core Principle 6.

38. 351 Additional sources for compliance.

Subpart H – Availability of General Information

38.400 Core Principle 7.

38.401 General requirements.

Subpart I – Daily Publication of Trading Information

38.450 Core Principle 8.

38.451 Reporting of trade information.

Subpart J - Execution of Transactions

38.500 Core Principle 9.

Subpart K - Trade Information

38.550 Core Principle 10.

38.551 Audit trail required.

38.552 Elements of an acceptable audit trail program.

38.553 Enforcement of audit trail requirements.

Subpart L - Financial Integrity of Transactions

38.600 Core Principle 11.

38.601 Mandatory clearing.

38.602 General financial integrity.

38.603 Protection of customer funds.

38.604 Financial surveillance.

38.605 Requirements for financial surveillance program.

38.606 Financial regulatory services provided by a third party.

38.607 Direct access.

Subpart M - Protection of Markets and Market Participants

38.650 Core Principle 12.

38.651 Protection of Markets and Market Participants.

Subpart N - Disciplinary Procedures

38.700 Core Principle 13.

38.701 Enforcement staff.

38.702 Disciplinary panels.

38.703 Notice of charges.

38.704 Right to representation.

38.705 Answer to charges.

38.706 Denial of charges and right to hearing.

38.707 Hearings.

38.708 Decisions.

38.709 Final decisions.

38.710 Disciplinary sanctions.

38.711 Warning letters.

38.712 Additional sources for compliance.

Subpart O - Dispute Resolution

38.750 Core Principle 14.

38.751 Additional sources for compliance.

Subpart P - Governance Fitness Standards

38.800 Core Principle 15.

38.801 Additional sources for compliance.

Subpart Q - Conflicts of Interest

38.850 Core Principle 16.

38.851 Additional sources for compliance.

Subpart R - Composition of Governing Boards of Contract Markets

38.900 Core Principle 17.

Subpart S – Recordkeeping

38.950 Core Principle 18.

38.951 Additional sources for compliance.

Subpart T – Antitrust Considerations

38.1000 Core Principle 19.

38.1001 Additional sources for compliance.

Subpart U - System Safeguards

38.1050 Core Principle 20.

38.1051 General requirements.

Subpart V - Financial Resources

38.1100 Core Principle 21.

38.1101 General requirements.

Subpart W - Diversity of Boards of Directors

38.1150 Core Principle 22.

Subpart X - Securities and Exchange Commission

38.1200 Core Principle 23.

38.1201 Additional sources for compliance.

Subpart B- Designation as Contract Market

§ 38.100 Core Principle 1.

(a) In general. To be designated, and maintain a designation, as a contract market, a board of trade shall comply with:

(1) Any core principle described in section 5(d) of the Act, and

(2) Any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5) of the Act.

(b) Reasonable discretion of the contract market. Unless otherwise determined by the Commission by rule or regulation, a board of trade described in paragraph (a) of this

section shall have reasonable discretion in establishing the manner in which the board of trade complies with the core principles described in this subsection.

Subpart C – Compliance with Rules

§ 38.150 Core Principle 2.

(a) In general. The board of trade shall establish, monitor, and enforce compliance with the rules of the contract market, including:

(1) Access requirements;

(2) The terms and conditions of any contracts to be traded on the contract market; and

(3) Rules prohibiting abusive trade practices on the contract market.

(b) Capacity of contract market. The board of trade shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market.

(c) Requirement of rules. The rules of the contract market shall provide the board of trade with the ability and authority to obtain any necessary information to perform any function described in this section, including the capacity to carry out such international information-sharing agreements, as the Commission may require.

§ 38.151 Access requirements.

(a) Jurisdiction. Prior to granting any member or market participant access to its markets, a designated contract market must require that the member or market participant consent to its jurisdiction.

(b) Impartial access by members, persons with trading privileges and independent software vendors. A designated contract market must provide its members, persons with

trading privileges, and independent software vendors with impartial access to its markets and services, including:

(1) Access criteria that are impartial, transparent, and applied in a non-discriminatory manner; and

(2) Comparable fee structures for members, persons with trading privileges and independent software vendors receiving equal access to, or services from, the designated contract market.

(c) Limitations on access. A designated contract market must establish and impartially enforce rules governing denials, suspensions, and revocations of a member's and a person with trading privileges' access privileges to the designated contract market, including when such actions are part of a disciplinary or emergency action by the designated contract market.

§ 38.152 Abusive trading practices prohibited.

A designated contract market must prohibit abusive trading practices on its markets by members and market participants. Designated contract markets that permit intermediation must prohibit customer-related abuses including, but not limited to, trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading. Specific trading practices that must be prohibited by all designated contract markets include front-running, wash trading, pre-arranged trading (except for certain transactions specifically permitted under part 38 of this chapter), fraudulent trading, money passes, and any other trading practices that a designated contract market deems to be abusive. In addition, a designated contract market also must

prohibit any other manipulative or disruptive trading practices prohibited by the Act or by the Commission pursuant to Commission regulation.

§ 38.153 Capacity to detect and investigate rule violations.

A designated contract market must have arrangements and resources for effective enforcement of its rules. Such arrangements must include the authority to collect information and documents on both a routine and non-routine basis, including the authority to examine books and records kept by the designated contract market's members and by persons under investigation. A designated contract market's arrangements and resources must also facilitate the direct supervision of the market and the analysis of data collected to determine whether a rule violation occurred.

§ 38.154 Regulatory services provided by a third party.

(a) Use of third-party provider permitted. A designated contract market may choose to utilize a registered futures association or another registered entity, as such terms are defined under the Act, (collectively, "regulatory service provider"), for the provision of services to assist in complying with the core principles, as approved by the Commission. Any designated contract market that chooses to utilize a regulatory service provider must ensure that its regulatory service provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and automated surveillance systems. A designated contract market will at all times remain responsible for the performance of any regulatory services received, for compliance with the designated contract market's obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf.

(b) Duty to supervise third party. A designated contract market that elects to utilize a regulatory service provider must retain sufficient compliance staff to supervise the quality and effectiveness of the services provided on its behalf. Compliance staff of the designated contract market must hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern. A designated contract market also must conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf. Such reviews must be documented carefully and made available to the Commission upon request.

(c) Regulatory decisions required from the designated contract market. A designated contract market that elects to utilize a regulatory service provider must retain exclusive authority in decisions involving the cancellation of trades, the issuance of disciplinary charges against members or market participants, and the denials of access to the trading platform for disciplinary reasons. A designated contract market may also retain exclusive authority in other areas of its choosing. A designated contract market must document any instances where its actions differ from those recommended by its regulatory service provider, including the reasons for the course of action recommended by the regulatory service provider and the reasons why the designated contract market chose a different course of action.

§ 38.155 Compliance staff and resources.

(a) Sufficient compliance staff. A designated contract market must establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and

real-time market monitoring. The designated contract market's compliance staff also must be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner, as set forth in § 38.158(b) of this part.

(b) Ongoing monitoring of compliance staff resources. A designated contract market must monitor the size and workload of its compliance staff annually, and ensure that its compliance resources and staff are at appropriate levels. In determining the appropriate level of compliance resources and staff, the designated contract market should consider trading volume increases, the number of new products or contracts to be listed for trading, any new responsibilities to be assigned to compliance staff, the results of any internal review demonstrating that work is not completed in an effective or timely manner, and any other factors suggesting the need for increased resources and staff.

§ 38.156 Automated trade surveillance system.

A designated contract market must maintain an automated trade surveillance system capable of detecting and investigating potential trade practice violations. The automated system must load and process daily orders and trades no later than 24 hours after the completion of the trading day. In addition, the automated trade surveillance system must have the capability to detect and flag specific trade execution patterns and trade anomalies; compute, retain, and compare trading statistics; compute trade gains, losses, and futures-equivalent positions; reconstruct the sequence of market activity; perform market analyses; and support system users to perform in-depth analyses and ad hoc queries of trade-related data.

§ 38.157 Real-time market monitoring.

A designated contract market must conduct real-time market monitoring of all trading activity on its electronic trading platform(s) to identify disorderly trading and any market or system anomalies. A designated contract market must have the authority to adjust trade prices or cancel trades when necessary to mitigate market disrupting events caused by malfunctions in its electronic trading platform(s) or errors in orders submitted by members and market participants. Any trade price adjustments or trade cancellations must be transparent to the market and subject to standards that are clear, fair, and publicly available.

§ 38.158 Investigations and investigation reports.

(a) Procedures. A designated contract market must establish and maintain procedures that require its compliance staff to conduct investigations of possible rule violations. An investigation must be commenced upon the receipt of a request from Commission staff or upon the discovery or receipt of information by the designated contract market that indicates a reasonable basis for finding that a violation may have occurred or will occur.

(b) Timeliness. Each compliance staff investigation must be completed in a timely manner. Absent mitigating factors, a timely manner is no later than 12 months after the date that an investigation is opened. Mitigating factors that may reasonably justify an investigation taking longer than 12 months to complete include the complexity of the investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined and analyzed by compliance staff.

(c) Investigation reports when a reasonable basis exists for finding a violation. Compliance staff must submit a written investigation report for disciplinary action in

every instance in which compliance staff determines from surveillance or from an investigation that a reasonable basis exists for finding a rule violation. The investigation report must include the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; compliance staff's analysis and conclusions; and a recommendation as to whether disciplinary action should be pursued.

(d) Investigation reports when no reasonable basis exists for finding a violation. If after conducting an investigation, compliance staff determines that no reasonable basis exists for finding a violation, it must prepare a written report including the reason(s) the investigation was initiated; a summary of the complaint, if any; the relevant facts; and compliance staff's analysis and conclusions.

(e) Warning letters. No more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling twelve month period.

§ 38.159 Ability to obtain information.

A designated contract market must have the ability and authority to obtain any necessary information to perform any function required under this subpart C of the Commission's regulations, including the capacity to carry out international information-sharing agreements as the Commission may require. Appropriate information-sharing agreements can be established with other designated contract markets and swap execution facilities, or the Commission can act in conjunction with the designated contract market to carry out such information sharing.

§ 38.160 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.150 of this part.

Subpart D – Contracts Not Readily Subject to Manipulation

§ 38.200 Core Principle 3.

The board of trade shall list on the contract market only contracts that are not readily susceptible to manipulation.

§ 38.201 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance in appendix C of this part to demonstrate to the Commission compliance with the requirements of § 38.200 of this part.

Subpart E – Prevention of Market Disruption

§ 38.250 Core Principle 4.

The board of trade shall have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures, including:

(a) Methods for conducting real-time monitoring of trading; and

(b) Comprehensive and accurate trade reconstructions.

§ 38.251 General requirements.

A designated contract market must:

(a) Collect and evaluate data on individual traders' market activity on an ongoing basis in order to detect and prevent manipulation, price distortions and, where possible, disruptions of the physical-delivery or cash-settlement process;

(b) Monitor and evaluate general market data in order to detect and prevent manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand;

(c) Demonstrate an effective program for conducting real-time monitoring of market conditions, price movements and volumes, in order to detect abnormalities and, when necessary, make a good-faith effort to resolve conditions that are, or threaten to be, disruptive to the market; and

(d) Demonstrate the ability to comprehensively and accurately reconstruct daily trading activity for the purposes of detecting trading abuses and violations of exchange-set position limits, including those that may have occurred intraday.

§ 38.252 Additional requirements for physical-delivery contracts.

For physical-delivery contracts, the designated contract market must demonstrate that it:

(1) Monitors a contract's terms and conditions as they relate to the underlying commodity market and to the convergence between the contract price and the price of the underlying commodity and show a good-faith effort to resolve conditions that are interfering with convergence; and

(2) Monitors the supply of the commodity and its adequacy to satisfy the delivery requirements and make a good-faith effort to resolve conditions that threaten the adequacy of supplies or the delivery process.

§ 38.253 Additional requirements for cash-settled contracts.

(a) For cash-settled contracts, the designated contract market must demonstrate that it:

(1) Monitors the pricing of the index to which the contract will be settled; and

(2) Monitors the continued appropriateness of the methodology for deriving the index and makes a good-faith effort to resolve conditions, including amending contract terms where necessary, where there is a threat of market manipulation, disruptions, or distortions.

(b) If a contract listed on a designated contract market is settled by reference to the price of a contract or commodity traded in another venue, including a price or index derived from prices on another designated contract market, the designated contract market must have rules or agreements that allow the designated contract market access to information on the activities of its traders in the reference market.

§ 38.254 Ability to obtain information.

(a) The designated contract market must have rules that require traders in its contracts to keep records of their trading, including records of their activity in the underlying commodity and related derivatives markets, and make such records available, upon request, to the designated contract market.

(b) A designated contract market with participants trading through intermediaries must either use a comprehensive large-trader reporting system (LTRS) or be able to demonstrate that it can obtain position data from other sources in order to conduct an effective surveillance program.

§ 38.255 Risk controls for trading.

The designated contract market must establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions, including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the designated contract market.

§ 38.256 Trade reconstruction.

The designated contract market must have the ability to comprehensively and accurately reconstruct all trading on its trading facility. All audit-trail data and reconstructions must be made available to the Commission in a form, manner, and time that is acceptable to the Commission.

§ 38.257 Regulatory service provider.

A designated contract market must comply with the regulations in this subpart through a dedicated regulatory department, or by delegation of that function to a registered futures association or a registered entity (collectively, "regulatory service provider"), as such terms are defined in the Act and over which the designated contract market has supervisory authority.

§ 38. 258 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance and acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.250 of this part.

Subpart F – Position Limitations or Accountability

§ 38.300 Core Principle 5.

To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators. For any contract that is subject to a position limitation established by the Commission, pursuant to section 4a(a), the board of trade shall set the position limitation of the board of trade at a level not higher than the position limitation established by the Commission.

§ 38.301 Position limitations and accountability.

A designated contract market must meet the requirements of parts 150 and 151 of this chapter, as applicable.

Subpart G – Emergency Authority

§ 38. 350 Core Principle 6.

The board of trade, in consultation or cooperation with the Commission, shall adopt rules to provide for the exercise of emergency authority, as is necessary and appropriate, including the authority:

(a) To liquidate or transfer open positions in any contract;

(b) To suspend or curtail trading in any contract; and

(c) To require market participants in any contract to meet special margin requirements.

§ 38.351 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance and/or acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.350.

Subpart H – Availability of General Information

§ 38.400 Core Principle 7.

The board of trade shall make available to market authorities, market participants, and the public accurate information concerning:

(a) The terms and conditions of the contracts of the contract market; and

(b) (1) The rules, regulations and mechanisms for executing transactions on or through the facilities of the contract market, and

(2) The rules and specifications describing the operation of the contract market's:

(i) Electronic matching platform, or

(ii) Trade execution facility.

§ 38.401 General requirements.

(a) General. (1) A designated contract market must have procedures, arrangements and resources for disclosing to the Commission, market participants and the public accurate information pertaining to:

(i) Contract terms and conditions;

(ii) Rules and regulations pertaining to the trading mechanisms; and

(iii) Rules and specifications pertaining to operation of the electronic matching platform or trade execution facility.

(2) Through the procedures, arrangements and resources required in paragraph (a) of this section, the designated contract market must ensure public dissemination of information pertaining to new product listings, new rules, rule amendments or other changes to previously-disclosed information, in accordance with the timeline provided in paragraph (c) of this section. (3) A designated contract market shall meet the requirements of this paragraph (a), by placing the information described in paragraph (a) on the designated contract market's website within the time prescribed in paragraph (c) of this section.

(b) Accuracy Requirement. With respect to any communication with the Commission, and any information required to be transmitted or made available to market participants and the public, including on its website or otherwise, a designated contract market must provide information that it believes, to the best of its knowledge, is accurate and complete, and must not omit material information.

(c) Notice of Regulatory Submissions. (1) A designated contract market, in making available on its website information pertaining to new product listings, new rules, rule amendments or other changes to previously-disclosed information, must place such information and submissions on its website concurrent with the filing of such information or submissions with the Secretary of the Commission. (2) To the extent that a designated contract market requests confidential treatment of any information filed with the Secretary of the Commission, the designated contract market must post on its website the public version of such filing or submission.

(d) Rulebook. A designated contract market must ensure that the rulebook posted on its website is accurate, complete, current and readily accessible to the public. A designated contract market must publish or post in its rulebook all new or amended rules, both substantive and non-substantive, on the date of implementation of such new or amended rule, on the date a new product is listed, or on the date any changes to previously-disclosed information take effect.

Subpart I – Daily Publication of Trading Information

§ 38.450 Core Principle 8.

The board of trade shall make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market.

§ 38.451 Reporting of trade information.

A designated contract market must meet the reporting requirements set forth in part 16 of this chapter.

Subpart J - Execution of Transactions

§ 38.500 Core Principle 9.

The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade. The rules of the board of trade may authorize, for bona fide business purposes:

(a) Transfer trades or office trades;

(b) An exchange of:

(1) Futures in connection with a cash commodity transaction;

(2) Futures for cash commodities; or

(3) Futures for swaps; or

(c) A futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization.

Subpart K - Trade Information

§ 38.550 Core Principle 10.

The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information:

(a) To assist in the prevention of customer and market abuses; and

(b) To provide evidence of any violations of the rules of the contract market.

§ 38.551 Audit trail required.

A designated contract market must capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses. Such data must be sufficient to reconstruct all transactions within a reasonable period of time and to provide evidence of any violations of the rules of the designated contract market. An acceptable audit trail must also permit the designated contract market to track a customer order from the time of receipt through fill, allocation, or other disposition, and must include both order and trade data.

§ 38.552 Elements of an acceptable audit trail program.

(a) Original source documents. A designated contract market's audit trail must include original source documents. Original source documents include unalterable, sequentially identified records on which trade execution information is originally recorded, whether recorded manually or electronically. Records for customer orders (whether filled, unfilled, or cancelled, each of which shall be retained or electronically captured) must reflect the terms of the order, an account identifier that relates back to the account(s) owner(s), and the time of order entry. For open-outcry trades, the time of report of execution of the order shall also be captured.

(b) Transaction history database. A designated contract market's audit trail program must include an electronic transaction history database. An adequate transaction history database includes a history of all trades executed via open outcry or via entry into an electronic trading system, and all orders entered into an electronic trading system, including all order modifications and cancellations. An adequate transaction history database also includes:

(1) All data that are input into the trade entry or matching system for the transaction to match and clear;

(2) The customer type indicator code;

(3) Timing and sequencing data adequate to reconstruct trading; and

(4) Identification of each account to which fills are allocated.

(c) Electronic analysis capability. A designated contract market's audit trail program must include electronic analysis capability with respect to all audit trail data in the transaction history database. Such electronic analysis capability must ensure that the designated contract market has the ability to reconstruct trading and identify possible trading violations with respect to both customer and market abuse.

(d) Safe storage capability. A designated contract market's audit trail program must include the capability to safely store all audit trail data retained in its transaction history database. Such safe storage capability must include the capability to store all data in the database in a manner that protects it from unauthorized alteration, as well as from accidental erasure or other loss. Data must be retained in accordance with the recordkeeping requirements of Core Principle 18 and the associated regulations in subpart S of this part.

§ 38.553 Enforcement of audit trail requirements.

(a) Annual audit trail and recordkeeping reviews. A designated contract market must enforce its audit trail and recordkeeping requirements through at least annual reviews of all members and persons and firms subject to designated contract market recordkeeping rules to verify their compliance with the contract market's audit trail and recordkeeping requirements. Such reviews must include, but are not limited to, the following:

(1) For electronic trading, audit trail and recordkeeping reviews must include reviews of randomly selected samples of front-end audit trail data for order routing systems; a review of the process by which user identifications are assigned and user identification records are maintained; a review of usage patterns associated with user identifications to monitor for violations of user identification rules; and reviews of account numbers and customer type indicator codes in trade records to test for accuracy and improper use.

(2) For open outcry trading, audit trail and recordkeeping reviews must include reviews of members' and market participants' compliance with the designated contract market's trade timing, order ticket, and trading card requirements.

(b) Enforcement program required. A designated contract market must establish a program for effective enforcement of its audit trail and recordkeeping requirements for both electronic and open-outcry trading, as applicable. An effective program must identify members and persons and firms subject to designated contract market recordkeeping rules that have failed to maintain high levels of compliance with such requirements, and levy meaningful sanctions when deficiencies are found. Sanctions must be sufficient to deter recidivist behavior. No more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling twelve month period.

Subpart L - Financial Integrity of Transactions

§ 38.600 Core Principle 11.

The board of trade shall establish and enforce:

(a) Rules and procedures for ensuring the financial integrity of transactions entered into on or through the facilities of the contract market (including the clearance and settlement of the transactions with a derivatives clearing organization); and

(b) Rules to ensure:

(1) The financial integrity of any:

(i) Futures commission merchant, and

(ii) Introducing broker; and

(2) The protection of customer funds.

§ 38.601 Mandatory clearing.

(a) Transactions executed on or through the designated contract market must be cleared through a Commission-registered derivatives clearing organization, in accordance with the provisions of part 39 of this chapter. Notwithstanding the foregoing, transactions in security futures products executed on or through the designated contract market may alternatively be cleared through a clearing agency, registered pursuant to section 17A of the Securities Exchange Act of 1934.

§ 38.602 General financial integrity.

A designated contract market must provide for the financial integrity of its transactions by establishing and maintaining appropriate minimum financial standards for its members and non-intermediated market participants.

§ 38.603 Protection of customer funds.

A designated contract market must have rules concerning the protection of customer funds. These rules shall address appropriate minimum financial standards for intermediaries, the segregation of customer and proprietary funds, the custody of

customer funds, the investment standards for customer funds, intermediary default procedures and related recordkeeping. A designated contract market must review the default rules and procedures of the derivatives clearing organization that clears for such designated contract market to wind down operations, transfer customers, or otherwise protect customers in the event of a default of a clearing member or the derivatives clearing organization.

§ 38.604 Financial surveillance.

A designated contract market must monitor members' compliance with the designated contract market's minimum financial standards and, therefore, must routinely receive and promptly review financial and related information from its members, as well as continuously monitor the positions of members and their customers. A designated contract market must have rules that prescribe minimum capital requirements for member futures commission merchants and introducing brokers. A designated contract market must:

(a) Continually survey the obligations of each futures commission merchant created by the positions of its customers;

(b) As appropriate, compare those obligations to the financial resources of the futures commission merchant; and

(c) Take appropriate steps to use this information to protect customer funds.

§ 38.605 Requirements for financial surveillance program.

A designated contract market's financial surveillance program for futures commission merchants, retail foreign exchange dealers, and introducing brokers must comply with the

requirements of § 1.52 of this chapter to assess the compliance of such entities with applicable contract market rules and Commission regulations.

§ 38.606 Financial regulatory services provided by a third party.

A designated contract market may comply with the requirements of § 38.604 (Financial Surveillance) and § 38.605 (Requirements for Financial Surveillance Program) of this part through the regulatory services of a registered futures association or a registered entity (collectively, "regulatory service provider"), as such terms are defined under the Act. A designated contract market must ensure that its regulatory service provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and appropriate surveillance systems. A designated contract market will at all times remain responsible for compliance with its obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf. Regulatory services must be provided under a written agreement with a regulatory services provider that shall specifically document the services to be performed as well as the capacity and resources of the regulatory service provider with respect to the services to be performed.

§ 38.607 Direct access.

A designated contract market that permits direct electronic access by customers (i.e., allowing customers of futures commission merchants to enter orders directly into a designated contract market's trade matching system for execution) must have in place effective systems and controls reasonably designed to facilitate the FCM's management of financial risk, such as automated pre-trade controls that enable member futures commission merchants to implement appropriate financial risk limits. A designated

contract market must implement and enforce rules requiring the member futures commission merchants to use the provided systems and controls.

Subpart M - Protection of Markets and Market Participants

§ 38.650 Core Principle 12.

The board of trade shall establish and enforce rules:

(a) To protect markets and market participants from abusive practices committed by any party, including abusive practices committed by a party acting as an agent for a participant; and

(b) To promote fair and equitable trading on the contract market.

§ 38.651 - Protection of Markets and Market Participants.

A designated contract market must have and enforce rules that are designed to promote fair and equitable trading and to protect the market and market participants from abusive practices including fraudulent, noncompetitive or unfair actions, committed by any party. The designated contract market must have methods and resources appropriate to the nature of the trading system and the structure of the market to detect trade practice and market abuses and to discipline such behavior, in accordance with Core Principles 2 and 4, and the associated regulations in subparts C and E of this part, respectively. The designated contract market also must provide a competitive, open and efficient market and mechanism for executing transactions in accordance with Core Principle 9 and the associated regulations under subpart J of this part.

Subpart N - Disciplinary Procedures

§ 38.700 Core Principle 13.

The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.

§ 38.701 Enforcement staff.

A designated contract market must establish and maintain sufficient enforcement staff and resources to effectively and promptly prosecute possible rule violations within the disciplinary jurisdiction of the contract market. A designated contract market must also monitor the size and workload of its enforcement staff annually, and ensure that its enforcement resources and staff are at appropriate levels. The enforcement staff may not include either members of the designated contract market or persons whose interests conflict with their enforcement duties. A member of the enforcement staff may not operate under the direction or control of any person or persons with trading privileges at the contract market. A designated contract market's enforcement staff may operate as part of the designated contract market's compliance department.

§ 38.702 Disciplinary panels.

A designated contract market must establish one or more disciplinary panels that are authorized to fulfill their obligations under the rules of this subpart. Disciplinary panels must meet the composition requirements of part 40 of this chapter, and must not include any members of the designated contract market's compliance staff or any person involved in adjudicating any other stage of the same proceeding.

§ 38.703 Notice of charges.

If compliance staff authorized by a designated contract market or a designated contract market disciplinary panel determines that a reasonable basis exists for finding a violation and that adjudication is warranted, it must direct that the person or entity alleged to have committed the violation be served with a notice of charges and must proceed in accordance with the rules of this section. A notice of charges must adequately state the acts, conduct, or practices in which the respondent is alleged to have engaged; state the rule, or rules, alleged to have been violated (or about to be violated); and prescribe the period within which a hearing on the charges may be requested. The notice must also advise that the charged respondent is entitled, upon request, to a hearing on the charges.

§ 38.704 Right to representation.

Upon being served with a notice of charges, a respondent must have the right to be represented by legal counsel or any other representative of its choosing in all succeeding stages of the disciplinary process, except any member of the designated contract market's board of directors or disciplinary panel, any employee of the designated contract market, or any person substantially related to the underlying investigations, such as material witness or respondent.

§ 38.705 Answer to charges.

A respondent must be given a reasonable period of time to file an answer to a notice of charges. The rules of a designated contract market governing the requirements and timeliness of a respondent's answer to charges must be fair, equitable, and publicly available.

§ 38.706 Denial of charges and right to hearing.

In every instance where a respondent has requested a hearing on a charge that is denied, or on a sanction set by the disciplinary panel, the respondent must be given an opportunity for a hearing in accordance with the requirements of § 38.707 of this part.

§ 38.707 Hearings.

(a) A designated contract market must adopt rules that provide for the following minimum requirements for any hearing conducted pursuant to a notice of charges:

(1) The hearing must be fair, must be conducted before members of the disciplinary panel, and must be promptly convened after reasonable notice to the respondent. The formal rules of evidence need not apply; nevertheless, the procedures for the hearing may not be so informal as to deny a fair hearing. No member of the disciplinary panel for the matter may have a financial, personal, or other direct interest in the matter under consideration.

(2) In advance of the hearing, the respondent must be entitled to examine all books, documents, or other evidence in the possession or under the control of the designated contract market. The designated contract market may withhold documents that are privileged or constitute attorney work product, documents that were prepared by an employee of the designated contract market but will not be offered in evidence in the disciplinary proceedings, documents that may disclose a technique or guideline used in examinations, investigations, or enforcements proceedings, and documents that disclose the identity of a confidential source.

(3) The designated contract market's enforcement and compliance staffs must be parties to the hearing, and the enforcement staff must present their case on those charges and sanctions that are the subject of the hearing.

(4) The respondent must be entitled to appear personally at the hearing, must be entitled to cross-examine any persons appearing as witnesses at the hearing, and must be entitled to call witnesses and to present such evidence as may be relevant to the charges.

(5) The designated contract market must require persons within its jurisdiction who are called as witnesses to participate in the hearing and to produce evidence. It must make reasonable efforts to secure the presence of all other persons called as witnesses whose testimony would be relevant.

(6) If the respondent has requested a hearing, a copy of the hearing must be made and must become a part of the record of the proceeding. The record must be one that is capable of being accurately transcribed; however, it need not be transcribed unless the transcript is requested by Commission staff or the respondent, the decision is appealed pursuant to the rules of the designated contract market, or is reviewed by the Commission pursuant to section 8c of the Act or part 9 of this chapter. In all other instances a summary record of a hearing is permitted

§ 38.708 Decisions.

Promptly following a hearing conducted in accordance with § 38.707 of this part, the disciplinary panel must render a written decision based upon the weight of the evidence contained in the record of the proceeding and must provide a copy to the respondent. The decision must include:

(a) The notice of charges or a summary of the charges;

(b) The answer, if any, or a summary of the answer;

(c) A summary of the evidence produced at the hearing or, where appropriate, incorporation by reference of the investigation report;

(d) A statement of findings and conclusions with respect to each charge, and a complete explanation of the evidentiary and other basis for such findings and conclusions with respect to each charge;

(e) An indication of each specific rule that the respondent was found to have violated; and

(f) A declaration of all sanctions imposed against the respondent, including the basis for such sanctions and the effective date of such sanctions.

§ 38.709 Final decisions.

Each designated contract market must establish rules setting forth when a decision rendered pursuant to this section will become the final decision of such designated contract market.

§ 38.710 Disciplinary sanctions.

All disciplinary sanctions imposed by a designated contract market or its disciplinary panels must be commensurate with the violations committed and must be clearly sufficient to deter recidivism or similar violations by other market participants. All disciplinary sanctions, including sanctions imposed pursuant to an accepted settlement offer, must take into account the respondent's disciplinary history. In the event of demonstrated customer harm, any disciplinary sanction must also include full customer restitution, except where the amount of restitution, or to whom it should be provided, cannot be reasonably determined.

§ 38.711 Warning letters.

Where a rule violation is found to have occurred, no more than one warning letter may be issued per rolling 12-month period for the same violation.

§ 38.712 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.700 of this part.

Subpart O - Dispute Resolution

§ 38.750 Core Principle 14.

The board of trade shall establish and enforce rules regarding, and provide facilities for alternative dispute resolution as appropriate for, market participants and any market intermediaries.

§ 38.751 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance and acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.750 of this part.

Subpart P - Governance Fitness Standards

§ 38.800 Core Principle 15.

The board of trade shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other person with direct access to the facility (including any party affiliated with any person described in this paragraph).

§ 38.801 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.800 of this part.

Subpart Q - Conflicts of Interest

§ 38.850 Core Principle 16.

The board of trade shall establish and enforce rules:

(a) To minimize conflicts of interest in the decision-making process of the contract market; and

(b) To establish a process for resolving conflicts of interest described in paragraph (a) of this section.

§ 38.851 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance and/or acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.850 of this part.

Subpart R - Composition of Governing Boards of Contract Markets

§ 38.900 Core Principle 17.

The governance arrangements of the board of trade shall be designed to permit consideration of the views of market participants.

Subpart S – Recordkeeping

§ 38.950 Core Principle 18.

The board of trade shall maintain records of all activities relating to the business of the contract market:

(a) In a form and manner that is acceptable to the Commission; and

(b) For a period of at least 5 years.

§ 38.951 Additional sources for compliance.

A designated contract market must maintain such records, including trade records and investigatory and disciplinary files, in accordance with the requirements of § 1.31 of this chapter, and in accordance with part 45 of this chapter, if applicable.

Subpart T – Antitrust Considerations

§ 38.1000 Core Principle 19.

Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall not:

(a) Adopt any rule or taking any action that results in any unreasonable restraint of trade; or

(b) Impose any material anticompetitive burden on trading on the contract market.

§ 38.1001 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance and acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.1000 of this part.

Subpart U - System Safeguards

§ 38.1050 Core Principle 20.

Each designated contract market shall:

(a) Establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and the development of automated systems, that are reliable, secure, and have adequate scalable capacity;

(b) Establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for the timely recovery and resumption of operations and the fulfillment of the responsibilities and obligations of the board of trade; and

(c) Periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, transmission of matched orders to a designated clearing organization for clearing, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.

§ 38.1051 General requirements.

(a) A designated contract market's program of risk analysis and oversight with respect to its operations and automated systems must address each of the following categories of risk analysis and oversight:

(1) Information security;

(2) Business continuity-disaster recovery planning and resources;

(3) Capacity and performance planning;

(4) Systems operations;

(5) Systems development and quality assurance; and

(6) Physical security and environmental controls.

(b) In addressing the categories of risk analysis and oversight required under paragraph (a) of this section, a designated contract market should follow generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of automated systems.

(c) A designated contract market must maintain a business continuity-disaster recovery plan and business continuity-disaster recovery resources, emergency procedures, and

backup facilities sufficient to enable timely recovery and resumption of its operations and resumption of its ongoing fulfillment of its responsibilities and obligations as a designated contract market following any disruption of its operations. Such responsibilities and obligations include, without limitation, order processing and trade matching; transmission of matched orders to a designated clearing organization for clearing; price reporting; market surveillance; and maintenance of a comprehensive audit trail. The designated contract market's business continuity-disaster recovery plan and resources generally should enable resumption of trading and clearing of the designated contract market's products during the next business day following the disruption. Designated contract markets determined by the Commission to be critical financial markets are subject to more stringent requirements in this regard, set forth in § 40.9 of this chapter. Electronic trading is an acceptable backup for open outcry trading in the event of a disruption.

(d) A designated contract market that is not determined by the Commission to be a critical financial market satisfies the requirement to be able to resume trading and clearing during the next business day following a disruption by maintaining either:

(1) Infrastructure and personnel resources of its own that are sufficient to ensure timely recovery and resumption of its operations and resumption of its ongoing fulfillment of its responsibilities and obligations as a designated contract market following any disruption of its operations; or

(2) Contractual arrangements with other designated contract markets or disaster recovery service providers, as appropriate, that are sufficient to ensure continued trading and clearing of the designated contract market's products, and ongoing fulfillment of all of

the designated contract market's responsibilities and obligations with respect to those products, in the event that a disruption renders the designated contract market temporarily or permanently unable to satisfy this requirement on its own behalf.

(e) A designated contract market must notify Commission staff promptly of all:

(1) Electronic trading halts and significant systems malfunctions;

(2) Cyber security incidents or targeted threats that actually or potentially jeopardize automated system operation, reliability, security, or capacity; and

(3) Activation of the designated contract market's business continuity-disaster recovery plan.

(f) A designated contract market must give Commission staff timely advance notice of all material:

(1) Planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems; and

(2) Planned changes to the designated contract market's program of risk analysis and oversight.

(g) A designated contract market must provide to the Commission upon request current copies of its business continuity-disaster recovery plan and other emergency procedures, its assessments of its operational risks, and other documents requested by Commission staff for the purpose of maintaining a current profile of the designated contract market's automated systems.

(h) A designated contract market must conduct regular, periodic, objective testing and review of its automated systems to ensure that they are reliable, secure, and have adequate scalable capacity. It must also conduct regular, periodic testing and review of

its business continuity-disaster recovery capabilities. Both types of testing should be conducted by qualified, independent professionals. Such qualified independent professionals may be independent contractors or employees of the designated contract market, but should not be persons responsible for development or operation of the systems or capabilities being tested. Pursuant to Core Principle 18 (Recordkeeping) and §§ 38.950 and 38.951 of this part, the designated contract market must keep records of all such tests, and make all test results available to the Commission upon request.

(i) To the extent practicable, a designated contract market should:

(1) Coordinate its business continuity-disaster recovery plan with those of the members and other market participants upon whom it depends to provide liquidity, in a manner adequate to enable effective resumption of activity in its markets following a disruption causing activation of the designated contract market's business continuity-disaster recovery plan;

(2) Initiate and coordinate periodic, synchronized testing of its business continuity-disaster recovery plan and the business continuity-disaster recovery plans of the members and other market participants upon whom it depends to provide liquidity; and

(3) Ensure that its business continuity-disaster recovery plan takes into account the business continuity-disaster recovery plans of its telecommunications, power, water, and other essential service providers.

(j) Part 46 of this chapter governs the obligations of those registered entities that the Commission has determined to be critical financial markets, with respect to maintenance and geographic dispersal of disaster recovery resources sufficient to meet a same-day

recovery time objective in the event of a wide-scale disruption. Section 40.9 of this chapter establishes the requirements for core principle compliance in that respect.

Subpart V - Financial Resources

§ 38.1100 Core Principle 21.

(a) In General. The board of trade shall have adequate financial, operational, and managerial resources to discharge each responsibility of the board of trade.

(b) Determination of Adequacy. The financial resources of the board of trade shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the contract market to cover the operating costs of the contract market for a 1-year period, as calculated on a rolling basis.

§ 38.1101 General requirements.

(a) General rule. (1) A designated contract market must maintain financial resources sufficient to enable it to perform its functions in compliance with the core principles set forth in section 5 of the Act and regulations thereunder.

(2) Financial resources shall be considered sufficient if their value is at least equal to a total amount that would enable the designated contract market, or applicant for designation as such, to cover its operating costs for a period of at least one year, calculated on a rolling basis.

(3) An entity that is registered with the Commission as both a designated contract market and a derivatives clearing organization also shall comply with the financial resource requirements of § 39.11 of this chapter, demonstrating that it has sufficient financial resources to operate the single, combined entity as both a designated contract market and a derivatives clearing organization. In lieu of filing separate quarterly reports under

paragraph (a)(2) of this section and § 39.11(f) of this chapter, such entity shall file single quarterly reports in accordance with § 39.11.

(b) Types of financial resources. Financial resources available to satisfy the requirements of paragraph (a) of this section may include:

(1) The designated contract market's own capital, calculated in accordance with U.S. generally accepted accounting principles; and

(2) Any other financial resource deemed acceptable by the Commission.

(c) Computation of financial resource requirement. A designated contract market must, on a quarterly basis, based upon its fiscal year, make a reasonable calculation of its projected operating costs over a 12-month period in order to determine the amount needed to meet the requirements of paragraph (a) of this section. The designated contract market shall have reasonable discretion in determining the methodology used to compute such projected operating costs. The Commission may review the methodology and require changes as appropriate.

(d) Valuation of financial resources. At appropriate intervals, but not less than quarterly, a designated contract market must compute the current market value of each financial resource used to meet its obligations under paragraph (a) of this section. Reductions in value to reflect market and credit risk ("haircuts") must be applied as appropriate.

(e) Liquidity of financial resources. The financial resources allocated by the designated contract market to meet the requirements of paragraph (a) of this section must include unencumbered, liquid financial assets (i.e., cash and/or highly liquid securities) equal to at least six months' operating costs. If any portion of such financial resources is not

sufficiently liquid, the designated contract market may take into account a committed line of credit or similar facility for the purpose of meeting this requirement.

(f) Reporting requirements. (1) Each fiscal quarter, or at any time upon Commission request, a designated contract market must:

(i) Report to the Commission:

(A) The amount of financial resources necessary to meet the requirements of paragraph (a) of this section; and

(B) The value of each financial resource available, computed in accordance with the requirements of paragraph (d) of this section; and

(ii) Provide the Commission with a financial statement, including the balance sheet, income statement, and statement of cash flows of the designated contract market or of its parent company.

(2) The calculations required by this paragraph shall be made as of the last business day of the designated contract market's fiscal quarter.

(3) The designated contract market must provide the Commission with:

(i) Sufficient documentation explaining the methodology used to compute its financial requirements under paragraph (a) of this section;

(ii) Sufficient documentation explaining the basis for its determinations regarding the valuation and liquidity requirements set forth in paragraphs (d) and (e) of this section; and

(iii) Copies of any agreements establishing or amending a credit facility, insurance coverage, or other arrangement evidencing or otherwise supporting the designated contract market's conclusions.

(4) The reports shall be filed not later than 40 calendar days after the end of the designated contract market's first three fiscal quarters, and not later than 60 calendar days after the end of the designated contract market's fourth fiscal quarter, or at such later time as the Commission may permit, in its discretion, upon request by the designated contract market.

(g) Delegation of Authority. The Commission hereby delegates, until it orders otherwise, the authority to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, to: (1) determine whether a particular financial resource under paragraph (b)(2) may be used to satisfy the requirements of paragraph (a)(1) and (a)(2); (2) review and make changes to the methodology used to compute the requirements of paragraph (c); (3) request financial reporting from a designated contract market (in addition to quarterly reports) under paragraph (f)(1); and (4) grant an extension of time for a designated contract market to file its quarterly financial report under paragraph (f)(4). The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

Subpart W - Diversity of Board of Directors

§ 38.1150 Core Principle 22.

The board of trade, if a publicly traded company, shall endeavor to recruit individuals to serve on the board of directors and the other decision-making bodies (as determined by the Commission) of the board of trade from among, and to have the composition of the bodies reflect, a broad and culturally diverse pool of qualified candidates.

Subpart X - Securities and Exchange Commission

§ 38.1200 Core Principle 23.

The board of trade shall keep any such records relating to swaps defined in section 1a(47)(A)(v) of the Act open to inspection and examination by the Securities and Exchange Commission.

§ 38.1201 Additional sources for compliance.

Applicants and designated contract markets may refer to the guidance and/or acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 38.1200 of this part.

APPENDIX A TO PART 38 – FORM DCM

COMMODITY FUTURES TRADING COMMISSION

FORM DCM

CONTRACT MARKET
APPLICATION OR AMENDMENT TO APPLICATION FOR DESIGNATION

DESIGNATION INSTRUCTIONS

Intentional misstatements or omissions of material fact may constitute federal criminal violations (7 U.S.C. § 13 and 18 U.S.C. § 1001) or grounds for disqualification from designation.

DEFINITIONS

Unless the context requires otherwise, all terms used in this Form DCM have the same meaning as in the Commodity Exchange Act, as amended ("CEA" or "Act"), and in the General Rules and Regulations of the Commodity Futures Trading Commission ("Commission") thereunder.

For the purposes of this Form DCM, the term "Applicant" shall include any board of trade applying for designation as a contract market, any board of trade amending a pending application, or any designated contract market that is applying for an amendment to its order of designation.

GENERAL INSTRUCTIONS

1. This Form DCM, which includes instructions, a Cover Sheet, and required Exhibits (together, "Form DCM") is to be filed with the Commission by all Applicants, pursuant to Section 5 of the CEA and the Commission's regulations thereunder. Applicants may prepare their own Form DCM but must follow the format prescribed herein. Upon the filing of an application for designation or a designation amendment in accordance with the instructions provided herein, the Commission will publish notice of the filing and afford interested persons an opportunity to submit written data, views and arguments

concerning such application. No application for designation or designation amendment shall be effective unless the Commission, by order, grants such designation or amended designation.

2. Individuals' names, except the executing signature, shall be given in full (Last Name, First Name, Middle Name).

3. Signatures on all copies of the Form DCM filed with the Commission can be executed electronically. If this Form DCM is filed by a corporation, it shall be signed in the name of the corporation by a principal officer duly authorized; if filed by a limited liability company, it shall be signed in the name of the limited liability company by a manager or member duly authorized to sign on the limited liability company's behalf; if filed by a partnership, it shall be signed in the name of the partnership by a general partner duly authorized; if filed by an unincorporated organization or association which is not a partnership, it shall be signed in the name of such organization or association by the managing agent, i.e., a duly authorized person who directs or manages or who participates in the directing or managing of its affairs.

4. If this Form DCM is being filed as an application for designation, all applicable items must be answered in full. If any item is inapplicable, indicate by "none," "not applicable," or "N/A," as appropriate.

5. Under Section 5 of the CEA and the Commission's regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this Form DCM from any Applicant seeking designation as a contract market and from any designated contract market. Disclosure by the Applicant of the information specified on this Form DCM is mandatory prior to the start of the processing of an application for, or an amendment to, designation as a contract market. The information provided in this Form DCM will be used for the principal purpose of determining whether the Commission should grant or deny designation to an Applicant. The Commission may determine that additional information is required from the Applicant in order to process its application. **A Form DCM which is not prepared and executed in compliance with applicable requirements and instructions may be returned as not acceptable for filing. Acceptance of this Form DCM, however, shall not constitute a finding that the Form DCM has been filed as required or that the information submitted is true, current, or complete.**

6. Except in cases where confidential treatment is requested by the Applicant and granted by the Commission pursuant to the Freedom of Information Act and the rules of the Commission thereunder, information supplied on this Form DCM will be included routinely in the public files of the Commission and will be available for inspection by any interested person.

APPLICATION AMENDMENTS

1. Part 38 of the Commission's regulations requires that if any information contained in this application, or any supplement or amendment thereto, is or becomes inaccurate for any reason, an amendment to Form DCM, or a submission under Part 40 of the Commission's regulations, in either case correcting such information must be filed promptly with the Commission.

2. Applicants, when filing this Form DCM for purposes of amending an application, must re-file the Cover Sheet, amended if necessary and including an executing signature, and attach thereto revised Exhibits or other materials marked to show changes, as applicable. The submission of an amendment represents that the remaining items and Exhibits that are not amended remain true, current, and complete as previously filed.

WHERE TO FILE

This Form DCM must be filed electronically with the Secretary of the Commission in a format specified by the Secretary of the Commission.

COMMODITY FUTURES TRADING COMMISSION

FORM DCM

CONTRACT MARKET
APPLICATION OR AMENDMENT TO APPLICATION FOR DESIGNATION

COVER SHEET

_____

Exact name of Applicant as specified in charter

_____

Address of principal executive offices

☐ If this is an **APPLICATION** for designation, complete in full and check here.

☐ If this is an **AMENDMENT** to an application, or to an existing designation, list all items that are amended and check here.

_____ _____

_____ _____

_____ _____

_____ _____

GENERAL INFORMATION

1. Name under which the business of the designated contract market is or will be conducted, if different than name specified above (include acronyms, if any):

   _____

2. If name of designated contract market is being amended, state previous designated contract market name:

   _____

3. Contact information, including mailing address if different than address specified above:

   _____
   Number and Street

   _____
   City State Country Zip Code

   _____
   Main Phone number Fax

   _____
   Website URL E-mail Address

4. List of principal office(s) and address(es) where designated contract market activities are/will be conducted:

Office	Address

5. If Applicant is a successor to a previously designated contract market, please complete the following:

   a. Date of succession

   _____

   b. Full name and address of predecessor designee

   _____
   Name

   _____
   Number and Street

   _____
   City State Country Zip Code

   _____
   Main Phone Number Website URL

BUSINESS ORGANIZATION

6. Applicant is a:

☐ Corporation
☐ Partnership
☐ Limited Liability Company
☐ Other form of organization (specify)_____

7. Date of incorporation or formation: _____

8. State of incorporation or jurisdiction of organization:_____

9. Applicant agrees and consents that the notice of any proceeding before the Commission in connection with this application may be given by sending such notice by certified mail to the person named below at the address given.

_____
Print Name and Title

_____
Name of Applicant

_____
Number and Street

_____
City State Zip Code

SIGNATURES

10. The Applicant has duly caused this application or amendment to be signed on its behalf by the undersigned, hereunto duly authorized, this _____ day of _____, 20_____. The Applicant and the undersigned represent hereby that all information contained herein is true, current, and complete. It is understood that all required items and Exhibits are considered integral parts of this Form DCM and that the submission of any amendment represents that all un-amended items and Exhibits remain true, current, and complete as previously filed.

_____

Name of Applicant

_____

Signature of Duly Authorized Person

_____

Print Name and Title of Signatory

COMMODITY FUTURES TRADING COMMISSION

FORM DCM

CONTRACT MARKET
APPLICATION OR AMENDMENT TO APPLICATION FOR DESIGNATION

EXHIBITS INSTRUCTIONS

The following Exhibits must be filed with the Commission by each Applicant applying for designation as a contract market, or by a designated contract market amending its designation, pursuant to Section 5 of the CEA and the Commission's regulations thereunder. The Exhibits must be labeled according to the items specified in this Form DCM.

The application must include a Table of Contents listing each Exhibit required by this Form DCM and indicating which, if any, Exhibits are inapplicable. For any Exhibit that is inapplicable, next to the Exhibit letter specify "none," "not applicable," or "N/A," as appropriate.

LIST OF EXHIBITS

EXHIBITS – BUSINESS ORGANIZATION

1. Attach as **Exhibit A,** the name of any person(s) who own(s) ten percent (10%) or more of the Applicant's stock or who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of Applicant.

   Provide as part of Exhibit A the full name and address of each such person and attach a copy of the agreement or, if there is none written, describe the agreement or basis upon which such person exercises or may exercise such control or direction.

2. Attach as **Exhibit B**, a list of the present officers, directors, governors (and, in the case of an Applicant that is not a corporation, the members of all standing committees grouped by committee), or persons performing functions similar to any of the foregoing, of the designated contract market or of any entity that performs the regulatory activities of the Applicant, indicating for each:
   1. Name
   2. Title
   3. Dates of commencement and termination of present term of office or position
   4. Length of time each present officer, director, or governor has held the same office or position
   5. Brief account of the business experience of each officer and director over the last five (5) years
   6. Any other business affiliations in the derivatives and securities industry
   7. For directors, list any committees on which they serve and any compensation received by virtue of their directorship
   8. A description of:
      (1) Any order of the Commission with respect to such person pursuant to Section 5e of the CEA;
      (2) Any conviction or injunction against such person within the past ten (10) years;
      (3) Any disciplinary action with respect to such person within the last five (5) years;
      (4) Any disqualification under Sections 8b and 8d of the CEA;
      (5) Any disciplinary action under Section 8c of the CEA; and
      (6) Any violation pursuant to Section 9 of the CEA.

3. Attach as **Exhibit C**, a narrative that sets forth the fitness standards for the Board of Directors and its composition including the number and percentage of public directors.

4. Attach as **Exhibit D,** a narrative or graphic description of the organizational structure of the Applicant. Include a list of all affiliates of the Applicant and indicate the general nature of the affiliation. Note: If the designated contract market activities of the Applicant are or will be conducted primarily by a division, subdivision, or other separate entity, corporation or organization, describe the relationship of such entity within the overall organizational structure and attach as Exhibit D a description only as it applies to the division, subdivision or separate entity, as applicable. Additionally, provide any relevant jurisdictional information, including any and all jurisdictions in which you or any affiliated entity are doing business, and registration status, including pending applications (e.g., country, regulator, registration category, date of registration). Provide the address for legal service of process for each jurisdiction, which cannot be a post office box.

5. Attach as **Exhibit E,** a description of the personnel qualifications for each category of professional employees employed by the Applicant or the division, subdivision, or other separate entity within the Applicant as described in Item 4.

6. Attach as **Exhibit F,** an analysis of staffing requirements necessary to carry out operations of the Applicant as a designated contract market and the name and qualifications of each key staff person.

7. Attach as **Exhibit G,** a copy of the constitution, articles of incorporation, formation or association with all amendments thereto, partnership or limited liability agreements, and existing by-laws, operating agreement, rules or instruments corresponding thereto, of the Applicant. Include any additional governance fitness information not included in Exhibit C. Provide a certificate of good standing dated within one week of the date of this Form DCM.

8. Attach as **Exhibit H,** a brief description of any material pending legal proceeding(s), other than ordinary and routine litigation incidental to the business, to which the Applicant or any of its affiliates is a party or to which any of its or their property is the subject. Include the name of the court or agency where the proceeding(s) are pending, the date(s) instituted, the principal parties involved, a description of the factual basis alleged to underlie the proceeding(s), and the relief sought. Include similar information as to any proceeding(s) known to be contemplated by the governmental agencies.

EXHIBITS — FINANCIAL INFORMATION

9. Attach as **Exhibit I:**
   1. (i) Balance sheet, (ii) Statement of income and expenses, (iii) Statement of cash flows, and (iv) Statement of sources and application of revenues and all notes or schedules thereto, as of the most recent fiscal year of the Applicant, or of its parent company, if applicable. If a balance sheet and any statement(s) certified by an independent public accountant are available, that balance sheet and statement(s) should be submitted as Exhibit I.

   2. Provide a narrative of how the value of the financial resources of the Applicant is at least equal to a total amount that would enable the Applicant to cover its operating costs for a period of at least one year, calculated on a rolling basis, and whether such financial resources include unencumbered, liquid financial assets (i.e. cash and/or highly liquid securities) equal to at least six months' operating costs.

   3. Attach copies of any agreements establishing or amending a credit facility, insurance coverage, or other arrangement evidencing or otherwise supporting the Applicant's conclusions regarding the liquidity of its financial assets.

   4. Representations regarding sources and estimates for future ongoing operational resources.

10. Attach as **Exhibit J,** a balance sheet and an income and expense statement for each affiliate of the designated contract market that also engages in designated contract market activities as of the end of the most recent fiscal year of each such affiliate, and each affiliate of the designated contract market that engages in swap execution facility activities.

11. Attach as **Exhibit K,** the following:

1. A complete list of all dues, fees and other charges imposed, or to be imposed, by or on behalf of Applicant for its designated contract market services that are provided on an exclusive basis and identify the service or services provided for each such due, fee, or other charge.

2. A description of the basis and methods used in determining the level and structure of the dues, fees and other charges listed in paragraph (a) of this item.

3. If the Applicant differentiates, or proposes to differentiate, among its customers, or classes of customers in the amount of any dues, fees, or other charges imposed for the same or similar exclusive services, so state and indicate the amount of each differential. In addition, identify and describe any differences in the cost of providing such services, and any other factors, that account for such differentiations.

EXHIBITS — COMPLIANCE

12. Attach as **Exhibit L**, a narrative and any other form of documentation that may be provided under other Exhibits herein that describe the manner in which the Applicant is able to comply with each core principle. Such documentation must include a regulatory compliance chart setting forth each core principle and providing citations to the Applicant's relevant rules, policies, and procedures that address each core principle. To the extent that the application raises issues that are novel, or for which compliance with a core principle is not self-evident, include an explanation of how that item and the application satisfy the core principles. Applicant must include a description of how it meets the definition of "Board of Trade" as defined in §1a(2) of the CEA.

13. Attach as **Exhibit M,** a copy of the Applicant's rules (as defined in § 40.1 of the Commission's regulations) and any technical manuals, other guides or instructions for users of, or participants in, the market, including minimum financial standards for members or market participants. Include rules citing applicable federal position limits and aggregation standards in Part 150 or 151, as applicab le, of the Commission's regulations and any exchange set position limit rules. Include rules on publication of daily trading information with regards to the requirements of Part 16 of the Commission's regulations. The Applicant should include an explanation, and any other forms of documentation the Applicant thinks will be helpful to its explanation, demonstrating how its rules, technical manuals, other guides or instructions for users of, or participants in, the market, or minimum financial standards for members or market participants as provided in this Exhibit M help support the designated contract market's compliance with the core principles.

14. Attach as **Exhibit N**, executed or executable copies of any agreements or contracts entered into or to be entered into by the Applicant, including third party regulatory service provider or member or user agreements that enable or empower the Applicant to comply with applicable core principles. Identify: (1) the services that will be provided; and (2) the core principles addressed by such agreement.

15. Attach as **Exhibit O,** a copy of any compliance manual, and any other documents, that describe with specificity the manner in which the Applicant will conduct trade practice, market and financial surveillance.

16. Attach as **Exhibit P**, a description of the Applicant's disciplinary and enforcement protocols, tools, and procedures and the arrangements for alternative dispute resolution.

17. Attach as **Exhibit Q**, a description of the Applicant's trading system and trade matching algorithm, and examples of how that algorithm works in various trading scenarios involving various types of orders.

18. Attach as **Exhibit R**, a list of rules prohibiting specific trade practice violations.

19. Attach as **Exhibit S**, a discussion of how trading data will be maintained by the designated contract market.

20. Attach as **Exhibit T**, a list of the name of the clearing organization(s) that will be clearing the Applicant's trades, and a representation that clearing members of that organization will be guaranteeing such trades.

21. Attach as **Exhibit U**, any information (described with particularity) included in the application that will be subject to a request for confidential treatment pursuant to § 145.9 of the Commission's regulations.

EXHIBITS –OPERATIONAL CAPABILITY

22. Attach as **Exhibit V**, information responsive to the Technology Questionnaire (link). This questionnaire focuses on information pertaining to the Applicant's program of risk analysis and oversight. Main topic areas include: information security; business continuity-disaster recovery planning and resources; capacity and performance planning; systems operations; systems development and quality assurance; and physical security and environmental controls.

Appendix B to Part 38--Guidance on, and Acceptable Practices in, Compliance with Core Principles

1. This appendix provides guidance on complying with core principles, both initially and on an ongoing basis, to obtain and maintain designation under section 5(d) of the Act and this part 38. Where provided, guidance is set forth in paragraph (a) following the relevant heading and can be used to demonstrate to the Commission compliance with the selected requirements of a core principle, under §§ 38.3 and 38.5 of this part. The guidance for the core principle is illustrative only of the types of matters a designated contract market may address, as applicable, and is not intended to be used as a mandatory checklist. Addressing the issues set forth in this appendix would help the Commission in its consideration of whether the designated contract market is in compliance with the selected requirements of a core principle; provided however, that the guidance is not intended to diminish or replace, in any event, the obligations and requirements of applicants and designated contract markets to comply with the regulations provided under this part.

2. Where provided, acceptable practices meeting selected requirements of core principles are set forth in paragraph (b) following guidance. Designated contract markets that follow specific practices outlined in the acceptable practices for a core principle in this appendix will meet the selected requirements of the applicable core principle; provided however, that the acceptable practice is not intended to diminish or replace, in any event, the obligations and requirements of applicants and designated contract markets to comply with the regulations provided under this part 38. The acceptable practices are for illustrative purposes only and do not state the exclusive means for satisfying a core principle.

Core Principle 1 of section 5(d) of the Act: DESIGNATION AS CONTRACT MARKET.—(A) IN GENERAL.—To be designated, and maintain a designation, as a contract market, a board of trade shall comply with—

(i) any core principle described in this subsection; and

(ii) any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5).

(B) REASONABLE DISCRETION OF CONTRACT MARKET— Unless otherwise determined by the Commission by rule or regulation, a board of trade described in subparagraph (A) shall have reasonable discretion in establishing the manner in which the board of trade complies with the core principles described in this subsection.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 2 of section 5(d) of the Act: COMPLIANCE WITH RULES—(A) IN GENERAL.—The board of trade shall establish, monitor, and enforce compliance with the rules of the contract market, including—

(i) access requirements;

(ii) the terms and conditions of any contracts to be traded on the contract market; and

(iii) rules prohibiting abusive trade practices on the contract market.

(B) CAPACITY OF CONTRACT MARKET.—The board of trade shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market.

(C) REQUIREMENT OF RULES.—The rules of the contract market shall provide the board of trade with the ability and authority to obtain any necessary information to perform any function described in this subsection, including the capacity to carry out such international information-sharing agreements as the Commission may require.

(a) Guidance. (1) Investigations and investigation reports - Warning letters. The rules of a designated contract market may authorize compliance staff to issue a warning letter to a person or entity under investigation or to recommend that a disciplinary panel take such an action.

(2) Additional rules required. A designated contract market should adopt and enforce any additional rules that it believes are necessary to comply with the requirements of subpart C of this chapter

(b) Acceptable Practices. [Reserved.]

Core Principle 3 of section 5(d) of the Act: CONTRACTS NOT READILY SUBJECT TO MANIPULATION. — The board of trade shall list on the contract market only contracts that are not readily susceptible to manipulation.

(a) Guidance. (1) Designated contract markets may list new products for trading by self-certification under § 40.2 of this chapter or may submit products for Commission approval under § 40.3 of this chapter.

(2) Guidance in appendix C to this part may be used as guidance in meeting this core principle for both new products listings and existing listed contracts.

(b) Acceptable Practices. [Reserved.]

Core Principle 4 of section 5(d) of the Act: PREVENTION OF MARKET DISRUPTION.—The board of trade shall have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures, including—

(A) methods for conducting real-time monitoring of trading; and

(B) comprehensive and accurate trade reconstructions.

(a) Guidance. The detection and prevention of market manipulation, disruptions, and distortions should be incorporated into the design of programs for monitoring trading activity. Monitoring of intraday trading should include the capacity to detect developing market anomalies, including abnormal price movements and unusual trading volumes, and position-limit violations. The designated contract market should have rules in place that allow it broad powers to intervene to prevent or reduce market disruptions. Once a

threatened or actual disruption is detected, the designated contract market should take steps to prevent the disruption or reduce its severity.

(2) Additional rules required. A designated contract market should adopt and enforce any additional rules that it believes are necessary to comply with the requirements of subpart E of this part.

(b) Acceptable Practices. (1) General Requirements. Real-time monitoring for market anomalies and position-limit violations are the most effective, but the designated contract market may also demonstrate that it has an acceptable program if some of the monitoring is accomplished on a T+1 basis. An acceptable program must include automated trading alerts to detect market anomalies and position-limit violations as they develop and before market disruptions occur or become more serious. In some cases, a designated contract market may demonstrate that its manual processes are effective.

(2) Physical-delivery contracts. For physical-delivery contracts, the designated contract market must demonstrate that it is monitoring the adequacy and availability of the deliverable supply, which, if such information is available, includes the size and ownership of those supplies and whether such supplies are likely to be available to short traders and saleable by long traders at the market value of those supplies under normal cash marketing conditions. Further, for physical-delivery contracts, the designated contract market must continually monitor the appropriateness of a contract's terms and conditions, including the delivery instrument, the delivery locations and location differentials, and the commodity characteristics and related differentials. The designated contract market must demonstrate that it is making a good-faith effort to resolve conditions that are interfering with convergence of its physical-delivery contract to the

price of the underlying commodity or causing price distortions or market disruptions, including, when appropriate, changes to contract terms.

(3) Cash-settled contracts. At a minimum, an acceptable program for monitoring cash-settled contracts must include access, either directly or through an information-sharing agreement, to traders' positions and transactions in the reference market for traders of a significant size in the designated contract market near the settlement of the contract.

(4) Ability to obtain information. With respect to the designated contract market's ability to obtain information, a designated contract market may limit the application of the requirement to keep and provide such records only to those that are reportable under its large-trader reporting system or otherwise hold substantial positions.

(5) Risk controls for trading. An acceptable program for preventing market disruptions must demonstrate appropriate trade risk controls, in addition to pauses and halts. Such controls must be adapted to the unique characteristics of the markets to which they apply and must be designed to avoid market disruptions without unduly interfering with that market's price discovery function. The designated contract market may choose from among controls that include: pre-trade limits on order size, price collars or bands around the current price, message throttles, and daily price limits, or design other types of controls. Within the specific array of controls that are selected, the designated contract market also must set the parameters for those controls, so long as the types of controls and their specific parameters are reasonably likely to serve the purpose of preventing market disruptions and price distortions. If a contract is linked to, or is a substitute for, other contracts, either listed on its market or on other trading venues, the designated contract market must, to the extent practicable, coordinate its risk controls with any

similar controls placed on those other contracts. If a contract is based on the price of an equity security or the level of an equity index, such risk controls must, to the extent practicable, be coordinated with any similar controls placed on national security exchanges.

Core Principle 5 of section 5(d) of the Act: POSITION LIMITATIONS OR ACCOUNTABILITY—(A) IN GENERAL.—To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators.

(B) MAXIMUM ALLOWABLE POSITION LIMITATION.—For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a), the board of trade shall set the position limitation of the board of trade at a level not higher than the position limitation established by the Commission.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 6 of section 5(d) of the Act: EMERGENCY AUTHORITY—The board of trade, in consultation or cooperation with the Commission, shall adopt rules to provide for the exercise of emergency authority, as is necessary and appropriate, including the authority—

(A) to liquidate or transfer open positions in any contract;

(B) to suspend or curtail trading in any contract; and

(C) to require market participants in any contract to meet special margin requirements.

(a) Guidance. In consultation and cooperation with the Commission, a designated contract market should have the authority to intervene as necessary to maintain markets with fair and orderly trading and to prevent or address manipulation or disruptive trading practices, whether the need for intervention arises exclusively from the DCM's market or as part of a coordinated, cross-market intervention. DCM rules should include procedures and guidelines to avoid conflicts of interest in accordance with the provisions of § 40.9 of this chapter, and include alternate lines of communication and approval procedures to address emergencies associated with real-time events. To address perceived market threats, the designated contract market should have rules that allow it to take certain actions in the event of an emergency, as defined in § 40.1(h) of this chapter, including: imposing or modifying position limits, price limits, and intraday market restrictions; imposing special margin requirements; ordering the liquidation or transfer of open positions in any contract; ordering the fixing of a settlement price; extending or shortening the expiration date or the trading hours; suspending or curtailing trading in any contract; transferring customer contracts and the margin or altering any contract's settlement terms or conditions; and, where applicable, providing for the carrying out of such actions through its agreements with its third-party provider of clearing or regulatory services. In situations where a contract is fungible with a contract on another platform, emergency action to liquidate or transfer open interest must be as directed, or agreed to, by the Commission or the Commission's staff. The DCM has the authority to independently respond to emergencies in an effective and timely manner consistent with the nature of the emergency, as long as all such actions taken by the DCM are made in good faith to protect the integrity of the markets. The Commission should be notified

promptly of the DCM's exercise of emergency action, explaining how conflicts of interest were minimized, including the extent to which the DCM considered the effect of its emergency action on the underlying markets and on markets that are linked or referenced to the contract market and similar markets on other trading venues. Information on all regulatory actions carried out pursuant to a DCM's emergency authority should be included in a timely submission of a certified rule pursuant to part 40 of this chapter.

(b) Acceptable Practices. A designated contract market must have procedures and guidelines for decision-making and implementation of emergency intervention in the market. At a minimum, the DCM must have the authority to liquidate or transfer open positions in the market, suspend or curtail trading in any contract, and require market participants in any contract to meet special margin requirements. In situations where a contract is fungible with a contract on another platform, emergency action to liquidate or transfer open interest must be directed, or agreed to, by the Commission or the Commission's staff. The DCM must promptly notify the Commission of the exercise of its emergency authority, documenting its decision-making process, including how conflicts of interest were minimized, and the reasons for using its emergency authority. The DCM must also have rules that allow it to take such market actions as may be directed by the Commission.

Core Principle 7 of section 5(d) of the Act: AVAILABILITY OF GENERAL INFORMATION.—The board of trade shall make available to market authorities, market participants, and the public accurate information concerning—

(A) the terms and conditions of the contracts of the contract market; and

(B)(i) the rules, regulations, and mechanisms for executing transactions on or through the facilities of the contract market; and

(ii) the rules and specifications describing the operation of the contract market's—

(I) electronic matching platform; or

(II) trade execution facility.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 8 of section 5(d) of the Act: DAILY PUBLICATION OF TRADING INFORMATION.—The board of trade shall make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 9 of section 5(d) of the Act: EXECUTION OF TRANSACTIONS.—

"(A) IN GENERAL.—The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade.

(B) RULES.—The rules of the board of trade may authorize, for bona fide business purposes—

(i) transfer trades or office trades;

(ii) an exchange of—

(I) futures in connection with a cash commodity transaction;

(II) futures for cash commodities; or

(III) futures for swaps; or

(iii) a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization.

(a) Guidance. [Reserved]

(b) Acceptable Practices. [Reserved]

Core Principle 10 of section 5(d) of the Act: TRADE INFORMATION.—The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information—

(A) to assist in the prevention of customer and market abuses; and

(B) to provide evidence of any violations of the rules of the contract market.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 11 of section 5(d) of the Act: FINANCIAL INTEGRITY OF TRANSACTIONS.—The board of trade shall establish and enforce—

(A) rules and procedures for ensuring the financial integrity of transactions entered into on or through the facilities of the contract market (including the clearance and settlement of the transactions with a derivatives clearing organization); and

(B) rules to ensure—

(i) the financial integrity of any—

(I) futures commission merchant; and

(II) introducing broker; and

(ii) the protection of customer funds.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 12 of section 5(d) of the Act: PROTECTION OF MARKETS AND MARKET PARTICIPANTS— The board of trade shall establish and enforce rules—

(A) to protect markets and market participants from abusive practices committed by any party, including abusive practices committed by a party acting as an agent for a participant; and

(B) to promote fair and equitable trading on the contract market.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 13 of section 5(d) of the Act: DISCIPLINARY PROCEDURES.—The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.

(a) Guidance. (1) Notice of charges. If the rules of the designated contract market so provide, a notice may also advise: (i) That failure to request a hearing within the period prescribed in the notice, except for good cause, may be deemed a waiver of the right to a hearing; and (ii) That failure to answer or to deny expressly a charge may be deemed to be an admission of such charge.

(2) Admission or failure to deny charges. The rules of a designated contract market may provide that if a respondent admits or fails to deny any of the charges, a disciplinary panel may find that the violations alleged in the notice of charges for which the respondent admitted or failed to deny any of the charges have been committed. If the designated contract market's rules so provide, then:

(i) The disciplinary panel should impose a sanction for each violation found to have been committed;

(ii) The disciplinary panel should promptly notify the respondent in writing of any sanction to be imposed pursuant to paragraph (2)(i) of this section and shall advise the respondent that it may request a hearing on such sanction within the period of time, which shall be stated in the notice;

(iii) The rules of a designated contract market may provide that if a respondent fails to request a hearing within the period of time stated in the notice, the respondent will be deemed to have accepted the sanction.

(3) Settlement offers. (i) The rules of a designated contract market may permit a respondent to submit a written offer of settlement at any time after an investigation report is completed. The disciplinary panel presiding over the matter may accept the offer of settlement, but may not alter the terms of a settlement offer unless the respondent agrees.

(ii) The rules of a designated contract market may provide that, in its discretion, a disciplinary panel may permit the respondent to accept a sanction without either admitting or denying the rule violations upon which the sanction is based.

(iii) If an offer of settlement is accepted, the panel accepting the offer should issue a written decision specifying the rule violations it has reason to believe were committed,

including the basis or reasons for the panel's conclusions, and any sanction to be imposed, which should include full customer restitution where customer harm is demonstrated, except where the amount of restitution and to whom it should be provided cannot be reasonably determined. If an offer of settlement is accepted without the agreement of the enforcement staff, the decision should adequately support the disciplinary panel's acceptance of the settlement. Where applicable, the decision should also include a statement that the respondent has accepted the sanctions imposed without either admitting or denying the rule violations.

(iv) The respondent may withdraw his or her offer of settlement at any time before final acceptance by a disciplinary panel. If an offer is withdrawn after submission, or is rejected by a disciplinary panel, the respondent should not be deemed to have made any admissions by reason of the offer of settlement and should not be otherwise prejudiced by having submitted the offer of settlement.

(4) Hearings. The rules of a designated contract market may provide that a sanction may be summarily imposed upon any person within its jurisdiction whose actions impede the progress of a hearing.

(5) Right to appeal. The rules of a designated contract market may permit the parties to a proceeding to appeal promptly an adverse decision of a disciplinary panel in all or in certain classes of cases. Such rules may require a party's notice of appeal to be in writing and to specify the findings, conclusions, or sanctions to which objection are taken. If the rules of a designated contract market permit appeals, then both the respondent and the enforcement staff should have the opportunity to appeal and the designated contract market should provide for the following:

(i) The designated contract market should establish an appellate panel that should be authorized to hear appeals of respondents. In addition, the rules of a designated contract market may provide that the appellate panel may, on its own initiative, order review of a decision by a disciplinary panel within a reasonable period of time after the decision has been rendered.

(ii) The composition of the appellate panel should be consistent with the requirements set forth in part 40 of this chapter and paragraph (4) of the acceptable practices for Core Principle 16, and should not include any members of the designated contract market's compliance staff, or any person involved in adjudicating any other stage of the same proceeding. The rules of a designated contract market should provide for the appeal proceeding to be conducted before all of the members of the appellate panel or a panel thereof.

(iii) Except for good cause shown, the appeal or review should be conducted solely on the record before the disciplinary panel, the written exceptions filed by the parties, and the oral or written arguments of the parties.

(iv) Promptly following the appeal or review proceeding, the appellate panel should issue a written decision and should provide a copy to the respondent. The decision issued by the appellate panel should adhere to all the requirements of § 38.708 of this part, to the extent that a different conclusion is reached from that issued by the disciplinary panel.

(6) Summary fines for violations of rules regarding timely submission of records, decorum, or other similar activities. A designated contract market may adopt a summary fine schedule for violations of rules relating to the timely submission of accurate records required for clearing or verifying each day's transactions, decorum, attire, or other similar

activities. A designated contract market may permit its compliance staff, or a designated panel of contract market officials, to summarily impose minor sanctions against persons within the designated contract market's jurisdiction for violating such rules. A designated contract market's summary fine schedule may allow for warning letters to be issued for first-time violations or violators. If adopted, a summary fine schedule should provide for progressively larger fines for recurring violations.

(7) Emergency disciplinary actions. (i) A designated contract market may impose a sanction, including suspension, or take other summary action against a person or entity subject to its jurisdiction upon a reasonable belief that such immediate action is necessary to protect the best interest of the marketplace.

(ii) Any emergency disciplinary action should be taken in accordance with a designated contract market's procedures that provide for the following:

(A) If practicable, a respondent should be served with a notice before the action is taken, or otherwise at the earliest possible opportunity. The notice should state the action, briefly state the reasons for the action, and state the effective time and date, and the duration of the action.

(B) The respondent should have the right to be represented by legal counsel or any other representative of its choosing in all proceedings subsequent to the emergency action taken. The respondent should be given the opportunity for a hearing as soon as reasonably practicable and the hearing should be conducted before the disciplinary panel pursuant to the requirements of § 38.707 of this part.

(C) Promptly following the hearing provided for in this rule, the designated contract market should render a written decision based upon the weight of the evidence contained

in the record of the proceeding and should provide a copy to the respondent. The decision should include a description of the summary action taken; the reasons for the summary action; a summary of the evidence produced at the hearing; a statement of findings and conclusions; a determination that the summary action should be affirmed, modified, or reversed; and a declaration of any action to be taken pursuant to the determination, and the effective date and duration of such action.

(b) Acceptable Practices. [Reserved.]

Core Principle 14 of section 5(d) of the Act: DISPUTE RESOLUTION.—The board of trade shall establish and enforce rules regarding, and provide facilities for alternative dispute resolution as appropriate for, market participants and any market intermediaries.

(a) Guidance. A designated contract market should provide customer dispute resolution procedures that are: appropriate to the nature of the market; fair and equitable; and available on a voluntary basis, either directly or through another self-regulatory organization, to customers that are non-eligible contract participants.

(b) Acceptable Practices.

(1) Fair and equitable procedure. Every contract market shall provide customer dispute resolution procedures that are fair and equitable. An acceptable customer dispute resolution mechanism would:

(i) Provide the customer with an opportunity to have his or her claim decided by an objective and impartial decision-maker;

(ii) Provide each party with the right to be represented by counsel at the commencement of the procedure, at the party's own expense;

(iii) Provide each party with adequate notice of the claims presented against such party, an opportunity to be heard on all claims, defenses and permitted counterclaims, and an opportunity for a prompt hearing;

(iv) Authorize prompt, written, final settlement awards that are not subject to appeal within the designated contract market; and

(v) Notify the parties of the fees and costs that may be assessed.

(2) Voluntary Procedures. The use of dispute settlement procedures shall be voluntary for customers other than eligible contract participants as defined in section 1a(18) of the Dodd-Frank Act, and may permit counterclaims as provided in § 166.5 of this chapter.

(3) Member-to-Member Procedures. If the designated contract market also provides procedures for the resolution of disputes that do not involve customers (i.e., member-to-member disputes), the procedures for resolving such disputes must be independent of and shall not interfere with or delay the resolution of customers' claims or grievances.

(4) Delegation. A designated contract market may delegate to another self-regulatory organization or to a registered futures association its responsibility to provide for customer dispute resolution mechanisms, provided, however, that in the event of such delegation, the designated contract market shall in all respects treat any decision issued by such other organization or association with respect to such dispute as if the decision were its own, including providing for the appropriate enforcement of any award issued against a delinquent member.

Core Principle 15 of section 5(d) of the Act: GOVERNANCE FITNESS STANDARDS.—The board of trade shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract

market, and any other person with direct access to the facility (including any party affiliated with any person described in this paragraph).

(a) Guidance. (1) A designated contract market should have appropriate eligibility criteria for the categories of persons set forth in the Core Principle that should include standards for fitness and for the collection and verification of information supporting compliance with such standards. Minimum standards of fitness for persons who have member voting privileges, governing obligations or responsibilities, or who exercise disciplinary authority are those bases for refusal to register a person under section 8a(2) of the Act. In addition, persons who have governing obligations or responsibilities, or who exercise disciplinary authority, should not have a significant history of serious disciplinary offenses, such as those that would be disqualifying under § 1.63 of this chapter. Members with trading privileges but having no, or only nominal, equity, in the facility and non-member market participants who are not intermediated and do not have these privileges, obligations, responsibilities or disciplinary authority could satisfy minimum fitness standards by meeting the standards that they must meet to qualify as a "market participant." Natural persons who directly or indirectly have greater than a ten percent ownership interest in a designated contract market should meet the fitness standards applicable to members with voting rights.

(2) The Commission believes that such standards should include providing the Commission with fitness information for such persons, whether registration information, certification to the fitness of such persons, an affidavit of such persons' fitness by the contract market's counsel or other information substantiating the fitness of such persons. If a contract market provides certification of the fitness of such a person, the Commission

believes that such certification should be based on verified information that the person is fit to be in his or her position.

(b) Applicable Practices. [Reserved.]

Core Principle 16 of section 5(d) of the Act: CONFLICTS OF INTEREST.—The board of trade shall establish and enforce rules—

(A) to minimize conflicts of interest in the decision making process of the contract market; and

(B) to establish a process for resolving conflicts of interest described in subparagraph (A).

(a) Guidance. The means to address conflicts of interest in decision-making of a contract market should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict. In addition, the Commission believes that the contract market should provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by board members, committee members and contract market employees or gained through an ownership interest in the contract market.

(b) Acceptable Practices. All designated contract markets ("DCMs" or "contract markets") bear special responsibility to regulate effectively, impartially, and with due consideration of the public interest, as provided for in section 3 of the Act. Under Core Principle 15, they are also required to minimize conflicts of interest in their decision-making processes. To comply with this Core Principle, contract markets should be particularly vigilant for such conflicts between and among any of their self-regulatory responsibilities, their commercial interests, and the several interests of their management,

members, owners, customers and market participants, other industry participants, and other constituencies. Acceptable practices for minimizing conflicts of interest shall include the following elements:

(1) Board composition for contract markets

(i) At least thirty-five percent of the directors on a contract market's board of directors shall be public directors; and

(ii) The executive committees (or similarly empowered bodies) shall be at least thirty-five percent public.

(2) Public director

(i) To qualify as a public director of a contract market, an individual must first be found, by the board of directors, on the record, to have no material relationship with the contract market. A "material relationship" is one that reasonably could affect the independent judgment or decision making of the director.

(ii) In addition, a director shall be considered to have a "material relationship" with the contract market if any of the following circumstances exist:

(A) The director is an officer or employee of the contract market or an officer or employee of its affiliate. In this context, "affiliate" includes parents or subsidiaries of the contract market or entities that share a common parent with the contract market;

(B) The director is a member of the contract market, or an officer or director of a member. "Member" is defined according to section 1a(34) of the Commodity Exchange Act and Commission Regulation 1.3(q);

(C) The director, or a firm with which the director is an officer, director, or partner, receives more than $100,000 in combined annual payments from the contract market, or

any affiliate of the contract market (as defined in subsection (2)(ii)(A)), for legal, accounting, or consulting services. Compensation for services as a director of the contract market or as a director of an affiliate of the contract market does not count toward the $100,000 payment limit, nor does deferred compensation for services prior to becoming a director, so long as such compensation is in no way contingent, conditioned, or revocable;

(D) Any of the relationships above apply to a member of the director's "immediate family," i.e., spouse, parents, children and siblings.

(iii) All of the disqualifying circumstances described in subsection (2)(ii) shall be subject to a one-year look back.

(iv) A contract market's public directors may also serve as directors of the contract market's affiliate (as defined in subsection (2)(ii)(A)) if they otherwise meet the definition of public director in this section (2).

(v) A contract market shall disclose to the Commission which members of its board are public directors, and the basis for those determinations.

(3) Regulatory oversight committee

(i) A board of directors of any contract market shall establish a Regulatory Oversight Committee ("ROC") as a standing committee, consisting of only public directors as defined in section (2), to assist it in minimizing actual and potential conflicts of interest. The ROC shall oversee the contract market's regulatory program on behalf of the board. The board shall delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the ROC to fulfill its mandate.

(ii) The ROC shall:

(A) Monitor the contract market's regulatory program for sufficiency, effectiveness, and independence;

(B) Oversee all facets of the program, including trade practice and market surveillance; audits, examinations, and other regulatory responsibilities with respect to member firms (including ensuring compliance with financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and the conduct of investigations;

(C) Review the size and allocation of the regulatory budget and resources; and the number, hiring and termination, and compensation of regulatory personnel;

(D) Supervise the contract market's chief regulatory officer, who will report directly to the ROC;

(E) Prepare an annual report assessing the contract market's self-regulatory program for the board of directors and the Commission, which sets forth the regulatory program's expenses, describes its staffing and structure, catalogues disciplinary actions taken during the year, and reviews the performance of disciplinary committees and panels;

(F) Recommend changes that would ensure fair, vigorous, and effective regulation; and

(G) Review regulatory proposals and advise the board as to whether and how such changes may impact regulation.

(4) Disciplinary panels

All contract markets shall minimize conflicts of interest in their disciplinary processes through disciplinary panel composition rules that preclude any group or class of industry participants from dominating or exercising disproportionate influence on such panels. Contract markets can further minimize conflicts of interest by including in all disciplinary panels at least one person who would qualify as a public director, as defined in

subsections (2)(ii) and (2)(iii) above, except in cases limited to decorum, attire, or the timely submission of accurate records required for clearing or verifying each day's transactions. If contract market rules provide for appeal to the board of directors, or to a committee of the board, then that appellate body shall also include at least one person who would qualify as a public director as defined in subsections (2)(ii) and (2)(iii) above.

Core Principle 17 of section 5(d) of the Act: COMPOSITION OF GOVERNING BOARDS OF CONTRACT MARKETS.—The governance arrangements of the board of trade shall be designed to permit consideration of the views of market participants.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 18 of section 5(d) of the Act: RECORDKEEPING.—The board of trade shall maintain records of all activities relating to the business of the contract market—

(A) in a form and manner that is acceptable to the Commission; and

(B) for a period of at least 5 years.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 19 of section 5(d) of the Act: ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall not—

(A) adopt any rule or taking any action that results in any unreasonable restraint of trade; or

(B) impose any material anticompetitive burden on trading on the contract market.

(a) Guidance. An entity seeking designation as a contract market may request that the Commission consider under the provisions of section 15(b) of the Act, any of the entity's rules, including trading protocols or policies, and including both operational rules and the terms or conditions of products listed for trading, at the time of designation or thereafter. The Commission intends to apply section 15(b) of the Act to its consideration of issues under this core principle in a manner consistent with that previously applied to contract markets.

(b) Acceptable Practices. [Reserved.]

Core Principle 20 of section 5(d) of the Act: SYSTEM SAFEGUARDS.—The board of trade shall—

(A) establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and the development of automated systems, that are reliable, secure, and have adequate scalable capacity;

(B) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for the timely recovery and resumption of operations and the fulfillment of the responsibilities and obligations of the board of trade; and

(C) periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 21 of section 5(d) of the Act: FINANCIAL RESOURCES.—

(A) IN GENERAL.—The board of trade shall have adequate financial, operational, and managerial resources to discharge each responsibility of the board of trade.

(B) DETERMINATION OF ADEQUACY.—The financial resources of the board of trade shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the contract market to cover the operating costs of the contract market for a 1-year period, as calculated on a rolling basis.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 22 of section 5(d) of the Act: DIVERSITY OF BOARD OF DIRECTORS.—The board of trade, if a publicly traded company, shall endeavor to recruit individuals to serve on the board of directors and the other decision-making bodies (as determined by the Commission) of the board of trade from among, and to have the composition of the bodies reflect, a broad and culturally diverse pool of qualified candidates.

(a) Guidance. [Reserved.]

(b) Acceptable Practices. [Reserved.]

Core Principle 23 of section 5(d) of the Act: SECURITIES AND EXCHANGE COMMISSION.—The board of trade shall keep any such records relating to swaps defined in section 1a(47)(A)(v) open to inspection and examination by the Securities and Exchange Commission.

(a) Guidance. A designated contract market should have arrangements and resources for collecting and maintaining accurate records pertaining to any swaps agreements defined

in section 1a(47)(A)(v) of the Act, and should leave them open to inspection and examination for a period of five years.

(b) Acceptable Practices. [Reserved.]

Appendix C—Demonstration of Compliance That a Contract is Not Readily Susceptible to Manipulation

(a) Futures Contracts—General Information. When a designated contract market certifies or submits for approval contract terms and conditions for a new futures contract, that submission should include the following information:

(1) A narrative describing the contract, including data and information to support the contract's terms and conditions, as set by the designated contract market. When designing a futures contract, the designated contract market should conduct market research so that the contract design meets the risk management needs of prospective users and promotes price discovery of the underlying commodity. The designated contract market should consult with market users to obtain their views and opinions during the contract design process to ensure the contract's term and conditions reflect the underlying cash market and that the futures contract will perform the intended risk management and/ or price discovery functions. A designated contract market should provide a statement indicating that it took such steps to ensure the usefulness of the submitted contract.

(2) A detailed cash market description for physical and cash-settled contracts. Such descriptions should be based on government and/or other publicly-available data whenever possible and be formulated for both the national and regional/local market relevant to the underlying commodity. For tangible commodities, the cash market descriptions for the relevant market (i.e., national and regional/local) should incorporate

at least three full years of data that may include, among other factors, production, consumption, stocks, imports, exports, and prices. Each of those cash market variables should be fully defined and the data sources should be fully specified and documented to permit Commission staff to replicate the estimates of deliverable supply (defined in paragraph (b)(1)(A) of this appendix C). Whenever possible, the Commission requests that monthly or daily prices (depending on the contract) underlying the cash settlement index be submitted for the most recent three full calendar years and for as many of the current year's months for which data are available. For contracts that are cash settled to an index, the index's methodology should be provided along with supporting information showing how the index is reflective of the underlying cash market, is not readily subject to manipulation or distortion, and is based on a cash price series that is reliable, acceptable, publicly available and timely (defined in paragraphs (c)(2) and (c)(3) of this appendix C). The Commission recognizes that the data necessary for accurate and cogent cash market analyses for an underlying commodity vary with the nature of the underlying commodity. The Commission may require that the designated contract market submit a detailed report on commodity definitions and uses.

(b) Futures Contracts Settled by Physical Delivery. (1) For listed contracts that are settled by physical delivery, the terms and conditions of the contract should conform to the most common commercial practices and conditions in the cash market for the commodity underlying the futures contract. The terms and conditions should be designed to avoid any impediments to the delivery of the commodity so as to promote convergence between the price of the futures contract and the cash market value of the commodity at the expiration of a futures contract.

(i) Estimating Deliverable Supplies.

(A) General definition. The specified terms and conditions, considered as a whole, should result in a "deliverable supply" that is sufficient to ensure that the contract is not susceptible to price manipulation or distortion. In general, the term "deliverable supply" means the quantity of the commodity meeting the contract's delivery specifications that reasonably can be expected to be readily available to short traders and salable by long traders at its market value in normal cash marketing channels at the contract's delivery points during the specified delivery period, barring abnormal movement in interstate commerce. Typically, deliverable supply reflects the quantity of the commodity that potentially could be made available for sale on a spot basis at current prices at the contract's delivery points. For a non-financial physical-delivery commodity contract, this estimate might represent product which is in storage at the delivery point(s) specified in the futures contract or can be moved economically into or through such points consistent with the delivery procedures set forth in the contract and which is available for sale on a spot basis within the marketing channels that normally are tributary to the delivery point(s). Furthermore, an estimate of deliverable supply would not include supply that is committed for long-term agreements (i.e., the amount of deliverable supply that would not be available to fulfill the delivery obligations arising from current trading). The size of commodity supplies that are committed to long-term agreements may be estimated by consulting with market participants. However, if the estimated deliverable supply that is committed for long-term agreements, or significant portion thereof, can be demonstrated by the designated contract market to be consistently and regularly made available to the spot market for shorts to acquire at prevailing economic values, then those "available"

supplies committed for long-term contracts may be included in the designated contract market's estimate of deliverable supply for that commodity. An adequate measure of deliverable supply would be an amount of the commodity that would meet the normal or expected range of delivery demand without causing futures prices to become distorted relative to cash market prices. Given the availability of acceptable data, deliverable supply should be estimated on a monthly basis for at least the most recent three years for which data are available. To the extent possible and that data resources permit, deliverable supply estimates should be constructed such that the data reflect, as close as possible, the market defined by the contract's terms and conditions, and should be formulated, whenever possible, with government or publicly available data. All deliverable supply estimates should be fully defined, have all underlying assumptions explicitly stated, and have documentation of all data/information sources in order to permit estimate replication by Commission staff.

(B) Accounting for variations in deliverable supplies. To assure the availability of adequate deliverable supplies and acceptable levels of commercial risk management utility, contract terms and conditions should account for variations in the patterns of production, consumption and supply over a period of years of sufficient length to assess adequately the potential range of deliverable supplies. This assessment also should consider seasonality, growth, and market concentration in the production/consumption of the underlying cash commodity. Deliverable supply implications of seasonal effects are more straightforwardly delineated when deliverable supply estimates are calculated on a monthly basis and when such monthly estimates are provided for at least the most recent three years for which data resources permit. In addition, consideration should be given to

the relative roles of producers, merchants, and consumers in the production, distribution, and consumption of the cash commodity and whether the underlying commodity exhibits a domestic or international export focus. Careful consideration also should be given to the quality of the cash commodity and to the movement or flow of the cash commodity in normal commercial channels and whether there exist external factors or regulatory controls that could affect the price or supply of the cash commodity.

(C) Calculation of deliverable supplies. Designated contract markets should derive a quantitative estimate of the deliverable supplies for the delivery period specified in the proposed contract. For commodities with seasonal supply or demand characteristics, the deliverable supply analysis should include that period when potential supplies typically are at their lowest levels. The estimate should be based on statistical data, when reasonably available, covering a period of time that is representative of the underlying commodity's actual patterns of production, patterns of consumption, and patterns of seasonal effects (if relevant). Often, such a relevant time period should include at least three years of monthly deliverable supply estimates permitted by available data resources. Deliverable supply estimates should also exclude the amount of the commodity that would not be otherwise deliverable on the futures contract. For example, deliverable supplies should exclude quantities that at current price levels are not economically obtainable or deliverable or were previously committed for long-term agreements.

(2) Contract terms and conditions requirements for futures contracts settled by physical delivery.

(i) For physical delivery contracts, an acceptable specification of terms and conditions would include, but may not be limited to, rules that address, as appropriate, the following criteria and comply with the associated standards:

(A) Quality Standards. The terms and conditions of a commodity contract should describe or define all of the economically significant characteristics or attributes of the commodity underlying the contract. In particular, the quality standards should be described or defined so that such standards reflect those used in transactions in the commodity in normal cash marketing channels. Documentation establishing that the quality standards of the contract's underlying commodity comply with those accepted/established by the industry, by government regulations, and/or by relevant laws should also be submitted. For any particular commodity contract, the specific attributes that should be enumerated depend upon the individual characteristics of the underlying commodity. These may include, for example, the following items: grade, quality, purity, weight, class, origin, growth, issuer, originator, maturity window, coupon rate, source, hours of trading, etc. If the terms of the contract provide for the delivery of multiple qualities of a specific attribute of the commodity having different cash market values, then a "par" quality should be specified with price differentials applicable to the "non-par" qualities that reflect discounts or premiums commonly observed or expected to occur in the cash market for that commodity.

(B) Delivery Points and Facilities. Delivery point/area specifications should provide for futures delivery at a single location or at multiple locations where the underlying cash commodity is normally transacted or stored and where there exists a viable cash market(s). If multiple delivery points are specified and the value of the commodity

differs between these locations, contract terms should include price differentials that reflect usual differences in value between the different delivery locations. If the price relationships among the delivery points are unstable and a designated contract market chooses to adopt fixed locational price differentials, such differentials should fall within the range of commonly observed or expected commercial price differences. In this regard, any price differentials should be supported with cash price data for the delivery location(s). The terms and conditions of the contracts also should specify, as appropriate, any conditions the delivery facilities and/or delivery facility operators should meet in order to be eligible for delivery. Specification of any requirements for delivery facilities also should consider the extent to which ownership of such facilities is concentrated and whether the level of concentration would be susceptible to manipulation of the futures contract's prices. Commodity contracts also should specify appropriately detailed delivery procedures that describe the responsibilities of deliverers, receivers and any required third parties in carrying out the delivery process. Such responsibilities could include allocation between buyer and seller of all associated costs such as load-out, document preparation, sampling, grading, weighing, storage, taxes, duties, fees, drayage, stevedoring, demurrage, dispatch, etc. Required accreditation for third-parties also should be detailed. These procedures should seek to minimize or eliminate any impediments to making or taking delivery by both deliverers and takers of delivery to help ensure convergence of cash and futures at the expiration of a futures delivery month.

(C) Delivery Period and Last Trading Day. An acceptable specification of the delivery period would allow for sufficient time for deliverers to acquire the deliverable commodity and make it available for delivery, considering any restrictions or

requirements imposed by the designated contract market. Specification of the last trading day for expiring contracts should consider whether adequate time remains after the last trading day to allow for delivery on the contract.

(D) Contract Size and Trading Unit. An acceptable specification of the delivery unit and/or trading unit would be a contract size that is consistent with customary transactions, transportation or storage amounts in the cash market (e.g., the contract size may be reflective of the amount of the commodity that represents a pipeline, truckload or railcar shipment). For purposes of increasing market liquidity, a designated contract market may elect to specify a contract size that is smaller than the typical commercial transaction size, storage unit or transportation size. In such cases, the commodity contract should include procedures that allow futures traders to easily take or make delivery on such a contract with a smaller size, or, alternatively, the designated contract market may adopt special provisions requiring that delivery be made only in multiple contracts to accommodate reselling the commodity in the cash market. If the latter provision is adopted, contract terms should be adopted to minimize the potential for default in the delivery process by ensuring that all contracts remaining open at the close of trading in expiring delivery months can be combined to meet the required delivery unit size. Generally, contract sizes and trading units should be determined after a careful analysis of relevant cash market trading practices, conditions and deliverable supply estimates, so as to ensure that the underlying market commodity market and available supply sources are able to support the contract sizes and trading units at all times.

(E) Delivery Pack. The term "delivery pack" refers to the packaging standards (e.g., product may be delivered in burlap or polyethylene bags stacked on wooden pallets) or

non-quality related standards regarding the composition of commodity within a delivery unit (e.g., product must all be imported from the same country or origin). An acceptable specification of the delivery pack or composition of a contract's delivery unit should reflect, to the extent possible, specifications commonly applied to the commodity traded or transacted in the cash market.

(F) Delivery Instrument. An acceptable specification of the delivery instrument (e.g., warehouse receipt, depository certificate or receipt, shipping certificate, bill of lading, in-line transfer, book transfer of securities, etc.) would provide for its conversion into the cash commodity at a commercially-reasonable cost. Transportation terms (e.g., FOB, CIF, freight prepaid to destination) as well as any limits on storage or certificate daily premium fees should be specified. These terms should reflect cash market practices and the customary provision for allocating delivery costs between buyer and seller.

(G) Inspection Provisions. Any inspection/certification procedures for verifying compliance with quality requirements or any other related delivery requirements (e.g., discounts relating to the age of the commodity, etc.) should be specified in the contract rules. An acceptable specification of inspection procedures would include the establishment of formal procedures that are consistent with procedures used in the cash market. To the extent that formal inspection procedures are not used in the cash market, an acceptable specification would contain provisions that assure accuracy in assessing the commodity, that are available at a low cost, that do not pose an obstacle to delivery on the contract and that are performed by a reputable, disinterested third party or by qualified designated contract market employees. Inspection terms also should detail

which party pays for the service, particularly in light of the possibility of varying inspection results.

(H) Delivery (Trading) Months. Delivery months should be established based on the risk management needs of commercial entities as well as the availability of deliverable supplies in the specified months.

(I) Minimum Price Fluctuation (Minimum Tick). The minimum price increment (tick) should be set at a level that is equal to, or less than, the minimum price increment commonly observed in cash market transactions for the underlying commodity. Specifying a futures' minimum tick that is greater than the minimum price increment in the cash market can undermine the risk management utility of the futures contract by preventing hedgers from efficiently establishing and liquidating futures positions that are used to hedge anticipated cash market transactions or cash market positions.

(J) Maximum Price Fluctuation Limits. Designated contract markets may adopt price limits to: (1) Reduce or constrain price movements in a trading day that may not be reflective of true market conditions but might be caused by traders overreacting to news; (2) Allow additional time for the collection of margins in times of large price movements; and (3) Provide a "cooling-off" period for futures market participants to respond to bona fide changes in market supply and demand fundamentals that would lead to large cash and futures price changes. If price limit provisions are adopted, the limits should be set at levels that are not overly restrictive in relation to price movements in the cash market for the commodity underlying the futures contract.

(K) Speculative Limits. Specific information regarding the establishment of speculative position limits are set forth in part 150, and/or part 151, as applicable, of the Commission's regulations.

(L) Reportable Levels. Refer to § 15.03 of the Commission's regulations.

(M) Trading Hours. Should be set by the designated contract market to delineate each trading day.

(c) Futures Contracts Settled by Cash Settlement. (1) Cash settlement is a method of settling certain futures or option contracts whereby, at contract expiration, the contract is settled by cash payment in lieu of physical delivery of the commodity or instrument underlying the contract. An acceptable specification of the cash settlement price for commodity futures and option contracts would include rules that fully describe the essential economic characteristics of the underlying commodity (e.g., grade, quality, weight, class, growth, issuer, maturity, source, rating, description of the underlying index and index's calculation methodology, etc.), as well as how the final settlement price is calculated. In addition, the rules should clearly specify the trading months and hours of trading, the last trading day, contract size, minimum price change (tick size) and any limitations on price movements (e.g., price limits or trading halts).

(2) Cash settled contracts may be susceptible to manipulation or price distortion. In evaluating the susceptibility of a cash-settled contract to manipulation, a designated contract market should consider the size and liquidity of the cash market that underlies the listed contract in a manner that follows the determination of deliverable supply as noted above in (b)(1). In particular, situations susceptible to manipulation include those in which the volume of cash market transactions and/or the number of participants

contacted in determining the cash-settlement price are very low. Cash-settled contracts may create an incentive to manipulate or artificially influence the data from which the cash-settlement price is derived or to exert undue influence on the cash-settlement price's computation in order to profit on a futures position in that commodity. The utility of a cash-settled contract for risk management and price discovery would be significantly impaired if the cash settlement price is not a reliable or robust indicator of the value of the underlying commodity or instrument. Accordingly, careful consideration should be given to the potential for manipulation or distortion of the cash settlement price, as well as the reliability of that price as an indicator of cash market values. Appropriate consideration also should be given to the commercial acceptability, public availability, and timeliness of the price series that is used to calculate the cash settlement price. Documentation demonstrating that the settlement price index is a reliable indicator of market values and conditions and is commonly used as a reference index by industry/market agents should be provided. Such documentation may take on various forms, including carefully documented interview results with knowledgeable agents.

(3) Where an independent, private-sector third party calculates the cash settlement price series, a designated contract market should consider the need for a licensing agreement that will ensure the designated contract market's rights to the use of the price series to settle the listed contract.

(i) Where an independent, private-sector third party calculates the cash settlement price series, the designated contract market should verify that the third party utilizes business practices that minimize the opportunity or incentive to manipulate the cash-settlement price series. Such safeguards may include lock-downs, prohibitions against derivatives

trading by employees, or public dissemination of the names of sources and the price quotes they provide. Because a cash-settled contract may create an incentive to manipulate or artificially influence the underlying market from which the cash-settlement price is derived or to exert undue influence on the cash-settlement computation in order to profit on a futures position in that commodity, a designated contract market should, whenever practicable, enter into an information-sharing agreement with the third-party provider which would enable the designated contract market to better detect and prevent manipulative behavior.

(ii) Where a designated contract market itself generates the cash settlement price series, the designated contract market should establish calculation procedures that safeguard against potential attempts to artificially influence the price. For example, if the cash settlement price is derived by the designated contract market based on a survey of cash market sources, the designated contract market should maintain a list of such entities which all should be reputable sources with knowledge of the cash market. In addition, the sample of sources polled should be representative of the cash market, and the poll should be conducted at a time when trading in the cash market is active.

(iii) The cash-settlement calculation should involve computational procedures that eliminate or reduce the impact of potentially unrepresentative data.

(iv) The cash settlement price should be an accurate and reliable indicator of prices in the underlying cash market. The cash settlement price also should be acceptable to commercial users of the commodity contract. The registered entity should fully document that the settlement price is accurate, reliable, highly regarded by

industry/market agents, and fully reflects the economic and commercial conditions of the relevant designated contract market.

(v) To the extent possible, the cash settlement price should be based on cash price series that are publicly available and available on a timely basis for purposes of calculating the cash settlement price at the expiration of a commodity contract. A designated contract market should make the final cash settlement price and any other supporting information that is appropriate for release to the public, available to the public when cash settlement is accomplished by the derivatives clearing organization. If the cash settlement price is based on cash prices that are obtained from non-public sources (e.g., cash market surveys conducted by the designated contract market or by third parties on behalf of the designated contract market), a designated contract market should make available to the public as soon as possible after a contract month's expiration the final cash settlement price as well as any other supporting information that is appropriate or feasible to make available to the public.

(4) Contract terms and conditions requirements for futures contracts settled by cash settlement.

(i) An acceptable specification of the terms and conditions of a cash-settled commodity contract will also set forth the trading months, last trading day, contract size, minimum price change (tick size) and daily price limits, if any.

(A) Commodity Characteristics: The terms and conditions of a commodity contract should describe the commodity underlying the contract.

(B) Contract Size and Trading Unit: An acceptable specification of the trading unit would be a contract size that is consistent with customary transactions in the cash market.

A designated contract market may opt to set the contract size smaller than that of standard cash market transactions.

(C) Cash Settlement Procedure: The cash settlement price should be reliable, acceptable, publicly available, and reported in a timely manner as described in paragraphs (c)(3)(iv) and (c)(3)(v) of this appendix C.

(D) Pricing Basis and Minimum Price Fluctuation (Minimum Tick): The minimum price increment (tick) should be set a level that is equal to, or less than, the minimum price increment commonly observed in cash market transactions for the underlying commodity. Specifying a futures' minimum tick that is greater than the minimum price increment in the cash market can undermine the risk management utility of the futures contract by preventing hedgers from efficiently establishing and liquidating futures positions that are used to hedge anticipated cash market transactions or cash market positions.

(E) Maximum Price Fluctuation Limits: Designated contract markets may adopt price limits to: (1) Reduce or constrain price movements in a trading day that may not be reflective of true market conditions but might be caused by traders overreacting to news; (2) Allow additional time for the collection of margins in times of large price movements; and (3) Provide a "cooling-off" period for futures market participants to respond to bona fide changes in market supply and demand fundamentals that would lead to large cash and futures price changes. If price-limit provisions are adopted, the limits should be set at levels that are not overly restrictive in relation to price movements in the cash market for the commodity underlying the futures contract. For broad-based stock index futures contracts, rules should be adopted that coordinate with New York Stock Exchange

("NYSE") declared Circuit Breaker Trading Halts (or other market coordinated Circuit Breaker mechanism) and would recommence trading in the futures contract only after trading in the majority of the stocks underlying the index has recommenced.

(F) Last Trading Day: Specification of the last trading day for expiring contracts should be established such that it occurs before publication of the underlying third-party price index or determination of the final settlement price. If the designated contract market chooses to allow trading to occur through the determination of the final settlement price, then the designated contract market should show that futures trading would not distort the final settlement price calculation.

(G) Trading Months: Trading months should be established based on the risk management needs of commercial entities as well as the availability of price and other data needed to calculate the cash settlement price in the specified months. Specification of the last trading day should take into consideration whether the volume of transactions underlying the cash settlement price would be unduly limited by occurrence of holidays or traditional holiday periods in the cash market. Moreover, a contract should not be listed past the date for which the designated contract market has access to use a proprietary price index for cash settlement.

(H) Speculative Limits: Specific rules and policies for speculative position limits are set forth in part 150 and/or part 151, as applicable, of the Commission's regulations.

(I) Reportable Levels: Refer to § 15.03 of the Commission's regulations.

(J) Trading Hours: Should be set by the designated contract market to delineate each trading day.

(d) Options on a Futures Contract. (1) The Commission's experience with the oversight of trading in futures option contracts indicates that most of the terms and conditions associated with such trading do not raise any regulatory concerns or issues. The Commission has found that the following terms do not affect an option contract's susceptible to manipulation or its utility for risk management. Thus, the Commission believes that, in most cases, any specification of the following terms would be acceptable; the only requirement is that such terms be specified in an automatic and objective manner in the option contract's rules:

- Exercise method;
- Exercise procedure (if positions in the underlying futures contract are established via book entry);
- Strike price listing provisions, including provisions for listing strike prices on a discretionary basis;
- Strike price intervals;
- Automatic exercise provisions;
- Contract size (unless not set equal to the size of the underlying futures contract); and
- Option minimum tick should be equal to or smaller than that of the underlying futures contract.

(2) Option Expiration & Last Trading Day. For options on futures contracts, specification of expiration dates should consider the relationship of the option expiration date to the delivery period for the underlying futures contract. In particular, an assessment should be made of liquidity in the underlying futures market to assure that

any futures contracts acquired through exercise can be liquidated without adversely affecting the orderly liquidation of futures positions or increasing the underlying futures contract's susceptibility to manipulation. When the underlying futures contract exhibits a very low trading activity during an expiring delivery month's final trading days or has a greater risk of price manipulation than other contracts, the last trading day and expiration day of the option should occur prior to the delivery period or the settlement date of the underlying future. For example, the last trading day and option expiration day might appropriately be established prior to first delivery notice day for option contracts with underlying futures contracts that have very limited deliverable supplies. Similarly, if the futures contract underlying an option contract is cash settled using cash prices from a very limited number of underlying cash market transactions, the last trading and option expiration days for the option contract might appropriately be established prior to the last trading day for the futures contract.

(3) Speculative Limits. In cases where the terms of an underlying futures contract specify a spot-month speculative position limit and the option contract expires during, or at the close of, the futures contract's delivery period, the option contract should include a spot-month speculative position limit provision that requires traders to combine their futures and option position and be subject to the limit established for the futures contract. Specific rules and policies for speculative position limits are set forth in part 150 and/or part 151, as applicable, of the Commission's regulations.

(4) Options on Physicals Contracts.

(i) Under the Commission's regulations, the term "option on physicals" refers to option contracts that do not provide for exercise into an underlying futures contract. Upon

exercise, options on physicals can be settled via physical delivery of the underlying commodity or by a cash payment. Thus, options on physicals raise many of the same issues associated with trading in futures contracts regarding adequacy of deliverable supplies or acceptability of the cash settlement price series. In this regard, an option that is cash settled based on the settlement price of a futures contract would be considered an "option on physicals" and the futures settlement price would be considered the cash price series.

(ii) In view of the above, acceptable practices for the terms and conditions of options on physicals contracts include, as appropriate, those practices set forth above for physical-delivery or cash-settled futures contracts plus the practices set forth for options on futures contracts.

(e) Security Futures Products. The listing of security futures products are governed by the special requirements of part 41 of the Commission's regulations.

(f) Non-Price Based Futures Contracts. (1) Non-price based contracts are typically construed as binary options, but also may be designed to function similar to traditional futures or option contracts.

(2) Where the contract is settled to a third party cash-settlement series, the designated contract market should consider the nature and sources of the data comprising the cash-settlement calculation, the computational procedures, and the mechanisms in place to ensure the accuracy and reliability of the index value. The evaluation also considers the extent to which the third party has, or will adopt, safeguards against unauthorized or premature release of the index value itself or any key data used in deriving the index value.

(3) The designated contract market should follow the guidance in paragraph (c)(4) (Contract Terms and Conditions Requirements for Futures Contracts Settled by Cash Settlement) of this appendix C to meet compliance.

(g) Swap Contracts. (1) In general, swap contracts are an agreement to exchange a series of cash flows over a period of time based on reference price indices. When listing a swap for trading, a swap execution facility or designated contract market should determine that the reference price indices used for its contracts are not readily susceptible to manipulation. Accordingly, careful consideration should be given to the potential for manipulation or distortion of the cash settlement price, as well as the reliability of that price as an indicator of cash market values. Appropriate consideration also should be given to the commercial acceptability, public availability, and timeliness of the price series that is used to calculate the cash settlement price. Documentation demonstrating that the settlement price index is a reliable indicator of market values and conditions and is highly regarded by industry/market agents should be provided. Such documentation may take on various forms, including carefully documented interviews with principal market trading agents, pricing experts, marketing agents, etc. Appropriate consideration also should be given to the commercial acceptability, public availability, and timeliness of the price series that is used to calculate the cash flows of the swap.

(i) Where an independent, private-sector third party calculates the referenced price index, the designated contract market should verify that the third party utilizes business practices that minimize the opportunity or incentive to manipulate the cash-settlement price series. Such safeguards may include lock-downs, prohibitions against derivatives trading by employees, or public dissemination of the names of sources and the price

quotes they provide. Because a cash-settled contract may create an incentive to manipulate or artificially influence the underlying market from which the cash-settlement price is derived or to exert undue influence on the cash-settlement computation in order to profit on a futures position in that commodity, a designated contract market should, whenever practicable, enter into an information-sharing agreement with the third-party provider which would enable the designated contract market to better detect and prevent manipulative behavior.

(ii) Where a designated contract market itself generates the cash settlement price series, the designated contract market should establish calculation procedures that safeguard against potential attempts to artificially influence the price. For example, if the cash settlement price is derived by the designated contract market based on a survey of cash market sources, the designated contract market should maintain a list of such entities which all should be reputable sources with knowledge of the cash market. In addition, the sample of sources polled should be representative of the cash market, and the poll should be conducted at a time when trading in the cash market is active.

(iii) The cash-settlement calculation should involve appropriate computational procedures that eliminate or reduce the impact of potentially unrepresentative data.

(2) Speculative Limits: Specific rules and policies for speculative position limits are set forth in part 151 and/or part 151, as applicable, of the Commission's regulations.

(3) Intraday Market Restrictions: Designated contract markets or swap execution facilities should have in place intraday market restrictions that pause or halt trading in the event of extraordinary price moves that may result in distorted prices. Such restrictions need to be coordinated with other markets that may be a proxy or a substitute for the

contracts traded on their facility. For example, coordination with NYSE rule 80.B Circuit Breaker Trading Halts. The designated contract market or swap execution facility should adopt rules to specifically address who is authorized to declare an emergency; how the designated contract market or swap execution facility will notify the Commission of its decision that an emergency exists; how it will address conflicts of interest in the exercise of emergency authority; and how it will coordinate trading halts with markets that trade the underlying price reference index or product.

(4) Settlement Method. The designated contract market or swap execution facility should follow the guidance in paragraph (c)(4) (Contract Terms and Conditions Requirements for Futures Contracts Settled by Cash Settlement) of this appendix C to meet compliance, or paragraph (b)(2) (Contract Terms and Conditions Requirements for Futures Contracts Settled by Physical Delivery) of this appendix C, as appropriate.

Issued in Washington, DC on May 10, 2012, by the Commission.

David A. Stawick
Secretary of the Commission

Appendices to Core Principles and Other Requirements for Designated Contract Markets—Commission Voting Summary and Statements of Commissioners

Note: The following appendices will not appear in the Code of Federal Regulations

Appendix 1—Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Sommers, Chilton, O'Malia and Wetjen voted in the affirmative; no Commissioner voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the final rulemaking on designated contract markets DCMs, which includes rules, guidance and acceptable practices. It advances important Dodd-Frank transparency reforms. The Dodd-Frank Act squarely addresses the historically opaque swaps market though its strong transparency provisions. A critical element is pre-trade transparency – requiring standardized swaps between financial firms – those that are cleared, made available for trading and not blocks – to be traded on exchanges, such as DCMs, swap execution facilities (SEFs) or foreign boards of trade (FBOTs). When markets are open and transparent, prices are more competitive, markets are more efficient and liquid, and costs are lowered for companies and their customers.

DCMs have long demonstrated the value of open and competitive trading. DCMs, for the first time, will be able to list and trade swaps, helping to bring the benefit of pre-trade transparency to the swaps marketplace.

In addition, the Dodd-Frank Act incorporated the previously existing eight statutory designation criteria for DCMs into the DCM core principles and expanded the principles from 18 to 23. The final rulemaking the Commission will consider today conforms to the Dodd-Frank transparency reforms.

The final rulemaking benefits from extensive public comment and provides exchanges rules, guidance and acceptable practices on complying with Dodd-Frank's 23 core principles. In many instances, we're codifying industry practices that the Commission has observed and found appropriate to comply with these core principles. While preserving a principles-based regime, these regulations will provide greater legal certainty and transparency to DCMs in determining their compliance obligations, and to market participants in determining their obligations as DCM members, and will facilitate the enforcement of such provisions.

The final rulemaking is consistent with the core principles-based regime of the Commodity Exchange Act. It provides each DCM with the flexibility to employ additional measures to address core principle requirements.

As an example, the final rulemaking requires DCMs to put in place effective pre-trade risk filters, including pauses and/or trading halts to address extraordinary price movements that may result in distorted prices or trigger market disruptions. The rulemaking, though, also recognizes that pauses and halts comprise only one category of risk controls, and that additional controls may be necessary to be put in place by exchanges to reduce the potential for market disruptions. The final guidance included in today's rulemaking lists that exchanges may possibly implement price collars or bands, maximum order size limits, and message throttles.

This rulemaking does not yet finalize the Commission's proposal relating to core principle 9 – which requires DCMs to provide an open, competitive and efficient market and mechanism for transactions that protects the price discovery process of the DCM's central marketplace. I expect the Commission to consider a final rule on this matter when it takes up the SEF rule this summer. The additional time will allow the Commission to

more fully analyze the many public comments on these provisions, including comments on the implications of exchange of futures for swap transactions, or so-called "EFS transactions," in relation to the transparency reforms of Dodd-Frank, as well as the requirement for non-discriminatory open access to clearing.