

## COMMENT

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OFFICE OF THE SECRETARY

J.P. Morgan Securities Inc.      October 27, 2000

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Ms. Jean Webb  
Secretary  
Commodity Futures Trading Commission  
3 Lafayette Center  
1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

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Dear Ms. Webb:

Re: 65 Fed. Reg. 38986; 65 Fed. Reg. 39008; 65 Fed. Reg. 39027; 65 Fed. Reg. 39033 (June 22, 2000); and J.P. Morgan Comment Letter (August 21, 2000)

Attached please find specific revisions to the Commission's proposed new regulations concerning bilateral transactions, multilateral transaction execution facilities ("MTEFs"), clearing organizations, and intermediaries, submitted pursuant to my testimony before the Commission and comment letter on the subject.

We believe that these proposed changes will correct a potentially serious problem that could arise under the draft regulations. Without these changes, it is possible to misconstrue the extent to which the Commission's New Regulatory Framework is intended to apply to, or raises questions about the enforceability of, contracts that have not been and are not subject to regulation under the Commodity Exchange Act. Furthermore, our changes to Parts 36 and 37 are consistent with the drafting approach taken in corresponding provisions of the version of H.R. 4541 passed by the House of Representatives, which the Commission supports.

In addition, in Appendix B, we identify certain questions about the extent to which the protections that appear to be available under the proposed regulations would, in fact, be available for all "contracts, agreements, or transactions." The Appendix includes proposed changes that address these questions to the extent that it is possible to do so.

We look forward to working with the Commission to implement improvements along the lines we have suggested and stand ready to provide any assistance necessary. If you have any questions regarding the revisions we are proposing, please call me at (202) 533-2135 or (212) 648-6605 or Steve Ganis at the law firm of Goodwin, Procter & Hoar, LLP at (617) 570-1626.

Sincerely,



Mark C. Brickell  
Managing Director

**APPENDIX A – SUPPLEMENT TO COMMENT LETTER OF AUGUST 21, 2000,  
CONCERNING PROPOSED NEW REGULATORY FRAMEWORK OF THE  
COMMODITY FUTURES TRADING COMMISSION**

**SUBMITTED BY J. P. MORGAN & CO., INC.**

## PART I-GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

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

2. Section 1.37 is proposed to be amended by revising it to read as follows:

**§1.37 Customer's or option customer's name, address, and occupation recorded; record of guarantor or controller of account.**

\* \* \* \* \*

(c) Each derivatives transactions facility and each recognized futures exchange shall keep a record in permanent form which shall show the true name; address; and principal occupation or business of any foreign trader executing ~~transactions~~ ~~contracts of sale of a commodity for future delivery or commodity option contracts~~ on the facility or exchange, as well as the name of any person guaranteeing such transactions or exercising any control over the trading of such foreign trader.

(d) Paragraph (c) of this section shall not apply to a derivatives transactions facility or recognized futures exchange on which transactions in futures contracts or options contracts of foreign traders are executed through and the resulting transactions are maintained in accounts carried by a registered futures commission merchant or introducing broker subject to the provisions of paragraph (a) of this section.

3. Section 1.41 is proposed to be amended by removing and reserving paragraph (b), by redesignating paragraph (e) as paragraph (i), by revising paragraphs (c) through (e), by revising paragraphs (f) and (g) to add the words "or recognized futures exchange" after the words

“contract market” each time they appear, and by removing and reserving paragraphs (j) through (t), to read as follows:

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

\* \* \* \* \*

(b) [Reserved.]

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

(1) *Rules of designated contract markets, recognized futures exchanges and recognized clearing organizations.* Notwithstanding the rule approval and filing requirements of Section 5a(a)(12) of the Act, designated contract markets, recognized futures exchanges and recognized clearing organizations may place a rule into effect without prior Commission review or approval if:

(i) The rule is not a term or condition of a contract for future delivery of an agricultural commodity listed in section 1(a)(3) of the Act;

(ii) The entity has filed a submission for the rule, and the Commission has received the submission at its Washington, D.C. headquarters and at the regional office having jurisdiction over the entity by close of business on the business day preceding implementation of the rule; and

(iii) The rule submission includes:

(A) The label, “Submission of rule by self-certification;”

(B) The text of the rule (in the case of a rule amendment, brackets must indicate words deleted and underscoring must indicate words added);

(C) A brief explanation of the rule including any substantive opposing views not incorporated into the rule; and

(D) A certification by the eligible entity that the rule does not violate any provision of the Act and regulations thereunder.

(iv) The Commission retains the authority to stay the effectiveness of a rule implemented pursuant to paragraph (c)(1) during the pendency of Commission proceedings to disapprove, alter or amend the rule. The decision to stay the effectiveness of a rule in such circumstances may not be delegable to any employee of the Commission.

(2) *Rules of derivatives transaction facilities.* Notwithstanding the rule approval and filing requirements of section 5a(a)(12)(A) of the Act, derivatives transaction facilities may place a rule into effect without prior Commission review or approval if the derivatives transaction facility files with the Commission at its Washington, D.C. headquarters a submission labeled, "DTF Rule Notice" which includes the text of the rule or rule amendment (brackets must indicate words deleted and underscoring must indicate words added) at the time traders or participants in the market are notified, but in no event later than the close of business on the business day preceding implementation of the rule.

(d)(1) *Voluntary submission of rules for fast-track approval.* A designated contract market, recognized futures exchange, derivatives transaction facility or recognized clearing organization may submit any rule or proposed rule, except those submitted to the Commission under paragraph (f) of this section, for approval by the Commission pursuant to section 5a(a)(12)(A) of the Act, whether or not so required by section 5a(a)(12) of the Act under the following procedures:

(i) One copy of each rule submitted under this section shall be furnished in hard copy or electronically in a format specified by the Secretary of the Commission to the Commission at its Washington, DC headquarters. If a hard copy is furnished for submissions under appendix A to part 5 of this chapter, two additional hard copies shall be furnished to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581. Each submission under this paragraph (d)(1) shall be in the following order:

(A) Label the submission as “Submission for Commission rule approval.”

(B) Set forth the text of the rule or proposed rule (in the case of a rule amendment, brackets must indicate words deleted and underscoring must indicate words added);

(C) Describe the proposed effective date of a proposed rule and any action taken or anticipated to be taken to adopt the proposed rule by the contract market, recognized futures exchange, derivatives transaction facility or recognized clearing organization or by its governing board or by any committee thereof, and cite the rules of the entity that authorize the adoption of the proposed rule;

(D) Explain the operation, purpose, and effect of the proposed rule, including, as applicable, a description of the anticipated benefits to market participants or others, any potential anticompetitive effects on market participants or others, how the rule fits into the contract market, recognized futures exchange, derivatives transaction facility or recognized clearing organization’s framework of self-regulation, and any other information which may be beneficial to the Commission in analyzing the proposed rule. If a proposed rule affects, directly or indirectly, the application of any other rule of the submitting entity, set forth the pertinent text of any such rule and describe the anticipated effect;

(E) Note and briefly describe any substantive opposing views expressed with respect to the proposed rule which were not incorporated into the proposed rule prior to its submission to the Commission; and

(F) Identify any Commission regulation that the Commission may need to amend, or sections of the Act or Commission regulations that the Commission may need to interpret in order to approve or allow into effect the proposed rule. To the extent that such an amendment or interpretation is necessary to accommodate a proposed rule, the submission should include a reasoned analysis supporting the change.

(ii) All rules submitted for Commission approval under paragraph (d)(1)(i) shall be deemed approved by the Commission under section 5a(a)(12)(A) of the Act, forty-five days after receipt by the Commission, unless notified otherwise within that period, if:

(A) The submission complies with the requirements of paragraphs (d)(1)(i) (A) through (F), of this section or, for dormant contracts of sale of a commodity for future delivery or commodity option contracts, the requirements of §5.3 of this chapter;

(B) The submitting entity does not amend the proposed rule or supplement the submission, except as requested by the Commission, during the pendency of the review period; and

(C) The submitting entity has not instructed the Commission in writing during the review period to review the proposed rule under the 180 day review period under section 5a(a)(12)(A) of the Act.

(iii) The Commission, within forty-five days after receipt of a submission filed pursuant to paragraph (d)(1)(i) of this section, may notify the entity making the submission that the review period has been extended for a period of thirty days where the proposed rule raises novel or

complex issues which require additional time for review or is of major economic significance. This notification shall briefly describe the nature of the specific issues for which additional time for review is required. Upon such notification, the period for review shall be extended for a period of thirty days, and, unless the entity is notified otherwise during that period, the rule shall be deemed approved at the end of the enlarged review time .

(iv) During the forty-five day period for fast-track review, or the thirty-day extension when the period has been enlarged under paragraph (d)(1)(iii) of this section, the Commission shall notify the submitting entity that the Commission is terminating fast-track review procedures and will review the proposed rule under the 180 day review period of section 5a(a)(12)(A) of the Act, if it appears that the proposed rule may violate a specific provision of the Act, regulations, or form or content requirements of this section. This termination notification will briefly specify the nature of the issues raised and the specific provision of the Act, regulations, or form or content requirements of this section that the proposed rule appears to violate. Within fifteen days of receipt of this termination notification, the designated contract market, recognized futures exchange, derivatives transaction facility or recognized clearing organization may:

(A) Withdraw the rule;

(B) Request the Commission to review the rule pursuant to the one hundred and eighty day review procedures set forth in section 5a(a)(12)(A) of the Act; or

(C) Request the Commission to render a decision whether to approve the proposed rule or to institute a proceeding to disapprove the proposed rule under the procedures specified in section 5a(a)(12)(A) of the Act by notifying the Commission that the submitting entity views its submission as complete and final as submitted.



(2) *Voluntary submission of rules for expedited approval.* Notwithstanding the provisions of paragraph (d)(1) of this section, changes to terms and conditions of a contract of sale of a commodity for future delivery or commodity option that are consistent with the Act and Commission regulations and with standards approved or established by the Commission in a written notification to the market or clearing organization of the applicability of this paragraph (d)(2) shall be deemed approved by the Commission at such time and under such conditions as the Commission shall specify, provided, however, that the Commission may at any time alter or revoke the applicability of such a notice to any particular contract of sale of a commodity for future delivery or commodity option.

(e)(1) *Notification of rule amendments.* Notwithstanding the rule approval and filing requirements of Section 5a(a)(12) of the Act and of paragraphs (c) and (d) of this section, designated contract markets, recognized futures exchanges, derivatives transaction facilities and recognized clearing organizations may place the following rules into effect without prior notice to the Commission if the following conditions are met:

(i) The designated contract market, recognized futures exchange, derivatives transaction facility or clearing organization provides to the Commission at least weekly a summary notice of all rule changes made effective pursuant to this paragraph during the preceding week. Such notice must be labeled “Weekly Notification of Rule Changes” and need not be filed for weeks during which no such actions have been taken. One copy of each such submission shall be furnished in hard copy or electronically in a format specified by the Secretary of the Commission to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street N.W., Washington, DC 20581; and

(ii) the rule change governs:

(A) *Non-material revisions.* Corrections of typographical errors, renumbering, periodic routine updates to identifying information about approved entities and other such nonsubstantive revisions of contract terms and conditions that have no effect on the economic characteristics of the contract;

(B) *Delivery standards set by third parties.* Changes to grades or standards of commodities deliverable on futures contracts that are established by an independent third party and that are incorporated by reference as terms of the contract, provided that the grade or standard is not established, selected or calculated solely for use in connection with futures or option trading;

(C) *Index contracts.* Routine changes in the composition, computation, or method of selection of component entities of an index other than a stock index referenced and defined in the contract's terms, made by an independent third party whose business relates to the collection or dissemination of price information and that was not formed solely for the purpose of compiling an index for use in connection with a futures or option contract;

(D) *Transfer of membership or ownership.* Procedures and forms for the purchase, sale or transfer of membership or ownership, but not including qualifications for membership or ownership, any right or obligation of membership or ownership or dues or assessments; or

(E) *Administrative Procedures.* The organization and administrative procedures of a contract market's governing bodies such as a Board of Directors, Officers and Committees, but not voting requirements and procedures or requirements or procedures relating to conflicts of interest.

(2) *Notification of rule amendments not required.* Notwithstanding the rule approval and filing requirements of Section 5a(a)(12) of the Act and of paragraphs (c) and (d) of this section,

designated contract markets, recognized futures exchanges, derivatives transaction facilities and recognized clearing organizations may place into effect without notice to the Commission, rules governing:

(i) *Administration.* The routine, daily administration, direction and control of employees, requirements relating to gratuity and similar funds, but not guaranty, reserves, or similar funds; declaration of holidays, and changes to facilities housing the market, trading floor or trading area; or

(ii) *Standards of decorum.* Standards of decorum or attire or similar provisions relating to admission to the floor, badges, visitors, but not the establishment of penalties for violations of such rules.

(f) \* \* \*

(i) *Membership lists.* Upon request of the Commission each designated contract market, recognized futures exchange, derivatives transaction facility or recognized clearing organization shall promptly furnish to the Commission a current list of the facility's or entity's members or owners subject to fitness requirements.

4. In part 1, §§ 1.43, 1.45, and 1.50 are proposed to be removed and reserved.

5. Part 5 is proposed to be revised to read as follows:

## **PART 5-PROCEDURES FOR LISTING NEW PRODUCTS**

**Authority:** 7 U.S.C. 6(c), 6c, 7, 7a, 8 and 12a.

### **§5.1 Listing contracts for trading by exchange certification.**

(a) Notwithstanding the provisions of section 4(a)(1) of the Act or §33.2 of this chapter, a board of trade that has been recognized by the Commission as a recognized futures exchange

under §38.3 of this chapter may list for trading contracts of sale of a commodity for future delivery or commodity option contracts, if the recognized futures exchange:

(1) Lists for trading at least one contract of sale of a commodity for future delivery or commodity option contract which is not dormant within the meaning of §5.3 of this part;

(2) In connection with the trading of the contract of sale of a commodity for future delivery or commodity option contract complies with all requirements of the Act and Commission regulations thereunder applicable to the recognized futures exchange under part 38 of this chapter;

(3) Files with the Commission at its Washington, D.C., headquarters either in electronic or hard-copy form a copy of the contract's initial terms and conditions and a certification by the recognized futures exchange that the contract's initial terms and conditions neither violate nor are inconsistent with any requirement of part 38 of this chapter, any applicable provision of the Commodity Exchange Act or of the rules thereunder, and the filing is received no later than the close of business of the business day preceding the contract's initial listing; and

(4) Identifies the contract in its rules as listed for trading pursuant to exchange certification.

(b) The provisions of this section shall not apply to

(1) A contract subject to the provisions of section 2(a)(1)(B) of the Act;

(2) A contract of sale of a commodity for future delivery or commodity option contract to be listed initially for trading that is the same or substantially the same as one for which an application for Commission review and approval pursuant to §5.2 of this chapter was filed by another board of trade while the application is pending before the Commission; or

(3) A contract of sale of a commodity for future delivery or commodity option contract to be listed initially for trading that is the same or substantially the same as one which is the subject of a pending Commission proceeding to disapprove designation under section 6 of the Act, to disapprove a term or condition under section 5a(a)(12) of the Act, to alter or supplement a term or condition under section 8a(7) of the Act, to amend terms or conditions under section 5a(a)(10) of the Act, to declare an emergency under section 8a(9) of the Act, or to any other proceeding the effect of which is to disapprove, alter, supplement, or require a contract market to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

#### **§5.2 Listing products for trading by derivatives transaction facilities.**

(a) Notwithstanding the provisions of section 4(a)(1) of the Act or §33.2 of this chapter, a recognized derivatives transaction facility under §37.3 of this chapter may list contracts of sale of a commodity for future delivery or commodity options for trading if it files with the Commission at its Washington, D.C. headquarters, a submission labeled “DTF Notice of Product Listing,” which includes the text of the contract’s terms or conditions at the time traders or participants in the market are notified, but in no event later than the close of business on the business day preceding initial listing.

(b) Additionally, a derivatives transaction facility recognized in accordance with §37.4 of this chapter may list a contract, agreement or transaction that is neither a contract of sale of a commodity for future delivery nor a commodity option, or is excluded from all or part of the Act by any provision of the Act or other federal law. By listing such contract, agreement or transaction, such recognized derivatives transaction facility agrees that provisions of this chapter that apply to contracts of sale of a commodity for future delivery or commodity options traded on

recognized derivatives transaction facilities shall apply to such contract, agreement or transaction not subject to the Act, *provided, however,* that the applicability of any provisions of this chapter to the listing and trading of any contract, agreement or transaction on a recognized trading facility shall not imply or be construed to mean that any similar or identical contract, agreement or transaction is subject to any provision of the Act or this chapter (unless the similar or identical contract, agreement or transaction is traded on a derivatives transaction facility recognized in accordance with §37.4 and has been specifically listed in accordance with this part).

### **§5.3 Voluntary submission of new products for Commission review and approval.**

(a) *Cash-settled contracts.* A new contract of sale of a commodity for future delivery or commodity option to be listed for trading by a recognized futures exchange under §38.3 of this chapter or a recognized derivatives transaction facility under §37.3 of this chapter shall be deemed approved by the Commission ten business days after receipt by the Commission of the application for contract approval, unless notified otherwise within that period, if:

(1) The submitting entity labels the submission as being submitted pursuant to Commission rule 5.2--Fast Track Ten-Day Review;

(2)(i) The application for approval is for a futures contract providing for cash settlement or for delivery of a foreign currency for which there is no legal impediment to delivery and for which there exists a liquid cash market; or

(ii) For an option contract that is itself cash-settled, is for delivery of a foreign currency that meets the requirements of paragraph (a)(2)(i) of this section or is to be exercised into a futures contract which has already been designated as a contract market or approved under this section;

(3) The application for approval is for a commodity other than those enumerated in section 1a(3) of the Act or one that is subject to the procedures of section 2(a)(1)(B) of the Act;

(4) The submitting entity trades at least one contract which is not dormant within the meaning of this part;

(5) The submission complies with the requirements of Appendix A of this part--Guideline No. 1;

(6) The submitting entity does not amend the terms or conditions of the proposed contract or supplement the application for designation, except as requested by the Commission or for correction of typographical errors, renumbering or other such nonsubstantive revisions, during that period; and

(7) The submitting entity has not instructed the Commission in writing during the review period to review the application for designation under the usual procedures under section 6 of the Act.

(b) *Contracts for physical delivery.* A new contract to be listed for trading by a recognized futures exchange under §38.3 of this chapter or by a derivatives transaction facility under §37.3 of this chapter shall be deemed approved by the Commission forty-five days after receipt by the Commission of the application for contract approval, unless notified otherwise within that period, if.

(1) The submitting entity labels the submission as being submitted pursuant to Commission rule 5.2--Fast Track Forty-Five Day Review;

(2) The application for contract approval is for a commodity other than those subject to the procedures of section 2(a)(1)(B) of the Act;

(3) The submitting entity lists for trading at least one contract which is not dormant within the meaning of this part;

(4) The submission complies with the requirements of Appendix A of this part--Guideline No. 1;

(5) The submitting entity does not amend the terms or conditions of the proposed contract or supplement the application for designation, except as requested by the Commission or for correction of typographical errors, renumbering or other such nonsubstantive revisions, during that period; and

(6) The submitting entity has not instructed the Commission in writing during the fortyfive day review period to review the application for designation under the usual procedures under section 6 of the Act.

(c) *Notification of extension of time.* The Commission, within ten days after receipt of a submission filed under paragraph (a) of this section, or forty-five days after receipt of a submission filed under paragraph (b) of this section, may notify the submitting entity that the review period has been extended for a period of thirty days where the application for approval raises novel or complex issues which require additional time for review. This notification will briefly specify the nature of the specific issues for which additional time for review is required. Upon such notification, the period for fast-track review of paragraphs (a) and (b) of this section shall be extended for a period of thirty days.

(d) *Notification of termination of fast-track procedures.* During the fast-track review period provided under paragraphs (a) or (b) of this section, or of the thirty-day extension when the period has been enlarged under paragraph (c) of this section, the Commission shall notify the submitting entity that the Commission is terminating fast-track review procedures and will review



the proposed rule under the usual procedures of section 6 of the Act, if it appears that the proposed contract may violate a specific provision of the Act, regulations, or form or content requirements of Appendix A of this part. This termination notification will briefly specify the nature of the issues raised and the specific provision of the Act, regulation, or form or content requirement of Appendix A of this part that the proposed contract appears to violate. Within ten days of receipt of this termination notification, the submitting entity may request that the Commission render a decision whether to approve the designation or to institute a proceeding to disapprove the proposed application for designation under the procedures specified in section 6 of the Act by notifying the Commission that the exchange views its application as complete and final as submitted.

(e) *Delegation of authority.* (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Economic Analysis or to the Director's delegatee, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to request under paragraphs (a)(6) and (b)(5) of this section that the recognized futures exchange or derivatives transaction facility amend the proposed contract or supplement the application, to notify a submitting entity under paragraph (c) of this section that the time for review of a proposed contract term submitted for review under paragraphs (a) or (b) of this section has been extended, and to notify the submitting entity under paragraph (d) of this section that the fast-track procedures of this section are being terminated.

(2) The Director of the Division of Economic Analysis may submit to the Commission for its consideration any matter which has been delegated in paragraph (e)(1) of this section.

(3) Nothing in the paragraph prohibits the Commission, at its election, from exercising the authority delegated in paragraph (e)(1) of this section.

#### §5.4 Dormant contracts.

(a) *Definitions.* For purposes of this section: (1) The term *dormant contract* means any commodity futures or option contract:

(i) In which no trading has occurred in any future or option expiration for a period of six complete calendar months; or

(ii) Which has been certified by a recognized futures exchange or a recognized derivatives transaction facility to the Commission to be a dormant contract market.

(2) [Reserved]

(b) *Listing of additional futures trading months or option expiration by certification.* A contract of sale of a commodity for future delivery or commodity option that has been listed for trading initially under the procedures of either §§5.1 or 5.3 of this part that has become dormant may be relisted for trading additional months pursuant to the procedures of § 1.41 (c) by filing the bylaw, rule, regulation or resolution to list additional trading months or expirations with the Commission as specified in that section. Upon relisting, the contract of sale of a commodity for future delivery or commodity option must be identified by the recognized futures exchange as listed for trading by exchange certification.

(c) *Approval for listing of additional futures trading months or option expirations.* A contract that has been initially approved by the Commission under §5.3 of this part and that has become dormant may be relisted for trading additional months pursuant to the procedures of § 1.41 (d) by filing the bylaw, rule, regulation or resolution to list additional trading months or expirations with the Commission as specified in that section.

(1) Each such submission shall clearly designate the submission as filed pursuant to Commission Rule 5.3; and

(2) Include the information required to be submitted pursuant to §5.3 of this part or an economic justification for the listing of additional months or expirations in the dormant contract market, which shall include an explanation of those economic conditions which have changed subsequent to the time the contract became dormant and an explanation of how any new terms and conditions which are now being proposed, or which have been proposed for an option market's underlying futures contract market, would make it reasonable to expect that the futures or option contract will be used on more than an occasional basis for hedging or price basing.

(d) *Exemptions.* No contract shall be considered dormant until the end of sixty (60) complete calendar months:

(1) Following initial listing; or

(2) Following Commission approval of the contract market bylaw, rule, regulation, or resolution to relist trading months submitted pursuant to paragraph (c) of this section.

APPENDIX A TO PART 5-GUIDELINE NO. 1; INTERPRETIVE STATEMENT  
REGARDING ECONOMIC AND PUBLIC INTEREST REQUIREMENTS FOR CONTRACT  
APPROVAL

\* \* \*

APPENDIX C [Reserved]

APPENDIX D [Reserved]

\* \* \*

**PART 15-REPORTS-GENERAL PROVISIONS**

6. The authority citation for Part 15 is proposed to be amended to read as follows:

**Authority:** 7 U.S.C. 2, 4, 5, 6(c), 6a, 6c(a)-(d), 6f, 6g, 6i, 6k, 6m, 6n, 7, 9, 12a, 19 and 21.

7. Section 15.05 is proposed to be amended by revising it to read as follows:

**§15.05 Designation of agent for foreign brokers, customers of a foreign broker and foreign traders.**

\* \* \* \* \*

(e) Any derivatives transaction facility or recognized futures exchange that permits a foreign broker to intermediate transactions in futures contracts or options contracts on the facility or exchange, or permits a foreign trader to effect transactions in futures contracts or options contracts on the facility or exchange shall be deemed to be the agent of the foreign broker and any of its customers for whom the transactions were executed, or the foreign trader for purposes of accepting delivery and service of any communication issued by or on behalf of the Commission to the foreign broker, any of its customers or the foreign trader with respect to any futures or options contracts executed by the foreign broker or the foreign trader on the derivatives transaction facility or recognized futures exchange. Service or delivery of any communication issued by or on behalf of the Commission to a derivatives transaction facility or recognized futures exchange pursuant to such agency shall constitute valid and effective service upon the foreign broker, any of its customers, or the foreign trader. A derivatives transaction facility or recognized futures exchange who has been served with, or to whom there has been delivered, a communication issued by or on behalf of the Commission to a foreign broker, any of its customers, or a foreign trader shall transmit the communication promptly and in a manner which is reasonable under the circumstances, or in a manner specified by the Commission in the communication, to the foreign broker, any of its customers or the foreign trader.

(f) It shall be unlawful for any derivatives transaction facility or recognized futures exchange to permit a foreign broker, any of its customers or a foreign trader to effect transactions

in futures contracts or options contracts unless the derivatives transaction facility or recognized futures exchange prior thereto informs the foreign broker, any of its customers or the foreign trader in any reasonable manner the derivatives transaction facility or recognized futures exchange deems to be appropriate, of the requirements of this section.

(g) The requirements of paragraphs (e) and (f) of this section shall not apply to any transactions in futures contracts or options if the foreign broker, any of its customers or the foreign trader has duly executed and maintains in effect a written agency agreement in compliance with this paragraph with a person domiciled in the United States and has provided a copy of the agreement to the derivatives transaction facility or recognized futures exchange prior to effecting any transactions in futures contracts or options contracts on the derivatives transaction facility or recognized futures exchange. This agreement must authorize the person domiciled in the United States to serve as the agent of the foreign broker, any of its customers or the foreign trader for purposes of accepting delivery and service of all communications issued by or on behalf of the Commission to the foreign broker, any of its customers or the foreign trader and must provide an address in the United States where the agent will accept delivery and service of communications from the Commission. This agreement must be filed with the Commission by the derivatives transaction facility or recognized futures exchange prior to permitting the foreign broker, any of its customers or the foreign trader to effect any transactions in futures contracts or options contracts. Unless otherwise specified by the Commission, the agreements required to be filed with the Commission shall be filed with the Secretary of the Commission at Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581. A foreign broker, any of its customers or a foreign trader shall notify the Commission immediately if the written agency agreement is terminated, revoked, or is otherwise no longer in effect. If the derivatives transaction facility or

recognized futures exchange knows or should know that the agreement has expired, been terminated, or is no longer in effect, the derivatives transaction facility or recognized futures exchange shall notify the Secretary of the Commission immediately. If the written agency agreement expires, terminates, or is not in effect, the derivatives transaction facility or recognized futures exchange and the foreign broker, any of its customers or the foreign trader are subject to the provisions of paragraphs (e) and (f).

(h) The provisions of paragraphs (e), (f) and (g) shall not apply to a derivatives transactions facility or recognized futures exchange on which all transactions in futures contracts or options contracts of foreign brokers, their customers or foreign traders are executed through and the resulting transactions are maintained in accounts carried by a registered futures commission merchant or introducing broker subject to the provisions of Rules 15.05 (a), (b), (c) and (d).

8. Chapter I of 17 CFR is proposed to be amended by adding a new Part 20 to read as follows:

**Part 20 - Special Calls Relating to Transactions on Derivatives Transaction Facilities**

**Authority:** 7 U.S.C. 6(c), 6i and 12(a)(5).

**§ 20.1 Special calls for information from derivatives transaction facilities.**

Upon special call by the Commission, a derivatives transaction facility shall provide to the Commission such information related to its business as a derivatives transaction facility, including information relating to data entry and trade details, in the form and manner and within the time as specified by the Commission in the special call.

**§ 20.2 Special calls for information from futures commission merchants.**

Upon special call by the Commission, each person registered or deemed to be registered as a futures commission merchant that carries or has carried an account for a customer on a

derivatives transaction facility shall provide information to the Commission concerning such accounts or related positions carried for the customer on other facilities or markets, in the form and manner and within the time specified by the Commission in the special call.

**§ 20.3 Special calls for information from participants.**

Upon special call by the Commission, any person who enters into or has entered into a ~~contract, agreement, or transaction of sale of a commodity for future delivery or commodity option~~ on a derivatives transaction facility shall provide information to the Commission concerning such ~~contracts, agreements, or transactions of sale of a commodity for future delivery or commodity options~~ or related positions on other facilities or markets, in the form and manner and within the time specified by the Commission in the special call.

**§ 20.4 Delegation of authority**

The Commission hereby delegates, until the Commission orders otherwise, the authority to make special calls for information set forth in §§ 20.1, 20.2 and 20.3 to the Directors of the Division of Economic Analysis and the Division of Trading and Markets to be exercised separately by each Director or by such other employee or employees as the Director may designate from time to time. The Director of the Divisions of Economic Analysis and Trading and Markets 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.

9. Part 36 is proposed to be revised to read as follows:

**Part 36- EXEMPTION OF TRANSACTIONS ON MULTILATERAL TRANSACTION EXECUTION FACILITIES**

**Authority:** 7 U.S.C. §§2, 6, 6c, and 12a.

**§36.1 Definitions.**

As used in this part:

(a) *Eligible participant* means and shall be limited to the parties or entities listed in §35.1(b)(1)-(1 1) of this chapter; and

(b) *Multilateral transaction execution facility* means an electronic or non-electronic market or similar facility through which persons, for their own accounts or for the accounts of others, enter into, agree to enter into or execute binding transactions contracts of sale of a commodity for future delivery or commodity option contracts by accepting bids or offers made by one person that are open to multiple persons who conduct business through such market or similar facility, but does not include:

(i) a facility whose participants individually negotiate (or have individually negotiated) with counterparties the material terms applicable to transactions between them, including transactions conducted on the facility, and which are subject to subsequent acceptance by the counterparties;

(ii) any electronic communications system on which the execution of a transaction results from the content of bilateral communications exchanged between the parties and not by the interaction of multiple orders within a predetermined, non-discretionary automated trade matching algorithm; or



(iii) any facility on which only a single firm may participate as market maker and participants other than the market maker may not accept bids or offers of other non-market maker participants.

### **§ 36.2 Exemption.**

A contract, ~~agreement or transaction~~ of sale of a commodity for future delivery or commodity option traded on a multilateral transaction execution facility as defined in § 36.1(b) is exempt from all provisions of the Act and any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to such contract, ~~agreement or transaction~~ of sale of a commodity for future delivery or commodity option is exempt for such activity from all provisions of the Act (except in each case the provisions enumerated in §36.3(a)) provided the following terms and conditions are met:

(a) Only eligible participants, either trading for their own account or through another eligible participant, have trading access to the multilateral transaction execution facility;

(b) The contract, ~~agreement or transaction~~ of sale of a commodity for future delivery or commodity option listed on or traded through the multilateral transaction execution facility is based upon:

- (1) A debt obligation;
- (2) A foreign currency;
- (3) An interest rate;
- (4) An exempt security or index thereof, as provided in §2a(1)(B)(iv) of the Act;
- (5) A measure of credit risk or quality, including instruments known as “total return swaps,” “credit swaps” or “spread swaps;”

(6) An occurrence, extent of an occurrence or contingency beyond the control of the counterparties to the ~~transaction contract of sale of a commodity for future delivery or commodity option~~; or

(7) Cash-settled, based upon an economic or commercial index or measure beyond the control of the counterparties to the ~~transaction contract of sale of a commodity for future delivery or commodity option~~ and not based upon prices derived from trading in a directly corresponding underlying cash market.

(c) If cleared, the submission of such contracts, ~~agreements or transactions of sale of a commodity for future delivery or commodity options~~ for clearance and/or settlement must be to a clearing organization that is authorized by the Commission under §39.2 of this chapter: *Provided, however*, that nothing in this paragraph precludes: (1) arrangements or facilities between parties to such contracts, ~~agreements or transactions of sale of a commodity for future delivery or commodity options~~ that provide for netting of payment obligations resulting from such ~~agreements contracts of sale of a commodity for future delivery or commodity options~~; or (2) arrangements or facilities among parties to such contracts, ~~agreements or transactions of sale of a commodity for future delivery or commodity options~~, that provide for netting of payments resulting from such contracts, ~~agreements or transactions of sale of a commodity for future delivery or commodity options~~;

(d) The multilateral transaction execution facility on or through which such contracts, ~~agreements or transactions of sale of a commodity for future delivery or commodity options~~ are traded and the parties to, participants in, or intermediaries in such a facility that is exempt under this section are prohibited from claiming that the facility is regulated, recognized or approved by the Commission;

(e) The facility must be legally separate from any designated contract market, any recognized futures exchange under Part 38 of this chapter and any facility recognized as a derivatives trading facility under Part 37 of this chapter;

(f) The facility:

(1) if an electronic system that also lists for trading products pursuant to parts 37 or 38 of this chapter, must provide notice of the ~~agreements, contracts or transactions of sale of a commodity for future delivery or commodity options~~ traded on the facility pursuant to this part 36 and that such ~~transactions contracts of sale of a commodity for future delivery or commodity options~~ are not subject to regulation under the Act; or

(2) if providing a physical trading environment, must provide that ~~products contracts of sale of a commodity for future delivery or commodity options~~ trading pursuant to parts 37 or part 38 of this chapter be traded in a location separate from ~~products contracts of sale of a commodity for future delivery or commodity options~~ traded pursuant to this chapter 36; and

(g) If the Commission determines by order, after notice and an opportunity for a hearing, that ~~trading in contracts of sale of a commodity for future delivery or commodity options~~ on the facility serves as a significant source for the discovery of prices for an underlying commodity, the facility must on a daily basis disseminate publicly trading volume and price ranges and other trading data appropriate to that market as specified in the order.

(h) Any person or entity may apply to the Commission for exemption from any of the provisions of the Act (except 2(a)(1)(B)) for other arrangements or facilities, on such terms and conditions as the Commission deems appropriate, including, but not limited to, the applicability of other regulatory regimes.

### §36.3 Enforceability.

(a) Notwithstanding the exemption in §36.2, sections 2(a)(1)(B), 4b, and 4o of the Act and §32.9 of this chapter as adopted under section 4c(b) of the Act, and sections 6(c) and 9(a)(2) of the Act to the extent they prohibit manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, continue to apply to ~~transactions~~ ~~contracts of sale of a commodity for future delivery, commodity options~~ and persons otherwise subject to those provisions. ~~The preceding sentence shall not apply to any contract, agreement or transaction that is excluded from all or part of the Act by any provision of the Act or other federal law.~~

(b) A party to a ~~contract, agreement, or transaction~~ ~~of sale of a commodity for future delivery or commodity option~~ that is with an eligible counterparty (or counterparty reasonably believed by such party to be an eligible counterparty) shall be exempt from any claim, counterclaim or affirmative defense by such counterparty under section 22(a)(1) of the Act or any other provision of the Act (i) that such ~~contract, agreement, or transaction~~ ~~of sale of a commodity for future delivery or commodity option~~ is void, voidable or unenforceable, or (ii) to rescind or recover any payment made in respect of such ~~contract, agreement, or transaction~~ ~~of sale of a commodity for future delivery or commodity option~~, based solely on the failure of such party or such ~~contract, agreement, or transaction~~ ~~of sale of a commodity for future delivery or commodity option~~ to comply with the terms or conditions of the exemption under this part.

10. Chapter I of 17 CFR is proposed to be amended by adding new Part 37 as follows:

**Part 37-Exemption of Futures and Options Transactions on a Derivatives Transaction Facility**

**Authority:** 7 U.S.C. §§ 2, 6, 6c,6(c)and 12a.

**§37.1 Scope and Definitions.**

(a) *Scope.* (i) The derivatives transaction facility and the products contracts of sale of a commodity for future delivery or commodity options listed for trading thereon under this exemption shall be deemed to be subject to all of the provisions of the Act and Commission regulations thereunder which are applicable to a “board of trade,” board of trade licensed by the Commission,” “exchange,” “contract market,” “designated contract market,” or “contract market designated by the Commission” as though those provisions were set forth in this section and included specific reference to contracts of sale of a commodity for future delivery or commodity option contracts listed for trading by recognized derivatives transaction facilities pursuant to this section.

(ii) The provisions of this section shall not apply to a commodity or a contract subject to the provisions of section 2(a)(1)(B) of the Act.

(b) *Definition.* As used in this part “*eligible commercial participant*” means, and shall be limited to, a party or entity listed in §§35.1(b)(1), (b)(2), (b)(3), (b)(6) and (b)(8) of this chapter that in connection with its business, makes and takes delivery of the underlying physical commodity and regularly incurs risks related to such commodity, or is a dealer that regularly provides hedging, risk management or market- making services to the foregoing entities.

## §37.2 Exemption.

Notwithstanding §37.1(a)(i), a contract, ~~agreement or transaction~~ ~~of sale of a commodity for future delivery or commodity option~~ traded on a multilateral transaction execution facility as defined in §36.1(b) of this chapter, the facility and the facility's operator are exempt from all provisions of the Act and from all Commission regulations thereunder for such activity, except for those provisions of the Act and Commission regulations which, as a condition of this exemption, are reserved in §37.5(a), provided the following terms and conditions are met:

(a)(1) Only eligible commercial participants trading for their own account have trading access to the derivatives transaction facility for contracts ~~of sale for future delivery or options;~~ ~~agreements or transactions~~ in any commodity except for those listed in section 1(a)(3) of the Act,;  
or

(2)(i) The contract, ~~agreement or transaction~~ ~~of sale of a commodity for future delivery or commodity option~~ listed on or traded through the multilateral transaction execution facility meets the requirements set forth in §36.2(b) of this chapter or has been found by the Commission on a case-by-case determination to have a sufficiently liquid and deep cash market and a surveillance history based on actual trading experience to provide assurance that the contract is highly unlikely to be manipulated ; and

(ii) Participants that are not eligible participants as defined in §35.1(b) of this chapter may have ~~trading access to trading in contracts of sale of a commodity for future delivery or commodity options~~ only through a registered futures commission merchant that operates in accordance with the provisions of § 1. 17(a)(1)(ii) of this chapter;

(b) The multilateral transaction execution facility through which the contract agreement or transaction of sale of a commodity for future delivery or commodity option is entered into has been recognized by the Commission as a derivatives transaction facility pursuant to §37.3;

(c) A multilateral transaction execution facility that applies to be, and is, a recognized derivatives transaction facility must comply with all of the conditions of this part 37 exemption and must disclose to participants transacting on or through its facility that transactions contracts of sale of a commodity for future delivery or commodity options conducted on or through the facility are subject to the provisions of part 37;

(d) If cleared, the submission of such contracts, agreements or transactions of sale of a commodity for future delivery or commodity options for clearance and/or settlement must be to a clearinghouse that is authorized by the Commission under part 39 of this chapter. *Provided, however,* that nothing in this paragraph precludes: (i) arrangements or facilities between parties to such contracts, agreements or transactions of sale of a commodity for future delivery or commodity options that provide for netting of payment obligations resulting from such agreements; or (ii) arrangements or facilities among parties to such contracts, agreements or transactions, of sale of a commodity for future delivery or commodity options that provide for netting of payments resulting from such contracts, agreements or transactions of sale of a commodity for future delivery or commodity options; and

(e) The products contracts of sale of a commodity for future delivery or commodity options, if traded on an electronic system, must be clearly identified as traded on a recognized derivatives transaction facility or if traded in a physical trading environment must be traded in a location separate from products contracts of sale of a commodity for future delivery or

commodity options traded as designated contract markets, or pursuant to parts 36 and 38 of this chapter;

**§ 37.3 Conditions for recognition as a derivatives transaction facility**

(a) To be recognized as a derivatives transaction facility, the facility initially must have:

(1) Rules relating to trading on its facility, including, depending on the nature of the trading mechanism:

(i) Rules to deter trading abuses, and adequate power and capacity to detect, investigate and take action against violation of its trade rules including arrangements to obtain necessary information to perform the above functions, or

(ii) Use of technology that provides participants with impartial access to transactions and captures information that is available for use in determining whether violations of its rules have occurred;

(2) Rules or terms and conditions defining, or specifications detailing, the operation of the trading mechanism or electronic matching platform;

(3) Rules or terms and conditions detailing the financial framework applying to the transactions or ensuring the financial integrity of transactions entered into by, or through, its facilities; and

(b) Initially, and on a continuing basis, must meet and adhere to the following seven core principles:

(1) *Enforcement.* Monitor and enforce its rules or terms and conditions including, if applicable, limitations on access.

(2) *Market oversight.* As appropriate to the market and the contracts of sale of a commodity for future delivery or commodity options traded:



(i) Monitor markets on a routine and nonroutine basis as necessary to ensure orderly trading and have and where appropriate exercise authority to maintain an orderly market; or

(ii) Provide information to the CFTC as requested by the CFTC to satisfy its obligations under the CEA.

(3) *Operational information.* Disclose to regulators and market participants, to the extent possible, information concerning trading terms, contract terms and conditions, trading mechanisms, financial integrity arrangements or mechanisms, as well as other relevant information.

(4) *Transparency.* Provide to market participants on a fair, equitable and timely basis information regarding prices, bids and offers, and other information appropriate to the market and, as appropriate to the market, make available to the public with respect to actively traded ~~products contracts of sale of a commodity for future delivery or commodity options~~ and, to the extent applicable, information regarding daily opening and closing prices, price range, trading volume and other related market information.

(5) *Fitness.* As appropriate to the market, have fitness standards for members, operators or owners with greater than 10 percent interest or an affiliate of such an owner, members of the governing board, and those who make disciplinary determinations.

(6) *Recordkeeping.* Keep full books and records of all activities related to its business as a recognized derivatives transaction facility, including full information relating to data entry and trade details sufficient to reconstruct trading, in a form and manner acceptable to the CFTC for a period of five years, during the first two of which the books and records are readily available, and which shall be open to inspection by any representative of the CFTC or the U.S. Department of Justice.

(7) *Competition.* Avoid unreasonable restraints of trade or imposing any burden on competition not necessary or appropriate in furtherance of the objectives of the Act or the regulations thereunder.

**§37. 4 Procedures for recognition.**

(a) *Recognition by certification.* A board of trade, facility or entity that is designated under sections 4c, 5, 5a(a) or 6 of the Act as a contract market in at least one commodity which is not dormant within the meaning of §5.2 of this part will be recognized by the Commission as a derivatives transaction facility upon receipt by the Commission at its Washington, D.C. headquarters of a copy of the derivatives transaction facility's rules and a certification by the board of trade, facility or entity that it meets the conditions for recognition under this part.

(b) *Recognition by application.* A board of trade, facility or entity shall be recognized by the Commission as a derivatives transaction facility thirty days after receipt by the Commission of an application for recognition as a derivatives transaction facility unless notified otherwise during that period, if:

(1) The application demonstrates that the applicant satisfies the conditions for recognition under this part;

(2) The submission is labeled as being submitted pursuant to this Part 37;

(3) The submission includes a copy of the derivatives transaction facility's rules and a brief explanation of how the rules satisfy each of the conditions for recognition under §37.3;

(4) The applicant does not amend or supplement the application for recognition, except as requested by the Commission or for correction of typographical errors, renumbering or other nonsubstantive revisions, during that period; and

(5) The applicant has not instructed the Commission in writing during the review period to review the application pursuant to procedures under Section 6 of the Act.

(6) Appendix A to this part provides guidance to applicants on how the conditions for recognition enumerated in §37.3 could be satisfied.

(7) Additionally, a board of trade, facility or entity may apply to be, and opt to become, a recognized derivatives transaction facility notwithstanding that contracts, agreements or transactions that are traded or will be traded on such board of trade, facility or entity are neither contracts of sale of a commodity for future delivery nor commodity options, or are excluded from all or part of the Act by any provision of the Act or other federal law. By filing an application to become a recognized derivatives transaction facility, such board of trade, facility or entity voluntarily submits to the jurisdiction of the Commission with respect to such contracts, agreements or transactions not subject to the Act. In such instances, all provisions of this chapter applicable to recognized derivatives transaction facilities with respect to trading in contracts of sale of a commodity for future delivery or commodity options shall also apply to a recognized derivatives transaction facility with respect to trading in a contract, agreement or transaction listed thereon that is not subject to the Act, *provided, however,* that:

(i) Provisions of this chapter shall apply to such recognized derivatives transaction facility with respect to trading in such contract, agreement or transaction that is not subject to the Act only if the recognized derivatives transaction facility on which such contract, agreement or transaction is traded has specifically listed such contract, agreement or transaction in accordance with §5.2(b) of this chapter; and

(ii) The applicability of this Part 37 or any other provisions of this chapter to any contract, agreement or transaction traded on a recognized derivatives transaction facility shall not imply or

be construed to mean that any unrecognized board of trade, facility or entity that is similar or identical to such recognized derivatives transaction facility or that trades contracts, agreements or transactions that are similar or identical to such contract, agreement or transaction is subject to any provision in the Act or this chapter.

(c) *Termination of Part 37 review.* During the thirty-day period for review pursuant to paragraph (b) of this section, the Commission shall notify the applicant seeking recognition that the Commission is terminating review under this section and will review the proposal under the procedures of Section 6 of the Act, if it appears that the application fails to meet the conditions for recognition under this part. This termination notification will state the nature of the issues raised and the specific condition of recognition that the application appears to violate, is contrary to or fails to meet. Within ten days of receipt of this termination notification, the applicant seeking recognition may request that the Commission render a decision whether to recognize the derivatives transaction facility or to institute a proceeding to disapprove the proposed submission under procedures specified in Section 6 of the Act by notifying the Commission that the applicant seeking recognition views its submission as complete and final as submitted.

(d) *Delegation of Authority.*

(1) The Commission hereby delegates, until it orders otherwise, to the Directors of the Division of Trading and Markets and the Division of Economic Analysis or their delegates, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to notify the entity seeking recognition under paragraph (b) of this section that review under those procedures is being terminated.

(2) The Directors of the Division of Trading and Markets or the Division of Economic Analysis may submit to the Commission for its consideration any matter which has been delegated in this paragraph.

(3) Nothing in the paragraph prohibits the Commission, at its election, from exercising the authority delegated in paragraph (d)(1) of this section.

(e) *Request for Commission approval of rules and products.* (1) An entity seeking recognition as a derivatives transaction facility may request that the Commission approve any or all of its rules and subsequent amendments thereto, including both operational rules and the terms or conditions of products listed for trading on the facility, at the time of recognition or thereafter, under section 5a(a)(12) of the Act and §§1.41 and 5.3 of this chapter, as applicable. A derivatives transaction facility may label a product in its rules as, "Listed for trading pursuant to Commission approval," if the product's terms or conditions have been approved by the Commission. Rules of the derivatives trading facility not submitted pursuant to §37.4(b)(3) shall be submitted to the Commission pursuant to §1.41.

(2) An entity seeking recognition as a derivatives transaction facility may request that the Commission consider under the provisions of section 15 of the Act any of the entity's rules or policies, including both operational rules and the terms or conditions of ~~products~~ ~~contracts of sale of a commodity for future delivery or commodity options~~ listed for trading, at the time of recognition or thereafter.

(f) *Request for withdrawal of recognition.* A recognized derivatives transaction facility may withdraw from Commission recognition by filing with the Commission at its Washington, D.C. headquarters such a request. Withdrawal from recognition 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 recognized by the Commission.

### **§37.5 Enforceability**

(a) Notwithstanding the exemption in §37.2, sections 1a, 2(a)(1), 4, 4b, 4c, 4g, 4i, 4o, 5(6), 5(7), the rule disapproval procedures of 5a(a)(12), 5b, 6(a), 6(b), 6(c), 6b, 6c, 8(a), 8(c), 8a(6), 8a(7), 8a(9) 8c(a), 9(a)(2), 9(a)(3), 9(f), 14, 20 and 22 of the Act and § § 1.3, 1.31, 1.37, 1.41, 5.3, 33. 10, Part 5, Part 20, and Part 37 of this chapter continue to apply.

(b) For purposes of Section 22(a) of the Act, a party to a contract, ~~agreement, or transaction of sale of a commodity for future delivery or commodity option~~ is exempt from a claim that the contract, ~~agreement, or transaction of sale of a commodity for future delivery or commodity option~~ is void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable solely for failure of the parties to a contract, ~~agreement, or transaction of sale of a commodity for future delivery or commodity option~~, or the contract, ~~agreement, or transaction of sale of a commodity for future delivery or commodity option~~ itself, to comply with the terms and conditions for the exemption under this part or as a result of:

(1) A violation by the recognized derivatives transaction facility of the provisions of this part 37; or

(2) Any Commission proceeding to disapprove a rule, term or condition under section 5a(a)(12) of the Act, to alter or supplement a rule, term or condition under section 8a(7) of the Act, to declare an emergency under section 8a(9) of the Act, or any other proceeding the effect of which is to disapprove, alter, supplement, or require a recognized derivatives transaction facility to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

**§ 37.6 Fraud in connection with Part 37 futures and options transactions.**

It shall be unlawful for any person, directly or indirectly, in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of any transaction contract of sale of a commodity for future delivery or commodity option entered pursuant to this part:

- (1) To cheat or defraud or attempt to cheat or defraud any person;
- (2) Willfully to make or cause to be made to any person any false report or statement thereof or cause to be entered for any person any false record thereof;
- (3) Willfully to deceive or attempt to deceive any person by any means whatsoever.

**APPENDIX A TO PART 37 - APPLICATION GUIDANCE**

This appendix provides guidance to applicants for recognition as derivatives transaction facilities under § 37.3. Addressing the issues and questions set forth below would help the Commission in its consideration of whether the application has met the conditions for recognition.

To the extent that compliance with, or satisfaction of, a core principle is not self-explanatory from the face of the derivatives transaction facilities rules or terms, the application should include an explanation or other form of documentation demonstrating that the applicant meets the conditions for recognition. F

**Core Principle #1: *Enforcement:* Monitoring and enforcement of its rules or terms and conditions including, if applicable, limitations on access.**

A derivatives transaction facility should have arrangements and resources and authority for effectively and affirmatively enforcing its rules, including the authority and ability to collect or capture information and documents on both a routine and non-routine basis and to investigate effectively possible rule violations.

This should include the authority and ability to discipline, and limit or suspend a member's or participant's activities and/or the authority and ability to terminate a member's or participant's activities or access pursuant to clear and fair standards.

**Core Principle #2: *Market Oversight*: As appropriate to the market and the contracts traded, to: (1) monitor markets on a routine and non-routine basis as necessary to ensure open and competitive trading and have and, where appropriate, exercise authority to maintain an open and competitive market; or (2) provide information to the Commission as necessary for the Commission to satisfy its obligations under the Act.**

Arrangements and resources for effective market surveillance programs should facilitate, on both a routine and non-routine basis, direct supervision of the market. Appropriate objective testing and review of any automated systems should occur initially and periodically to ensure proper system functioning, adequate capacity and security. The analysis of data collected should be suitable for the type of information collected and should occur in a timely fashion. A derivatives transaction facility should have the authority to collect the information and documents necessary to reconstruct trading for appropriate market analysis as it carries out its market surveillance programs. The derivatives transaction facility also should have the authority to intervene as necessary to maintain an open and competitive market. In carrying out this responsibility, the facility should address access to, and use of, material non-public information by members, owners or operators, participants or facility employees.

Alternatively, and as appropriate to the market, a derivatives transaction facility may choose to satisfy Core Principle #2 by providing information to the Commission as requested by the Commission to satisfy its obligations under the Act. The derivatives transaction facility should have the authority to collect or capture and retrieve all necessary information.

The Commission will collect reporting data from large traders only upon Special Call as provided in Part 20 of this chapter.



**Core Principle #3: *Operational Information*: Disclose to regulators and market participants, to the extent possible, information concerning trading terms, contract terms and conditions, trading mechanisms, financial integrity arrangements or mechanisms, as well as other relevant information.**

A derivatives transaction facility should have arrangements and resources for the disclosure and explanation of trading terms, contract terms and conditions, trading mechanisms, financial integrity arrangements or mechanisms. Such information may be made publicly available through the operation of a website by the derivatives transaction facility.

**CORE PRINCIPLE # 4: *Transparency*: Provide to market participants on a fair, equitable and timely basis information regarding prices, bids and offers, and other information appropriate to the market, make available to the public with respect to actively traded products and, to the extent applicable, information regarding daily opening and closing prices, price range, trading volume and other related market information.**

All market participants should have information regarding prices, bids and offers, or other information appropriate to the market readily available on a fair and equitable basis. The derivatives transaction facility should provide to the public information regarding daily opening and closing prices, price range, trading volume, open interest and other related market information for actively traded contracts. Provision of information could be through such means as provision of the information to a financial information service or by placement of the information on a facility's web site.

**CORE PRINCIPLE # 5: *Fitness*: Appropriate fitness standards for members, operators or owners with greater than 10 percent interest or an affiliate of such an owner, members of the governing board, and those who make disciplinary determinations.**

A derivatives transaction facility should have appropriate eligibility criteria for the categories of persons set forth in the Core Principle which would include standards for fitness and for the collection and verification of information supporting compliance with such standards.

Minimum standards of fitness are those bases for refusal to register a person under section 8a(2)

of the Act. A demonstration of the fitness of the applicant's members, operators or owners may include providing the Commission with registration information for such persons, certification to the fitness of such persons, an affidavit of such persons' fitness by the facility's Counsel or other information substantiating the fitness of such persons.

**CORE PRINCIPLE # 6: *Recordkeeping*: Maintenance of full books and records of all activities related to its business as a recognized derivatives transaction facility, including full information relating to data entry and trade details, in a form and manner acceptable to the Commission for a period of five years, during the first two of which the books and records are readily available, and which shall be open to inspection by any representative of the Commission or the United States Department of Justice.**

Commission rule 1.31 constitutes the acceptable practice regarding the form and manner for keeping records.

**CORE PRINCIPLE # 7: *Competition*: To avoid unreasonable restraints of trade or imposing any burden on competition not necessary or appropriate in furtherance of the objectives of the Act or the regulations thereunder.**

Guidance on individual rules, terms or practices is available by submitting a rule for Commission approval under the procedures of §1.41 of this chapter or by requesting that the Commission issue an Order considering the rule, term or practice under the provision of section 15 of the Act.

11. Chapter I of 17 CFR is proposed to be amended by adding new Part 38 as follows:

**Part 38-Exemption of Futures and Options Transactions on a Recognized Futures Exchange**

**Authority:** 7 U.S.C. §§ 2, 6, 6c, and 12a.

**§38.1 Scope.**

(a) Except for commodities subject to paragraph (a) of this section, the provisions of the exemption in §38.2 of this part shall apply to every board of trade that has been designated as a contract market in a commodity under section 6 of the Act. *Provided, however,* nothing in this provision affects the eligibility of designated contract markets for exemption under parts 36 or 37 of this chapter.

(b) Recognized futures exchanges that have been recognized by the Commission by application under §38.3 and the ~~products~~ **contracts of sale of a commodity for future delivery and commodity options** listed for trading thereon shall be deemed to be subject to all of the provisions of the Act and Commission regulations thereunder which are applicable to a “board of trade,” “board of trade licensed by the Commission,” “exchange,” “contract market,” “designated contract market,” or “contract market designated by the Commission” as though those provisions were set forth in this section and included specific reference to **contracts of sale of a commodity for future delivery or commodity options** listed for trading by recognized futures exchanges pursuant to this section.

(c) The provisions of this section shall not apply to a commodity or a contract subject to the provisions of section 2(a)(1)(B) of the Act.

## §38.2 Exemption.

Notwithstanding §38.1(b), a contract, ~~agreement or transaction~~ of sale of a commodity for future delivery or commodity option traded on a multilateral transaction execution facility as defined in §36.1(b) of this chapter, the facility and the facility's operator are exempt from all provisions of the Act and from all Commission regulations thereunder for such activity, except for those provisions of the Act and Commission regulations which, as a condition of this exemption, are reserved in §38.5(a), provided the following terms and conditions are met:

(a) The multilateral transaction execution facility on which the contract, ~~agreement or transaction~~ of sale of a commodity for future delivery or commodity option is entered into has been recognized by the Commission as a recognized futures exchange pursuant to §38.3;

(c) A multilateral transaction execution facility that applies to be, and is, a recognized futures exchange must comply with all of the conditions of this part 38 exemption and must disclose to participants transacting on or through its facilities that ~~transactions~~ contracts of sale of a commodity for future delivery or commodity options conducted on or through the facility are subject to the provisions of part 38;

(d) If cleared, the submission of such contracts, ~~agreements or transactions~~ of sale of a commodity for future delivery or commodity options for clearance and/or settlement must be to a clearinghouse which is authorized by the Commission under part 39 of this chapter. Provided, however, that nothing in this paragraph precludes: (i) arrangements or facilities between parties to such contracts, ~~agreements or transactions~~ of sale of a commodity for future delivery or commodity options that provide for netting of payment obligations resulting from such agreements; or (ii) arrangements or facilities among parties to such contracts, ~~agreements or~~

transactions, of sale of a commodity for future delivery or commodity options that provide for netting of payments resulting from such agreements; and

(e) The products contracts of sale of a commodity for future delivery or commodity options if traded on an electronic system must be clearly identified as traded on a recognized futures exchange or if traded in a physical trading environment must be traded in a location separate from products contracts of sale of a commodity for future delivery or commodity options traded pursuant to parts 36 and 37 of this chapter;

### **§ 38.3 Conditions for recognition as a recognized futures exchange**

(a) To be recognized as a recognized futures exchange, the exchange must demonstrate initially that it has:

(1) A clear framework for conducting programs of market surveillance, compliance, and enforcement, including having procedures in place to make use of collected data for real-time monitoring and for post-event audit and compliance purposes to prevent market manipulation;

(2) Rules relating to trading on the exchange, including rules to deter trading abuses, and adequate power and capacity to detect, investigate and take action against violations of its trading rules, and a dedicated regulatory department or delegation of that function to an appropriate entity;

(3) Rules defining, or specifications detailing, the manner of operation of the trading mechanism or electronic matching platform and a trading mechanism or electronic matching platform that performs as defined in the operational rules or specifications;

(4) A clear framework for ensuring the financial integrity of **transactions contracts of sale of a commodity for future delivery or commodity options** entered into by or through the exchange;

(5) Established procedures for impartial disciplinary committee(s) or other similar mechanisms empowered to discipline, suspend, and expel members, or to deny access to participants or, if provided for, discipline participants;

(6) Arrangements to obtain necessary information to perform the above functions, including the capacity and arrangements to carry out the International Information Sharing Agreement and Memorandum of Understanding developed by the Futures Industry Association (FIA) Global Task Force on Financial Integrity, and a mechanism to provide to the public ready access to its rules and regulations; and

(b) Initially, and on a continuing basis, must meet and adhere to the following fifteen core principles:

(1) *Rule enforcement.* Monitor and enforce its rules;

(2) *Products.* List **contracts of sale of a commodity for future delivery or commodity options** for trading which are not readily susceptible to manipulation;

(3) *Position monitoring and reporting.* Monitor markets on a routine and nonroutine basis as necessary to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process;

(4) *Position limits.* Adopt position limits on trading where necessary and appropriate to lessen the threat of market manipulation or congestion during delivery months;

(5) *Emergency authority.* Exercise authority to intervene to maintain fair and orderly trading, including where applicable authority to liquidate or transfer open positions, to require the suspension or curtailment of trading, and to require the posting of additional margin;

(6) *Public information.* Make information concerning the contract terms and conditions and the trading mechanism, as well as other relevant information, readily available to market authorities, users and the public;

(7) *Transparency.* Provide, appropriate to the market, information to the public regarding prices, bids and offers, including the opening and closing prices and daily range, and information on volume and open interest;

(8) *Trading system.* Provide a competitive, open, and efficient market;

(9) *Audit trail.* Have procedures to ensure the recording of full data entry and trade details sufficient to reconstruct trading, the safe storage of such information and systems to enable information to be used in assisting in detecting and deterring customer and market abuse. Such procedures should ensure the quality of data captured;

(10) *Financial standards.* Have, monitor, and enforce rules regarding the financial integrity of the ~~transactions~~ ~~contracts of sale of a commodity for future delivery or commodity options~~ that have been executed on the exchange and, where intermediaries are permitted, have rules addressing the financial integrity of the intermediary and the protection of customer funds as appropriate and a program to enforce those requirements;

(11) *Customer protection.* Have, monitor and enforce rules for customer protection;

(12) *Dispute resolution.* Provide for alternative dispute resolution mechanisms appropriate to the nature of the market;

(13) *Governance*. Have fitness standards for members, for owners or operators with greater than ten percent interest or an affiliate of such an owner, members of the governing board, and those who make disciplinary determinations. The recognized futures exchange must have a means to address conflicts of interest in making decisions and access to , and use of, material non-public information by the foregoing persons and by exchange employees. For mutually owned futures exchanges, the composition of the governing board must reflect market participants;

(14) *Recordkeeping*. Keep full books and records of all activities related to their business as a recognized futures exchange in a form and manner acceptable to the CFTC for a period of five years, during the first two of which the books and records are readily available, and which shall be open to inspection by any representative of the CFTC or the U.S. Department of Justice; and

(15) *Competition*. Avoid unreasonable restraints of trade or impose any burden on competition not necessary or appropriate in furtherance of the objectives of the Act or the regulations thereunder.

#### **§38. 4 Procedures for recognition.**

(a) *Recognition by prior designation*. A board of trade, facility or entity that is designated under sections 4c, 5, 5a(a) or 6 of the Act as a contract market on the effective date of this rule in at least one commodity which is not dormant within the meaning of §5.2 of this part is recognized by the Commission as a recognized futures exchange and each of the contracts of sale of a commodity for future delivery or commodity options traded thereon that has been designated by the Commission as a designated contract market in a commodity may be labeled in the recognized futures exchange's rules as listed for trading pursuant to Commission approval.



(b) *Recognition by application.* A board of trade, facility or entity shall be recognized by the Commission as a recognized futures exchange sixty days after receipt by the Commission of an application for recognition unless notified otherwise during that period, if:

(1) The application demonstrates that the applicant satisfies the conditions for recognition under this part;

(2) The submission is labeled as being submitted pursuant to this Part 38;

(3) The submission includes a copy of the applicant's rules and a brief explanation of how the rules satisfy each of the conditions for recognition under §38.3;

(4) The applicant does not amend or supplement the application for recognition, except as requested by the Commission or for correction of typographical errors, renumbering or other nonsubstantive revisions, during that period; and

(5) The applicant has not instructed the Commission in writing during the review period to review the application pursuant to procedures under Section 6 of the Act.

(6) Appendix A to this part provides guidance to applicants on how the conditions for recognition enumerated in §38.3 could be satisfied.

(c) *Termination of Part 38 review.* During the sixty-day period for review pursuant to paragraph (b) of this section, the Commission shall notify the applicant seeking recognition that the Commission is terminating review under this section and will review the proposal under the procedures of Section 6 of the Act, if it appears that the application fails to meet the conditions for recognition under this part. This termination notification will state the nature of the issues raised and the specific condition of recognition that the application appears to violate, is contrary to or fails to meet. Within ten days of receipt of this termination notification, the applicant seeking recognition may request that the Commission render a decision whether to recognize the futures

exchange or to institute a proceeding to disapprove the proposed submission under procedures specified in Section 6 of the Act by notifying the Commission that the applicant seeking recognition views its submission as complete and final as submitted.

*(d) Delegation of Authority.*

(1) The Commission hereby delegates, until it orders otherwise, to the Directors of the Division of Trading and Markets and the Division of Economic Analysis or their delegates, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to notify the entity seeking recognition under paragraph (b) of this section that review under those procedures is being terminated.

(2) The Directors of the Division of Trading and Markets or the Division of Economic Analysis may submit to the Commission for its consideration any matter which has been delegated in this paragraph..

(3) Nothing in the paragraph prohibits the Commission, at its election, from exercising the authority delegated in paragraph (d)(1) of this section.

*(e) Request for Commission approval of rules and products.* (1) An entity seeking recognition as a recognized futures exchange may request that the Commission approve any or all of its rules and subsequent amendments thereto, including both operational rules and the terms or conditions of products listed for trading on the exchange, at the time of recognition or thereafter, under section 5a(a)(12) of the Act and §§1.41 and 5.3 of this chapter, as applicable. A product the terms or conditions of which have been approved by the Commission may be labeled in its rules as listed for trading pursuant to Commission approval. In addition, rules of the recognized futures exchange not submitted pursuant to §38.4(b)(3) shall be submitted to the Commission pursuant to §1.41.

(2) An entity seeking recognition as a recognized futures exchange may request that the Commission consider under the provisions of section 15 of the Act any of the entity's rules or policies, including both operational rules and the terms or conditions of products listed for trading, at the time of recognition or thereafter.

*(f) Request for withdrawal of application for recognition or withdrawal of recognition.*

An entity may withdraw an application to be a recognized futures exchange or once recognized, may withdraw from Commission recognition by filing with the Commission at its Washington, D.C. headquarters such a request. Withdrawal from recognition 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 exchange was recognized by the Commission.

### **§38.5 Enforceability**

(a) Notwithstanding the exemption in §38.2, sections I a, 2(a)(1), 4, 4a, 4b, 4c, 4g, 4i, 4o, 5(6), 5(7), the rule disapproval procedures of 5a(a)(12), 5b, 6(a), 6(b), 6(c), 6b, 6c, 8(a), 8(c), 8a(6), 8a(7), 8a(9), 8c(a), 8c(b), 8c(c), 8c(d), 9(a), 9(f), 20 and 22 of the Act and §§1.3, 1.31, 1.37, 1.38, 1.41, 33.10, Part 5, Part 9, Parts 15-21 and Part 3 8 of this chapter continue to apply.

(b) For purposes of Section 22(a) of the Act, a party to a contract, ~~agreement, or transaction of sale of a commodity for future delivery or commodity option~~ is exempt from a claim that the contract, ~~agreement, or transaction of sale of a commodity for future delivery or commodity option~~ is void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable as a result of-

(1) A violation by the recognized futures exchange of the provisions of this part 38; or

(2) Any Commission proceeding to disapprove a rule, term or condition under section 5a(a)(12) of the Act, to alter or supplement a rule, term or condition under section 8a(7) of the

Act, to declare an emergency under section 8a(9) of the Act, or any other proceeding the effect of which is to disapprove, alter, supplement, or require a recognized futures exchange to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

**§ 38.6 Fraud in connection with Part 38 futures and options transactions.**

It shall be unlawful for any person, directly or indirectly, in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of any transaction contract of sale of a commodity for future delivery or commodity option entered pursuant to this part:

- (1) To cheat or defraud or attempt to cheat or defraud any person;
- (2) Willfully to make or cause to be made to any person any false report or statement thereof or cause to be entered for any person any false record thereof, or
- (3) Willfully to deceive or attempt to deceive any person by any means whatsoever.

**APPENDIX A TO PART 38-GUIDANCE FOR APPLICANTS AND ACCEPTABLE PRACTICES**

This appendix provides guidance and acceptable practices for the Core Principles found in Part 38. Guidance to applicants for recognition as recognized futures exchanges under § 38.3 is offered under subsection (a) following a Core Principle. Addressing the issues and questions set forth therein would help the Commission in its consideration of whether the application has met the conditions for recognition. To the extent that compliance with, or satisfaction of, a core principle is not self-explanatory from the face of the recognized futures exchange's rules or terms, the application should include an explanation or other form of documentation demonstrating that the applicant meets the conditions for recognition.

Acceptable practices meeting the requirements of the Core Principles are set forth in subsection (b). Recognized futures exchanges that follow specific practices outlined under subsection (b) for any Core Principle below will meet the applicable Core Principle. Except where otherwise provided, subsection (b) does not state the exclusive means for satisfying a Core Principle.

**Core Principle #1: Rule Enforcement: Monitor and enforce its rules.**

**(a) Application Guidance.**

A recognized futures exchange should have arrangements and resources for effective trade practice surveillance programs, with the authority to collect information and documents on both a routine and non-routine basis including the examination of books and records kept by members/participants of the exchange. The arrangements and resources should facilitate the direct supervision of the market and the analysis of data collected.

A recognized futures exchange should have arrangements, resources and authority for effective rule enforcement. The Commission believes that this should include the authority and ability to discipline and limit or suspend a member's or participant's activities as well as the authority and ability to terminate a member's or participant's activities pursuant to clear and fair standards.

**(b) Acceptable Practices**

An effective trade practice surveillance program should include: (1) maintenance of data reflecting the details of each transaction executed on an RFE; (2) electronic analysis of these data routinely to detect potential trading violations; (3) appropriate and thorough investigative analysis of these and other potential trading violations brought to its attention; and (4) prompt and effective disciplinary action for any violation that is found to have been committed. The

Commission believes that the latter element should include the authority and ability to discipline and limit or suspend a member's or participant's activities pursuant to clear and fair standards.

*See, e.g., 17 CFR Part 8.*

**Core Principle #2 Products: List contracts for trading which are not readily susceptible to manipulation.**

**(a) Application Guidance**

Applicants should submit their initial product for listing for Commission approval under §5.1 and Part 5, Appendix A of this chapter. Subsequent products may be listed for trading by self-certification under § 5.3 of this chapter.

**(b) Acceptable Practices**

Guideline No. 1, 17 CFR Part 5, Appendix A may be used as guidance in meeting this Core Principle.

**Core Principle #3: *Position monitoring and reporting*: Monitor markets on a routine and nonroutine basis as necessary to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process.**

**(a) Application Guidance**

[Reserved].

**(b) Acceptable Practices**

An acceptable program for monitoring markets will generally involve the collection of various market data, including information on traders' market activity. Those data should be evaluated on an ongoing basis in order to make an appropriate regulatory response to potential market disruptions or abusive practices.

The recognized futures exchange should collect data in order to assess whether the market price is responding to the forces of supply and demand. Appropriate data usually include various

fundamental data about the underlying commodity, its supply, its demand, and its movement through marketing channels. Especially important are data related 1) to the size and ownership of deliverable supplies-the existing supply and the future or potential supply, and 2) to the pricing of the deliverable commodity relative to the futures price and relative to similar, but nondeliverable, kinds of the commodity. For cash-settled markets, it is more appropriate to pay attention to the availability and pricing of the commodity making up the index to which the market will be settled, as well as monitoring the continued suitability of the methodology for deriving the index.

To assess a traders' activity and potential power in a market, at a minimum, every exchange should have routine access to the positions and trading done by the members of its clearing facility. Although clearing member data may be sufficient for some exchanges, an effective surveillance program for exchanges with substantial numbers of customers trading through intermediaries should employ a much more comprehensive large-trader reporting system (LTRS). The Commission operates an industry-wide LTRS. As an alternative to having its own LTRS or contracting out for such a system, exchanges may find it more efficient to use information available from the Commission's LTRS data for position monitoring.

**Core Principle #4: *Position Limits*: Adopt position limits on trading where necessary and appropriate to lessen the threat of market manipulation or congestion during delivery months.**

**(a) Application Guidance**

[Reserved].

**(b) Acceptable Practices**

In order to diminish potential problems arising from excessively large speculative positions, the Commission sets limits on traders' positions for certain commodities. These position limits specifically exempt bona fide hedging, permit other exemptions, and set limits

differently by markets, by futures or delivery months, or by time periods. For purposes of evaluating an exchange speculative-limit program, the Commission considers the specified limit levels, aggregation policies, types of exemptions allowed, methods for monitoring compliance with the specified levels, and procedures for enforcement to deal with violations.

In general, position limits are not necessary for markets where the threat of excessive speculation or manipulation is very low. Thus, exchanges do not need to set position-limit levels for futures markets in major foreign currencies and in certain financial futures having very liquid and deep underlying cash markets. Where speculative limits are appropriate, acceptable speculative-limit levels typically are set in terms of a trader's combined position in the futures contract plus its position in the option contract (on a delta-adjusted basis).

Spot-month levels for physical-delivery markets should be based upon an analysis of deliverable supplies and the history of spot-month liquidations. Spot-month limits for physical delivery markets are appropriately set at no more than 25 percent of the estimated deliverable supply. For cash-settled markets, spot-month position limits may be necessary if the underlying cash market is small or illiquid such that traders can disrupt the cash market or otherwise influence the cash-settlement price to profit on a futures position. In these cases, the limit should be set at a level that minimizes the potential for manipulation or distortion of the futures contract's or the underlying commodity's price. Markets may elect not to provide all-months combined and non-spot month limits.

An exchange may provide for position accountability provisions in lieu of position limits for contracts on financial instruments, intangible commodities, or certain tangible commodities. Markets appropriate for position accountability rules include those with large open-interest, high daily trading volumes and liquid cash markets.



Exchanges must have aggregation rules that apply to those accounts under common control, those with common ownership, *i.e.*, where there is a 10 percent or greater financial interest, and those traded according to an expressed or implied agreement. Exchanges will be permitted to set more stringent aggregation policies. For example, one major exchange adopted a policy of automatically aggregating members of the same household, unless they were granted a specific waiver. Exchanges may grant exemptions to their position limits for bona fide hedging (as defined in Commission Rule 1.3(z)) and may grant exemptions for reduced risk positions, such as spreads, straddles and arbitrage positions. Exchanges must establish a program for effective monitoring and enforcement of these limits. One acceptable enforcement mechanism is a program whereby traders apply for these exemptions by the exchange and are granted a position level higher than the applicable speculative limit. The position levels granted under hedge exemptions are based upon the trader's commercial activity in related markets. Exchanges may allow a brief grace period where a qualifying trader may exceed speculative limits or an existing exemption level pending the submission and approval of appropriate justification. An exchange should consider whether it wants to restrict exemptions during the last several days of trading in a delivery month. Acceptable procedures for obtaining and granting exemptions include a requirement that the exchange approve a specific maximum higher level.

Exchanges with many markets with large numbers of traders should have an automated means of detecting traders' violations of speculative limits or exemptions. Exchanges should monitor the continuing appropriateness of approved exemptions by periodically reviewing each trader's basis for exemption or requiring a reapplication.

Finally, an acceptable speculative limit program must have specific policies for taking regulatory action once a violation of a position limit or exemption is detected. The exchange

policy will need to consider appropriate actions where the violation is by a non-member and should address traders carrying accounts through more than one intermediary.

A violation of exchange position limits that have been approved by the Commission is also a violation of section 4a(e) of the Act.

**Core Principle #5: *Emergency Authority*: Exercise authority to intervene to maintain fair and orderly trading markets including where applicable authority to liquidate or transfer open positions, to require the suspension or curtailment of trading, and to require the posting of additional margin.**

**(a) Application Guidance**

[Reserved].

**(b) Acceptable Practices**

A recognized futures exchange should have clear procedures and guidelines for exchange decision-making regarding emergency intervention in the market. An exchange should also have the authority to intervene as necessary to maintain markets with fair and orderly trading as well as procedures for carrying out the intervention. As is necessary to address perceived market threats, the exchange, among other things, should be able to impose position limits in particular in the delivery month, impose or modify price limits, modify circuit breakers, call for additional margin either from customers or clearing members, order the liquidation or transfer of open positions, order the fixing of a settlement price, order the reduction in positions, extend or shorten the expiration date or the trading hours, suspend or curtail trading on the market, order the transfer of customer contracts and the margin for such contracts from one member of the exchange to another or alter the delivery terms or conditions. The Commission believes that a recognized futures exchange should also have procedures and guidelines for the notification of the Commission of the exercise of regulatory emergency authority as well as procedures and

guidelines for documentation of the exchange's decision-making process and the reasons for use of its emergency action authority.

**Core Principle #6: *Public Information*: Make information concerning the contract terms and conditions and the trading mechanism, as well as other relevant information, readily available to market authorities, users and the public.**

**(a) Application Guidance**

A recognized futures exchange should have arrangements and resources for the disclosure of contract terms and conditions and trading mechanisms to the Commission, users and the public. Procedures should also include the provision of information on listing new products, rule amendments or other changes to previously disclosed information to the Commission, users and the public.

**(b) Acceptable Practices**

[reserved]

**Core Principle #7: *Transparency*. Provide, appropriate to the market, information to the public regarding prices, bids and offers, including the opening and closing prices and daily range, and information on volume and open interest.**

**(a) Application Guidance**

[Reserved].

**(b) Acceptable Practices**

[Reserved]

**Core Principle #8: *Trading system*: Provide, a competitive, open, and efficient market.**

**(a) Application Guidance**

Appropriate objective testing and review of any automated systems should occur initially and periodically to ensure proper system functioning, adequate capacity and security. A recognized futures exchange's analysis of its automated system should address appropriate

principles for the oversight of automated systems, ensuring proper system function, adequate capacity and security. The Commission believes that the guidelines issued by the International Organization of Securities Commissions (“IOSCO”) in 1990 (which have been referred to as the “Principles for Screen-Based Trading Systems”), subsequently adopted by the Commission on November 21, 1990 (55 Fed. Reg. 48670), are appropriate guidelines for a recognized futures exchange to apply to electronic trading systems. Any program of objective testing and review of the system should be performed by an independent third party. A professional that is a certified member of the Informational Systems Audit and Control Association experienced in the industry would be an acceptable party to carry out such testing and review. The Commission believes that information gathered by analysis, oversight or any program of objective testing and review of any automated systems regarding system functioning, capacity and security should be made available to the Commission and the public.

A recognized futures exchange that determines to allow block trading should have rules which: (i) define the block based upon the customary size of large positions in the cash and derivatives market, (ii) restrict access to block trading to eligible participants, (iii) provide a mechanism for ensuring that the block’s price will be fair and reasonable, and (iv) provide for transparency of the trade by requiring that it be reported for clearing within a reasonable period of time and that it be identified separately in the price reporting system.

**(b) Acceptable Practices**

[Reserved]

**Core Principle #9: *Audit trail.* Have in place procedures to ensure the recording of full data entry and trade details sufficient to reconstruct trading, the safe storage of such information and systems to enable information to be used in assisting in combating customer and market abuse. Such procedures should ensure the quality of data captured.**

**(a) Application Guidance**

A recognized futures exchange should have arrangements and resources for recording of full data entry and trade details sufficient to reconstruct trading and the safe storage of audit trail data systems enabling information to be used in combating customer and market abuse.

**(b) Acceptable Practices**

The goal of an audit trail is to detect and deter customer and market abuse. An effective exchange audit trail should capture and retain sufficient trade-related information to permit exchange staff to detect trading abuses and to reconstruct all transactions. An audit trail should include specialized electronic surveillance programs that would identify potentially abusive trades and trade patterns, including for instance, withholding or disclosing customer orders, trading ahead, and preferential allocation. An acceptable audit trail must be able to track a customer order from time of receipt through fill allocation. The exchange must create and maintain an electronic transaction history database that contains information with respect to transactions affected on the recognized futures exchange.

An acceptable audit trail, therefore, should include the following: original source documents, transaction history, electronic analysis capability, and safe storage capability. A registered futures exchange whose audit trail satisfies the following acceptable practices would satisfy Core Principle 9.

Original Source Documents. Original source documents include unalterable, sequentially identified records on which trade execution information is originally recorded, whether recorded

manually or electronically. For each customer order, such records 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 floor-based exchanges, the time of report of execution of the order should also be captured.

Transaction History . A transaction history which consists of an electronic history of each transaction, including (a) all data that are input into the trade entry or matching system for the transaction to match and clear; (b) whether the trade was for a customer or proprietary account; (c) timing and sequencing data adequate to reconstruct trading; and (d) the identification of each account to which fills are allocated.

Electronic Analysis Capability. An electronic analysis capability that permits sorting and presenting data included in the transaction history so as to reconstruct trading and to identify possible trading violations with respect to both customer and market abuse.

Safe Storage Capability. Safe storage capability provides for a method of storing the data included in the transaction history in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss. Data should be retained in accordance with the recordkeeping standards of Core Principle 14.

**Core Principle #10: *Financial standards: Have, monitor, and enforce rules regarding the financial integrity of the transactions that have been executed on the exchange and, where intermediaries are permitted, have rules addressing the financial integrity of the intermediary and the protection of customer funds as appropriate and a program to enforce those requirements.***

**(a) Application Guidance**

Clearing of transactions executed on a recognized futures exchange should be provided through a Commission recognized clearing facility. In addition, a recognized futures exchange should maintain the financial integrity of its transactions by maintaining minimum financial standards and having default rules and procedures. The minimum financial standards should be

monitored for compliance purposes. The Commission believes that in order to monitor for minimum financial requirements, a recognized futures exchange should routinely receive financial and related information. Rules addressing the protection of customer funds should address the segregation of customer and proprietary funds, the custody of customer funds and the investment standards for customer funds.

**(b) Acceptable Practices**

[Reserved]

**Core Principle #11: *Customer protection*: Have, monitor and enforce rules for customer protection.**

**(a) Application Guidance**

A recognized futures exchange should have rules prohibiting conduct by intermediaries that is fraudulent, noncompetitive, unfair, or an abusive practice in connection with the execution of trades and a program to detect and discipline such behavior. Intermediated markets are not required to have, monitor or enforce rules requiring intermediaries to provide risk disclosure or to comply with other sales practices.

**(b) Acceptable Practices**

[Reserved]

**Core Principle #12: *Dispute resolution*: Provide for alternative dispute resolution mechanisms appropriate to the nature of the market.**

**(a) Application Guidance**

A recognized futures exchange should provide customer dispute resolution procedures that are fair and equitable and that are made available to the customer on a voluntary basis, either directly or through another self-regulatory organization.

**(b) Acceptable Practices**

**Core Principle #12 requires a recognized futures exchange to provide for dispute resolution mechanisms that are appropriate to the nature of the market.**

In order to satisfy acceptable standards, a recognized futures exchange should provide a customer dispute resolution mechanism that is fundamentally fair and is equitable. The procedure should provide:

- the customer with an opportunity to have his or her claim decided by a decision-maker that is objective and impartial,
- each party with the right to be represented by counsel, at the party's own expense,
- each party with adequate notice of claims presented against him or her, an opportunity to be heard on all claims, defenses and permitted counterclaims, and an opportunity for a prompt hearing,
- for prompt written final settlement awards that are not subject to appeal within the exchange, and
- notice to the parties of the fees and costs which may be assessed.

The procedure employed also must be voluntary, as provided in § 166.5 of this part. If the recognized futures exchange also provides a procedure for the resolution of disputes which do not involve customers (i.e., member-to-member disputes), the procedure for the resolution of such disputes must be independent of and shall not interfere with or delay the resolution of customers' claims or grievances.

A counterclaim which arises out of a transaction or occurrence that is the subject of a customer's claim or grievance and which does not require for adjudication the presence of essential witnesses, parties or third persons over whom the recognized futures exchanges does not have jurisdiction could be allowed under the recognized futures exchange's dispute resolution



procedures. Other counterclaims should be permissible only if the customer agreed to the submission after the counterclaim had arisen, and if the aggregate monetary value of the counterclaim was capable of calculation.

A recognized futures exchange 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, if the recognized futures exchange does so delegate that responsibility, the exchange shall in all respects treat any decision issued by such other organization or association as if the decision were its own including providing for the appropriate enforcement of any award issued against a delinquent member.

**Core Principle #13: Governance: Have fitness standards for members, for owners or operators with greater than 10 percent interest or an affiliate of such an owner, members of the governing board, and those who make disciplinary determinations. The recognized futures exchange must have a means to address conflicts of interest in making decisions and access to, and use of, material non-public information by the foregoing persons and by exchange employees. For mutually owned futures exchanges, the composition of the governing board must reflect market participants.**

**(a) Application Guidance**

A recognized futures exchange should have appropriate eligibility criteria for the categories of persons set forth in the Core Principle which should include standards for fitness and for the collection and verification of information supporting compliance with such standards. The standards could be based on the disqualification standards under section 8a(2) of the Act. The Commission believes that such standards should include the provision to the Commission of registration information for such persons, whether registration information, certification to the fitness of such persons, an affidavit of such persons' fitness by the facility's counsel or other information substantiating the fitness of such persons. If an exchange provided 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 their position. The means to address conflicts of interest in decision-making should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict. In addressing the access to, and use of, material non-public information, the Commission believes that the recognized futures exchange should provide for limitations on exchange employee trading.

**(b) Acceptable Practices**

[Reserved]

**Core Principle #14: *Recordkeeping*: Must keep full books and records of all activities related to their business as a recognized futures exchange in a form and manner acceptable to the Commission for a period of five years, during the first two of which the books and records are readily available, and which shall be open to inspection by any representative of the Commission or the United States Department of Justice.**

**(a) Application Guidance**

[Reserved].

**(b) Acceptable Practices**

Commission rule 1.31 constitutes the acceptable practice regarding the form and manner for keeping records.

**Core Principle #15: *Competition*: Recognized futures exchanges should avoid unreasonable restraints of trade or impose any burden on competition not necessary or appropriate in furtherance of the objectives of the Act or the regulations thereunder.**

**(a) Application Guidance**

A recognized futures exchange should avoid unreasonable restraints of trade in any terms and conditions of access or provision of services or any non-compete clauses or limitations on future activity.

**(b) Acceptable Practices**

[reserved]

12. Part 100 is proposed to be removed and reserved.

**PART 170 - REGISTERED FUTURES ASSOCIATIONS**

Subpart A - Standards Governing Commission Review of Applications for Registration as a Futures Association Under Section 17 of the Act

13. The authority citation for Part 170 continues to read as follows:

**Authority:** 7 U.S.C. 6p, 12a, and 21.

14. Rule 170.8 is proposed to be amended to read as follows:

**§ 170.8 Settlement of customer disputes (section 17(b)(10) of the Act).**

A futures association must be able to demonstrate its capacity to promulgate rules and to conduct proceedings which provide a fair, equitable and expeditious procedure, through arbitration or otherwise, for the voluntary settlement of a customer's claim or grievance brought against any member of the association or any employee of a member of the association. Such rules shall conform to and be consistent with Section 17(b)(10) of the Act and be consistent with the guidelines and acceptable practices for dispute resolution found within Appendix A and Appendix B to Part 38.

**PART 180 - ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES**

15. Part 180 is proposed to be deleted.

Issued in Washington, D.C., this 8h day of June, 2000, by the Commission.

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Jean A. Webb  
Secretary of the Commission