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COMMENT

Trade Options

RE: Agricultural Trade Options: Revised Interim Rules

The National Introducing Brokers Association (NIBA) would like to thank the Commission for the opportunity to comment on the interim final rules for Agricultural Trade Options.

As the Commission is well aware, the NIBA and its members strongly oppose any further relaxation of the rules associated with Agricultural Trade Options. In our testimony, both before the Commission and before the Senate Agriculture Committee, we have offered strong arguments supporting the fact that the rules related to Agricultural Trade Options should be no more or no less stringent than the rules and standards that the Introducing Brokerage community, Futures Commission Merchants and the futures industry as a whole must follow. Potential providers of Agricultural Trade Options are no more sophisticated, ethical or financially sound than those persons in the futures and options industry providing similar services to farmers. The fact that Agricultural Trade Option Merchants are most likely to be trusted local grain merchants increases the need for regulation and oversight. Problems associated with Hedge To Arrive Contracts clearly illustrate how this level of trust can easily lead to bad business practices, undisclosed risks and fraud.

Proposed Revisions to Agricultural Trade Options Rules

Registration Requirement: The NIBA strongly supports the Commission's recommendations that the registration requirement be maintained. A high level of customer protection is mandatory.

Testing and Fingerprints: The NIBA opposes the Commission's proposal to delete the mandatory 6-hour training course for sales agents. Furthermore, not only should training of this new product be required, but tests similar to the Series 3 exam should also be mandatory. Without such training and testing, Trade Option Merchants and Associated Persons may not be aware of the rules, the risks and their obligation for full disclosure to Trade Option clients. Only through training, testing and oversight (audits) can the Commission insure that its rules are being followed, ATOMs are providing full risk disclosure and that the public is being protected.

Paperwork Associated With Registration: The NIBA is supportive of the Commission's proposal to allow the National Futures Association (NFA) to handle the processing of registration applications and related oversight. The CFTC has neither the staff, the budget, nor the infrastructure to accomplish this task in an efficient and cost effective manner. The NFA already

has all of the policies and procedures in place to easily add this responsibility. An Agricultural Trade Option transaction fee, similar to those used on futures and options transactions, could provide the budget for the NFA to cover these additional costs and responsibilities.

Those who oppose the NFA's involvement are doing so because they wish to avoid all registration and oversight by any regulatory agency. Due to the exemption from regulation for grain merchants, the grain trade has been afforded broad use of futures, options and cash transaction alternatives with little or no oversight. Even those grain trade firms, which are registered as Futures Commission Merchants, have all but ignored the rules and regulations for which non-grain trade firms would have been prosecuted out of business. These firms have not registered to use Agricultural Trade Options because they do not wish to open the door to oversight. For this same reason, they do not wish to allow the NFA to become involved in registration, audits or oversight. Registration and oversight are the only reason that they have not used Agricultural Trade Options. Low prices and paperwork have just been used as an excuse.

Physical Delivery: The interim rules prohibit Agricultural Trade Options from being offset, and require physical delivery. Without the requirement of physical delivery, Agricultural Trade Options could easily develop into an off-exchange traded speculative marketplace. Unscrupulous Agricultural Trade Option Merchants could circumvent many of the registration requirements associated with being an Introducing Broker or FCM, and offer these contracts to the general public as a means of speculation. While this is not the intent of ATOs, it could very well be the end result. The Commission and the NFA have spent immeasurable amounts of resources and dollars in an effort to "clean up" the futures industry and to rid the industry of unscrupulous operators. Without the delivery requirement, the NIBA projects that the Commission will ultimately be put into a position to expend a substantial amount of its resources and budget to enforce its rules on unscrupulous ATOMs. The regulatory oversight, rules and compliance progress that the Commission has made in the last decade will suffer a substantial setback.

Risk Disclosure: With the understanding that ATOs are new, the requirement to provide customers with a full disclosure statement with each transaction, outlining the worst possible financial outcome, is a good common sense requirement. The problems associated with Hedge To Arrive Contracts show that full disclosure, in simple terms, is required to avoid financial catastrophe and widespread lawsuits. At a very minimum, the pilot program should require disclosure. After a period of possibly five to ten years, when the public awareness and understanding of Agricultural Trade Options becomes greater, the requirement for full disclosure of a worst case financial outcome may be less necessary. However, it is important to point out that agricultural futures have been traded for over 134 years. Even with a massive educational effort by the futures community over many decades, the public is still largely uninformed and uneducated on the proper use of futures and options. With the wide variety of ATO strategies that may be offered, the confusion on the part of the public user of these tools will likely be far greater than that associated with futures or options. Therefore, risk disclosure is absolutely necessary.

Account Information Reporting: ATOMs should be required to provide ATO customers with a transaction statement associated with every transaction. In addition, monthly statements

summarizing ATO activity should be required. ATO transactions will be as complicated or more complicated than futures and options transactions. Transactional statements and month-end statements are required for the futures and options industry, and should also be required for ATOs. With many ATO contracts being initially a verbal contract, a written paper trail is an absolute necessity. From a practical standpoint, we in the IB industry find that, very often, customers forget or lose track of their decisions. Many times they will call and discuss a variety of different strategies, then make a decision. Days later it is difficult for them to remember which strategy they finally decided on. It is an even greater problem when a farmer producer is unfamiliar with the strategies and is just learning, as they will be with ATOs. Furthermore, transactional statements and month-end statements will provide the Commission with the necessary paperwork to evaluate the Agricultural Trade Option pilot program, as well as for oversight purposes.

Required contract terms and limitations on certain strategies: The NIBA agrees with the Commission that there should be full disclosure of required contract terms and that limiting certain strategies is advisable.

Exemption level for sophisticated entities: The NIBA agrees with the Commission that the \$10 million net worth exemption not be reduced. In fact, it has been our position, and continues to be our position, that there should be no exemption level. Past events throughout the futures and financial industry has proven that large firms are no more or no less financially sound or ethical than small firms. Furthermore, the registration and training requirements for all participants in ATOs should be equal. The man standing behind the counter, explaining an ATO to a naive client, needs the same level of registration and training if he is working for a firm with a net worth of \$1 billion or \$5,000. That potential client deserves the same level of protection and disclosure. The only way to achieve that is for all participants to meet the same standard.

Conclusion: The grain trade industry has been the primary force seeking the approval of ATOs. They have been illegally trading futures and options for their farmer customers for years. They have pooled funds, not provided transaction statements, not disclosed fees and have buried transactional losses in farmers' grain checks. These practices violate nearly every rule that was put in place to protect the public from the unscrupulous use of futures and options. In pushing for the approval of ATOs, these merchants are, in effect, attempting to legitimize these practices. The initial ATO pilot program was a failure because these firms refused to use futures and options in a regulated environment. They do not want to be registered, and they do not want to be held accountable for their transactions. They do not want to be subject to CFTC or NFA oversight, audits or reparation. The NIBA has successfully argued at every opportunity that the grain trade could accomplish the goals of ATOs by becoming registered and using exchange-traded instruments. In the past, the Commission has been criticized for being too heavy-handed in its regulation and stifling commerce by over-regulating. By pushing for the deregulation of ATOs, the grain trade is trying to take advantage of the Commission's desire to be viewed as proactive and market-oriented. The end result will be substantial fraud, grain trade concentration and, ultimately, will bring the necessity for stricter regulation.

Like it or not, financial transactions involving the public require a high level of regulation. Whether it is futures, options or ATOs, misrepresentation, negligence and fraud will flourish if a high regulatory standard is not required by the regulatory agencies mandated to protect the public interest.

ATOMs should be held to the same standards, rules and registration requirements that registered futures and options market participants are required to meet.