PART 35—EXEMPTION OF BILATERAL AGREEMENTS

§35.1 Scope and Definitions.

(a)***

(b) *Definition.* As used in this part, "eligible participant" means, and shall be limited to, the following persons or classes of persons:

(1) A bank or trust company (acting on its own behalf or on behalf of another eligible participant);

(2) A savings association or credit union;

(3) An insurance company;

(4) An investment company subject to regulation under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) or a foreign person performing a similar role or function subject as such to foreign regulation, *provided* that such investment company or foreign person is not formed solely for the specific purpose of constituting an eligible participant;

(5) A commodity pool formed and operated by a person subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, *provided* that such commodity pool or foreign person is not formed solely for the specific purpose of constituting an eligible participant and has total assets exceeding $5,000,000;

(6) A corporation, partnership, proprietorship, organization, trust, or other entity not formed solely for the specific purpose of constituting an eligible participant (i) which has total assets exceeding $10,000,000, or (ii) the obligations of which under the agreement are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by any such entity referenced in this paragraph (b)(6)(i) of this section or by an entity referred to in paragraph (b)(1), (2), (3), (4), (5), (6) or (8) of this section; or (iii) which has a net worth of

$1,000,000 and enters into the agreement in connection with the conduct of its business; or which has a net worth of $1,000,000 and enters into the agreement to manage the risk of an asset or liability owned or incurred in the conduct of its business or reasonably likely to be owned or incurred in the conduct of its business;

(7) An employee benefit plan subject to the Employee Retirement Income Security Act of 1974 or a foreign person performing a similar role or function subject as such to foreign regulation with total assets exceeding $5,000,000, or whose investment decisions are made by a bank, trust company, insurance company, investment adviser subject to regulation under the Investment Advisers Act of 1940 (15 U.S.C. 80a-1 et seq.), or a commodity trading advisor subject to regulation under the Act;

(8) Any governmental entity (including the United States, any state, or any foreign government) or political subdivision thereof, or any multinational or supranational entity or any instrumentality, agency, or department of any of the foregoing;

(9) A broker-dealer subject to regulation under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible participant: *Provided, however*, that if such broker-dealer is a natural person or proprietorship, the broker-dealer must also meet the requirements of either paragraph (b)(6) or (11) of this section;

(10) A futures commission merchant, floor broker, or floor trader subject to regulation under the Act or a foreign person performing a similar role or function subject as such to foreign regulation, acting on its own behalf or on behalf of another eligible participant: *Provided, however*, that if such futures commission merchant, floor broker, or floor trader is a

natural person or proprietorship, the futures commission merchant, floor broker, or floor trader must also meet the requirements of paragraph (b)(6) or (b)(11) of this section; or

(11) Any natural person with total assets exceeding at least $10,000,000.

§35.2 Exemption.

A ~~contract, agreement or transaction~~ contract of sale of a commodity for future delivery or commodity option 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 agreement, is exempt for such activity from all provisions of the Act (except in each case the provisions enumerated in §35.3(a)) provided the following terms and conditions are met:

(a) The ~~contract, agreement or transaction~~ contract of sale of a commodity for future delivery or commodity option is entered into solely between eligible participants;

(b) The ~~contract, agreement or transaction~~ contract of sale of a commodity for future delivery or commodity option is not entered into and traded on or through a multilateral transaction execution facility as defined in §36.1 of this chapter; and

(c) Except for those ~~contracts, agreements or transactions~~ contracts of sale of a commodity for future delivery or commodity options submitted for clearance or settlement to a clearinghouse as provided under paragraph (d)(3) of this section, the creditworthiness of any party having an actual or potential obligation under the ~~contract, agreement or transaction~~ contract of sale of a commodity for future delivery or commodity option would be a material consideration in entering into or determining the terms of the ~~contract, agreement or transaction~~ contract of sale of a commodity for future delivery or commodity option, including pricing, cost, or credit enhancement terms.

(d) The provisions of paragraphs (b) and (c) of this section shall not be deemed to preclude:

(1) Arrangements or facilities between parties to such ~~contracts, agreements or transactions~~ contracts of sale of a commodity for future delivery or commodity options that provide for netting of payment obligations resulting from such ~~contracts, agreements or transactions~~ contracts of sale of a commodity for future delivery or commodity options;

(2) Arrangements or facilities among parties to such ~~contracts, agreements or transactions~~ contracts of sale of a commodity for future delivery or commodity options, that provide for netting of payments resulting from such ~~contracts, agreements or transactions~~ contracts of sale of a commodity for future delivery or commodity options;

(3) The submission of such ~~contracts, agreements or transactions~~ contracts of sale of a commodity for future delivery or commodity options for clearance and/or settlement to a clearing organization which is authorized under §39.2 of this chapter; or

(4) The use of an electronic or non-electronic market or similar facility used solely as a means of communicating bids or offers by market participants or the use of such a market or facility by a single counterparty to offer to enter into or to enter into bilateral transactions with multiple counterparties.

(e) Any person may apply to the Commission for exemption from any of the provisions of the Act (except section 2(a)(1)(13)) for other arrangements or facilities, on such terms and conditions as the Commission deems appropriate, including but not limited thereto, the applicability of other regulatory regimes.

§35.3 Enforceability.

(a) Notwithstanding the exemption in §35.2, sections 2(a)(1)(B), 4b, and 4o of the Act, §32.9 of this chapter as adopted under §4c(b) of the Act, §32.13 of this chapter, and sections 6(c) and 9(a)(2) of the Act to the extent that 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~~ contract of sale of a commodity for future delivery or commodity option that is with an eligible participant (or counterparty reasonably believed by such party to be an eligible participant) shall be exempt from any claim, counterclaim or affirmative defense by such counterparty under §22(a)(1) of the Act or any other provision of the Act:

(1) that such ~~contract, agreement, or transaction~~ contract of sale of a commodity for future delivery or commodity option is void, voidable or unenforceable; or

(2) to rescind or recover any payment made in respect of such ~~contract, agreement, or transaction~~ contract 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~~ contract of sale of a commodity for future delivery or commodity option to comply with the terms or conditions of the exemption under this part or from the terms or conditions of the Statement of Policy Concerning Swap Transactions in appendix A to this part 35.

(c) A party to a contract, agreement or transaction that qualifies under the Statement of Policy Concerning Swap Transactions in appendix A to this part 35 or the Statutory Interpretation Concerning Hybrid Instruments, found at 55 Fed. Reg. 13582 (April 11, 1990), as the same may be revised by the Commission from time to time, shall be exempt from any claim under Section 22(a)(1) of the Act or any other provision of the Act:

(1) that such contract, agreement or transaction is void, voidable, or unenforceable; or

(2) to rescind or recover any payment made in respect of such contract, agreement or transaction, based solely on the failure of such party, or such contract, agreement or transaction, to comply with any provision of the Act or Commission rules, excluding, in the case of this paragraph, any claim for manipulation or fraud arising under a provision of the Act or Commission rules applicable by its terms to a contract, agreement or transaction that is not otherwise subject to regulation under the Act.

3. Part 35 is proposed to be amended by adding new Appendix A to read as follows:

APPENDIX A TO PART 35-STATEMENT OF POLICY CONCERNING SWAP TRANSACTIONS

The statement of policy of the Commodity Futures Trading Commission entitled, "Policy Statement Concerning Swap Transactions," published at 54 FR 30694 (July 21, 1989), is incorporated herein as though set forth in this Appendix.

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

Jean A. Webb
Secretary of the Commission

PART 39 - RECOGNIZED CLEARING ORGANIZATIONS

The authority citation for Part 39 is proposed to read as follows:

Authority: 7 U.S.C. 2, 6(c), 7a, 12a(5).

§39.1 Definitions and Scope.

(a) *Definitions*. For purposes of this part:

(1) "Clearing organization" means a person, entity or association thereof, which performs a credit enhancement function in connection with ~~transactions~~ contracts of sale of a commodity for future delivery or commodity options executed on a designated contract market or pursuant to Parts 35-38 of this chapter by becoming a universal counterparty to market participants or by operating a facility for the netting of obligations and payments of such ~~transactions~~ contracts of sale of a commodity for future delivery or commodity options; but does not include those netting arrangements specified in §35.2(d)(1) and (d)(2), nor does it include an entity that is a single counterparty offering to enter into, or entering into, bilateral transactions with multiple counterparties.

(b) *Scope*.

(1) This section applies to all cleared ~~transactions~~ contracts of sale of a commodity for future delivery or commodity options effected on or through a designated contract market, a recognized futures exchange under Part 38 of this chapter, a derivatives transaction facility under Part 37 of this chapter, an exempt multilateral transaction execution facility under Part 36 of this chapter, and to contracts of sale of a commodity for future delivery or commodity options exempt ~~bilateral transactions~~ under Part 35 of this chapter.

(2) A clearing organization that has been recognized by the Commission under §39.3 of this part shall be deemed to be a contract market for purposes of the Act, and

Commission rules thereunder; provided, however, a recognized clearing organization shall be exempt from all provisions of the Act and Commission regulations thereunder except as reserved in §39.5 of this part.

§39.2 Permitted Clearing.

(a) Any ~~transaction~~ contract of sale of a commodity for future delivery or commodity option effected on a designated contract market, recognized futures exchange, or derivatives transaction facility, if cleared, shall be cleared by a recognized clearing organization.

(b) A ~~transaction~~ contract of sale of a commodity for future delivery or commodity option effected pursuant to Part 35 or Part 36 of this chapter, if cleared, shall be cleared by any of the following authorized clearing organizations:

(1) A recognized clearing organization under this part;

(2) A securities clearing agency subject to the supervisory jurisdiction of the Securities and Exchange Commission;

(3) A clearing system organized as a bank, bank subsidiary, affiliate of a bank, or Edge Act corporation established under the Federal Reserve Act authorized to engage in international banking or financial activities, and subject to the jurisdiction of the Federal Reserve or Comptroller of the Currency; or

(4) A foreign clearing organization that demonstrates to the Commission that it: (a) is subject to home country regulation and oversight comparable to the standards set forth by the Commission for recognition of clearing organizations under this part; and (b) is a party to and abides by appropriate and adequate information-sharing arrangements.

(c) ~~Transactions not specified in §39.1(b)(1) of this part may also be cleared by a~~ A recognized clearing organization may also clear:

(1) A contract, agreement or transaction (including a contract, agreement or transaction traded on a multilateral transaction execution facility exempt under Part 36 or on a derivatives transaction facility recognized under Part 37) that is neither a contract of sale of a commodity for future delivery nor a commodity option; or

(2) A contract, agreement or transaction (including a contract, agreement or transaction traded on a multilateral transaction execution facility exempt under Part 36 or on a derivatives transaction facility recognized under Part 37) that is excluded from all or part of the Act by any provision of the Act or other federal law; and

(d) By clearing any contract, agreement or transaction described in §39.2(c), a recognized clearing organization agrees that provisions of this chapter applicable to the clearing of contracts of sale of a commodity for future delivery or commodity options by recognized clearing organizations shall apply to the clearing of such contract, agreement or transaction, *provided, however*, that the applicability of this part 39 or any other provisions of this chapter to any contract, agreement or transaction cleared by a recognized clearing organization 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.

§39.3 Conditions for Recognition as a Recognized Clearing Organization.

To be recognized by the Commission under this Part 39 as a recognized clearing organization, an entity:

(a) Need not be affiliated with a designated contract market or recognized futures exchange under Part 38 of this chapter, derivatives transaction facility under Part 37 of this chapter or exempt multilateral transaction execution facility under Part 36 of this chapter;

(b) Must have rules and procedures relating to its governance and the operation of its clearing function; and

(c) Must initially, and on a continuing basis, meet and adhere to the following fourteen core principles:

(1) *Financial Resources:* Adequate capital resources to fulfill its guarantee function without interruption in various market conditions.

(2) *Participant and Product Eligibility:* Appropriate admission and continuing eligibility standards for members or participants of the organization and defined criteria for instruments it will accept for clearing.

(3) *Risk Management:* Ability to manage the risks associated with carrying out its guarantee function through the use of appropriate tools and procedures.

(4) *Settlement Procedures:* Ability to complete settlements on a timely basis under varying circumstances, to maintain an adequate record of the flow of funds associated with each ~~transaction~~ contract of sale of a commodity for future delivery or commodity option it clears, and to comply with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations.

(5) *Treatment of Client Funds:* Adequate standards and procedures designed to protect and ensure the safety of client funds.

(6) *Default Rules and Procedures:* Rules and procedures designed to allow for efficient, fair, and safe management of events when members or participants become insolvent or otherwise default on their obligations to the clearing organization.

(7) *Rule Enforcement:* Adequate arrangements and resources for the effective monitoring and enforcement of compliance with its rules and for resolution of disputes.

(8) *System Safeguards:* An adequate program of oversight and risk analysis to ensure that its automated systems function properly and have adequate capacity, security, and emergency and disaster recovery procedures.

(9) *Governance:* Have fitness standards for owners or operators with greater than ten percent interest or an affiliate of such an owner, and for members of the governing board, and have a means to address conflicts of interest in making decisions.

(10) *Reporting:* Provision to the Commission of all information necessary for the Commission to conduct its oversight function of the clearing organization's activities.

(11) *Recordkeeping:* Maintain full books and records of all activities related to business as a recognized clearing organization in a form and manner acceptable to the Commission for a period of five years.

(12) *Public Information:* Public disclosure of information concerning the rules and operating procedures governing its clearing and settlement systems, including default procedures.

(13) *Information Sharing:* Enter into and abide by the terms of all appropriate and applicable domestic and international information-sharing agreements and use relevant information obtained from such agreements in carrying out the clearing organization's risk management program.

(14) *Competition:* Endeavor 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.

§39.4 Procedures for Recognition.

(a) *Recognition by Certification.* A clearing organization that cleared for at least one nondormant contract within the meaning of §5.4 of this chapter on January 1, 2000, will be recognized by the Commission as a recognized clearing organization upon receipt by the Commission at its Washington, DC, headquarters of a copy of the clearing organization's rules and a certification by the clearing organization that it meets the conditions for recognition under this part.

(b) *Recognition by Application.* A clearing organization shall be recognized by the Commission as a recognized clearing organization 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;

(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 §39.3 of this part;

(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) Attached to this part as Appendix A is guidance to applicants concerning how the core principles set forth above could be satisfied.

(c) *Termination of Part 39 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 clearing organization 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 Director of the Division of Trading and Markets or the Director's delegatee, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to notify an entity seeking recognition under paragraph (b) of this section that review under those procedures is being terminated.

(2) The Director of the Division of Trading and Markets 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.*

(1) An applicant for recognition as a recognized clearing organization may request that the Commission approve any or all of its rules and subsequent amendments thereto, at the time of recognition or thereafter, under section 5a(a)(12) of the Act and § 1.41 of this chapter. The recognized clearing organization may label such rules as having been approved by the Commission. In addition, rules of the recognized clearing organization not submitted pursuant to § 39.4(b)(3) shall be submitted to the Commission pursuant to §1.41 of this Chapter.

(2) An applicant seeking recognition as a recognized clearing organization may request that the Commission consider under the provisions of section 15 of the Act any of the entity's rules or policies at the time of recognition or thereafter.

(f) *Request for Withdrawal of Recognition.* A recognized clearing organization may withdraw from Commission recognition by filing with the Commission at its Washington, DC, 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 clearing organization was recognized by the Commission.

§39.5 Enforceability.

In accordance with the proviso in §39. 1 (b)(2), sections 1a, 2(a)(1), 4, 4b, 4c, 4d, 4g, 4i, 4o, 5(7), the rule disapproval procedures of sections 5a(a)(12), 5b, 6, 6b, 6c, 8(a), 8(c), 8a(6), 8a(7), 8a(9), 8c(a), 8c(b), 8(c)(c), 8(c)(d), 9(a), 9(f), 20 and 22 of the Act and §§1.3, 1.20, 1.24,

1.25, 1.26, 1.27 1.31, 1.38, 1.41, 33.10, Parts 15-21, Part 39, and Part 190 of this chapter continue to apply.

§39.6 Fraud and Manipulation in Connection with ~~transactions~~ futures and options contracts cleared by a Recognized Clearing Organization.

(a) It shall be unlawful for any person, directly or indirectly, in or in connection with any ~~transaction~~ contract of sale of a commodity for future delivery or commodity option cleared by a recognized clearing organization:

(1) To cheat or defraud or attempt to cheat or defraud any other person;

(2) Willfully to make or cause to be made to any other 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 other person by any means whatsoever.

(b) Except as to any recognized clearing organization that is subject to this chapter, the provisions in §39.6(a) shall not apply to or in connection with 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.

Appendix A to Part 39 - Application Guidance

This appendix provides guidance to applicants for recognition as recognized clearing organizations in connection with satisfying each of the core principles of §39.4. In addressing the core principles, applicants should address the matters set forth below.

Core Principle 1 - Financial Resources. Adequate capital resources to fulfill the guarantee function without interruption in various market conditions.

In addressing core principle 1, applicants should describe or otherwise document:

1. The amount of resources dedicated to supporting the clearing function:

   a. The amount of resources available to the clearing organization and the sufficiency of those resources such that no break in clearing operations would occur in a variety of market conditions; and

   b. The level of member/participant default such resources could support as demonstrated through use of a hypothetical default scenario that explains assumptions and variables factored into the illustration.

2. The nature of resources dedicated to supporting the clearing function:

   a. The type of the resources, including their liquidity, and how they could be accessed and applied by the clearing organization without delay; and

   b. Any legal or operational impediments or conditions to access.

Core Principle 2 - Participant and Product Eligibility. Appropriate admission and continuing eligibility standards for members or participants of the organization and defined criteria for instruments it will accept for clearing.

In addressing core principle 2, applicants should describe or otherwise document:

1. Member/participant admission criteria:

   a. How admission standards for its clearing members would contribute to the soundness and integrity of operations; and

b. Matters such as whether these criteria would be in the form of organization rules that apply to all clearing members, whether different levels of membership would relate to different levels of net worth, income, and creditworthiness of members, and whether margin levels, position limits and other controls would vary in accordance with these levels.

2. Member/participant continuing eligibility criteria:

a. A program for monitoring the financial status of its members; and

b. Whether/how the clearing organization would be able to change continuing eligibility criteria in accordance with changes in a member's financial status.

3. Criteria for instruments acceptable for clearing:

a. How the clearing organization would establish specific criteria for the types of ~~derivatives~~ contracts of sale of a commodity for future delivery or commodity options it will clear; and

b. How those criteria take into account the different risks inherent in clearing different ~~derivatives~~ contracts of sale of a commodity for future delivery or commodity options and how they affect maintenance of assets to support the guarantee function in varying risk environments.

4. Clearing function for each instrument:

a. The clearing function for each instrument the organization undertakes to clear; and

b. How different functions would be made known to participants.

Core Principle 3 - Risk Management. Ability to manage the risks associated with carrying out the guarantee function through the use of appropriate tools and procedures.

In addressing core principle 3, applicants should describe or otherwise document:

1. Use of risk analysis tools and procedures:

a. How the adequacy of the overall level of financial resources would be tested on an ongoing periodic basis in a variety of market conditions; and

b. How the organization would use specific risk management tools including stress testing and value at risk calculations.

2. Use of collateral:

a. How appropriate forms and levels of collateral would be established and collected;

b. How amounts would be adequate to secure prudentially obligations arising from clearing ~~transactions~~ and performing as central counterparty;

c. Why particular margin levels would be appropriate for a contract cleared and the clearing member clearing the contract;

d. The appropriateness of required or allowed forms of margin given the liquidity and related requirements of the clearing organization;

e. How the clearing organization would ensure appropriate valuation of open positions and valuation of collateral assets; and

f. The proposed margin collection schedule and how it would synchronize with changes in the value of market positions and collateral values.

3. Use of credit limits:

If and how systems would be implemented that would prevent members and other market participants from exceeding appropriate credit limits; and

4. Appropriate use of cross margin reduction programs:

How collateral assets subject to cross-margining programs would provide for clear, fair, and efficient loss-sharing arrangements in the event of a program participant default.

Core Principle 4 - Settlement Procedures. Ability to complete settlements on a timely basis under varying circumstances, to maintain an adequate record of the flow of funds associated with each futures or option contract transaction it clears, and to comply with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations.

In addressing core principle 4, applicants should describe or otherwise document:

1. Settlement timeframe:

a. Procedures for completing settlements on a timely basis during times of normal operating conditions; and

b. Procedures for completing settlements on a timely basis in varying market circumstances including during a period when a significant participant or member has defaulted.

2. Recordkeeping:

a. The nature and quality of the information collected concerning the flow of funds involved in clearing and settlement; and

b. How the flow of funds associated with each cleared ~~transaction~~ contract of sale of a commodity for future delivery or commodity option would be recorded, maintained and easily accessed.

3. Appropriate interfaces with other clearing organizations:

How compliance with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations would be met, including, among others, common banking or common clearing programs.

Core Principle 5 - Treatment of Client Funds. Standards and procedures designed to protect and ensure the safety of client funds.

In addressing core principle 5, applicants should describe or otherwise document:

1. Safe custody:

a. The safekeeping of client funds, whether in accounts, in depositories, or with custodians, and how it would meet industry standards of safety;

b. Any written terms regarding the legal status of the funds and the specific conditions or prerequisites for movement of the funds; and

c. How the deposit of client funds in accounts in depositories or with custodians would also ensure adequate diversification of concentration of risk.

2. Segregation between customer and proprietary funds:

a. Requirements for segregation and requiring members or participants that clear trades executed on behalf of customers to segregate customer accounts and funds; and

b. Requirements or restrictions regarding commingling customer with proprietary funds, obligating customer funds for any purpose other than to purchase, clear, and settle the products the clearing organization is clearing, and any other aspects of customer fund segregation.

3. Investment standards:

How customer funds would be invested to meet high standards of safety and the proposed recordkeeping regarding all details of such investments.

Core Principle 6 - Default Rules and Procedures. Rules and procedures designed to allow for efficient, fair, and safe management of events when members or participants become insolvent or otherwise default on their obligations to the clearing organization.

In addressing core principle 6, applicants should describe or otherwise document:

1. Definition of default:

   a. The definition of default and how it would be established and enforced; and

   b. How it would address failure to meet margin requirements, the insolvent financial condition of a member or participant, failure to comply with certain rules, failure to maintain eligibility standards, actions taken by other regulatory bodies, or other events.

2. Remedial action:

   The authority pursuant to which, and how, the clearing organization would take appropriate action in the event of the default of a member which may include, among other things, closing out positions, replacing positions, set-off, and applying margin;

3. Process to address shortfalls:

   Procedures for the prompt, fair, and safe application of Clearing Organization and/or member financial resources to eliminate any monetary shortfall resulting from a default.

4. Customer priority rule:

   Rules and procedures regarding priority of customer accounts over proprietary accounts of intermediary members or participants and where applicable, in the context of other programs, such as specialized margin reduction programs like cross-margining or trading links with other exchanges.

Core Principle 7 - Rule Enforcement. Adequate arrangements and resources for the effective monitoring and enforcement of compliance with its rules and for resolution of disputes.

In addressing core principle 7, applicants should describe or otherwise document:

1. Surveillance:

   Arrangements and resources for the effective monitoring of compliance with rules including any clearing practice and financial surveillance programs.

2. Enforcement:

a. Arrangements and resources for effective enforcement of rules and authority and ability to discipline and limit or suspend a member's or participant's activities; and

b. Authority and ability to terminate a member's or participant's activities pursuant to clear and fair standards.

3. Dispute resolution:

Arrangements and resources for resolution of disputes between customers and members, and between members.

Core Principle 8 - System Safeguards. An adequate program of oversight and risk analysis to ensure that its automated systems function properly and have adequate capacity, security, and emergency and disaster recovery procedures.

In addressing core principle 8, applicants should describe or otherwise document:

1. Oversight/risk analysis program:

a. Any program of oversight and risk analysis and whether it addresses appropriate principles for the oversight of automated systems to ensure that its clearing system functions properly and has adequate capacity and security;

b. Emergency procedures and a plan for disaster recovery; and

c. Periodic testing of back-up facilities and ability to ensure daily processing, clearing, and settlement of ~~transactions~~ contracts of sale of a commodity for future delivery and commodity options.

2. Appropriate periodic objective system reviews/testing:

a. Any program for the periodic objective testing and review of the system; and

b. Confirmation that such testing and review would be performed by an independent third-party professional that is a certified member of the Information Systems Audit and Control Association with an appropriate level of experience in the industry.

Core Principle 9 - Governance. Have fitness standards for owners or operators with greater than ten percent interest, or an affiliate of such an owner, and for members of the governing board, and have a means to address conflicts of interest in making decisions.

In addressing core principle 9, applicants should describe or otherwise document:

1. Appropriate standards for fitness for clearing organization owners, operators, affiliates of owners or operators, and members of the governing board based on disqualification standards under Section 8a(2) of the Act.

2. Collection and verification of information supporting compliance with standards:

   a. Verification information could be registration information or certification of fitness or affidavit of fitness by outside counsel based on other verified information.

3. Methods to ascertain presence of conflicts of interest and methods of making decisions in that event.

Core Principle 10 - Reporting. Provision to the Commission of all information necessary for the Commission to conduct its oversight function of the recognized clearing organization's activities.

In addressing core principle 10, applicants should describe or otherwise document:

1. Information necessary for the Commission to perform its oversight activities of the recognized clearing organization's activities:

   a. All information available to or generated by the clearing organization that will be made available to the Commission as appropriate to enable the Commission to perform properly its oversight function, including counterparties and their positions, stress test results, internal governance, legal proceedings, and other clearing activities;

   b. The types of information which are not believed to be necessary to provide to the Commission and why; and

   c. The information the organization intends to make routinely available to members/participants or the general public.

2. Provision of information:

   a. The manner in which all relevant information will be provided to the Commission whether by electronic or other means; and

b. The means by which any information will be made available to members/participants and/or the general public.

Core Principle 11 - Recordkeeping. Maintaining complete books and records of all activities related to business as a recognized clearing organization in a form and manner acceptable to the Commission for a period of five years.

In addressing core principle 11, applicants should describe or otherwise document:

1. Maintaining records of all activities related to the function of a clearing organization:

a. The different activities related to the function of the clearing organization for which the organization intends to keep books or records; and

b. Any activity related to the function of a clearing organization for which the organization does not intend to keep books or records and why this is not viewed as necessary.

2. Maintenance of full books and records in a form and manner acceptable to the Commission:

3. How the entity would satisfy the requirements of Commission Regulation 1.31 including:

a. What "complete" would encompass with respect to each type of book or record that would be maintained;

b. How books or records would be compiled and maintained with respect to each type of activity for which such books or records would be kept;

c. Confirmation that books and records would be open to inspection by any representative of the Commission or of the U.S. Department of Justice;

d. How long books and records would be readily available and how they would be made readily available during the first two years; and

e. How long books and records would ultimately be maintained (and confirmation that, in any event, they would be maintained for at least five years).

Core Principle 12 - Public Information. Disclosure of information concerning the rules and operating procedures governing its clearing and settlement systems, including default procedures.

In addressing core principle 12, applicants should describe or otherwise document:

Disclosure of information regarding rules and operating procedures governing clearing and settlement systems:

a. Which rules and operating procedures governing clearing and settlement systems should be disclosed to the public, to whom they would be disclosed, and how they would be disclosed;

b. What other information would be available regarding the operation, purpose and effect of rules;

c. How member/participants may become familiar with such procedures before participating in operations; and

d. How member/participants will be informed of their specific rights and obligations preceding a default and upon a default, and of the specific rights, options and obligations of the clearing organization preceding and upon the participant's default.

Core Principle 13 - Information Sharing. Entering into and abiding by the terms of all appropriate and applicable domestic and international information-sharing agreements and using relevant information obtained from such agreements in carrying out the recognized clearing organization's risk management program.

In addressing core principle 13, applicants should describe or otherwise document:

1. Becoming a party to applicable appropriate domestic and international information sharing agreements and arrangements:

a. The utility of entering into various types of information-sharing arrangements;

b. The different types of domestic and international information-sharing arrangements, both formal and informal, which the clearing organization views as appropriate and applicable to its operations; and

c. The specific information-sharing agreements or other arrangements to which the clearing organization would become a party and how it would abide by the terms of these agreements.

2. Using information obtained from information-sharing arrangements in carrying out risk management and surveillance programs:

a. How information obtained from any information-sharing arrangements would be used to further the objectives of the clearing organization's risk management program and any of its surveillance programs including financial surveillance and continuing eligibility of its members/participants;

b. How accurate information is expected to be obtained and the mechanisms or procedures which would make timely use and application of all information; and

c. The types of information expected to be shared and how that information would be shared.

Core Principle 14 - Competition. Endeavoring 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.

In addressing core principle 14, applicants should describe or otherwise document:

1. Avoiding unreasonable restraints of trade:

a. Terms and conditions of access and provision of services;

b. Any contracts or agreements to which the organization is a party which contain any noncompete clauses or limitations on future activity which may compete with the interests of either party to the contract.

2. Avoiding burdening competition:

a. Any practice of the clearing organization that may appear to affect the competitiveness of any other entity or the practice of any entity that may appear to affect the competitive ability of the clearing organization; and

b. The extent to which the entity has endeavored to adopt a rule or practice that is the least anticompetitive means of achieving the objective, purposes and policies of the Act.

Issued in Washington, D.C. on June 8, 2000, by the Commission.

Jean A. Webb,
Secretary of the Commission

Part 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

Authority: 7 U.S.C. la, 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 61, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23 and 24.

2. Section 1.3 is proposed to be amended by adding a new paragraph (g) to read as follows:

§1.3 Definitions.

* * * * *

(g) Institutional customer. This term has the same meaning as "eligible participant" as defined in § 35.1(b) of this chapter.

* * * * *

3. Section 1.10 is proposed to be amended by revising paragraph (a)(2)(i)(B), by adding paragraph (a)(2)(i)(C), by designating the flush paragraph of paragraph (a)(2)(i) as paragraph (a)(2)(i)(D), by redesignating paragraph (a)(2)(ii)(C) as (a)(2)(ii)(D), by adding a new paragraph (a)(2)(ii)(C), and by designating the flush paragraph of paragraph (a)(2)(ii) as paragraph (a)(2)(ii)(E) and, as designated, revising it to read as follows:

§1.10 Financial reports of futures commission merchants and introducing brokers.

(a) * * *

(2) * * *

(i) * * *

(B) A Form 1-FR-FCM as of a date not more than 17 business days prior to the date on which such report is filed and a Form 1-FR-FCM certified by an independent public accountant

in accordance with §1.16 as of a date not more than one year prior to the date on which such report is filed; or

(C) A Form 1-FR-FCM, Provided however, that such applicant shall be subject to a review by the applicant's designated self-regulatory organization within six months of being granted registration.

(D) Each such person must include with such financial report a statement describing the source of his current assets and representing that his capital has been contributed for the purpose of operating his business and will continue to be used for such purpose.

(ii) * * *

(C) A Form 1-FR-IB, Provided however, that such applicant shall be subject to a review by the applicant's designated self-regulatory organization within six months of registration; or

(D) A guarantee agreement.

(E) Each person filing in accordance with paragraphs (a)(2)(ii) (A), (B) or (C) of this section must include with such financial report a statement describing the source of his current assets and representing that his capital has been contributed for the purpose of operating his business and will continue to be used for such purpose.

* * * * *

4. Section 1.17 is proposed to be amended by redesignating paragraph (a)(1)(ii) as (a)(1)(iii) and by adding new paragraphs (a)(1)(ii) and (a)(2)(iii) to read as follows:

§1.17 Minimum financial requirements for futures commission merchants and introducing brokers.

(a) * * *

(1) * * *

(ii) Each person registered as a futures commission merchant engaged in soliciting or accepting orders and customer funds related thereto for the purchase or sale of any commodity for future delivery on or subject to the rules of a derivatives transaction facility from any noninstitutional customer must be a clearing member of a designated contract market or recognized futures exchange, and must maintain adjusted net capital in the amount of the greater of $20,000,000 or the amounts otherwise specified in paragraph (a)(1)(i) of this section.

* * * * *

(2) * * *

(iii) The requirements of paragraph (a)(1) of this section shall not be applicable if the registrant is a futures commission merchant or introducing broker registered in accordance with §3.10(a)(1)(i)(B) of this chapter, whose business is limited to transacting business on behalf of institutional customers on a derivatives transaction facility, and who conforms to minimum financial standards and related reporting requirements set by such derivatives transaction facility in its bylaws, rules, regulations or resolutions.

* * * * *

5. Section 1.20 is proposed to be amended by revising paragraphs (a) and (c) to read as follows:

§1.20 Customer funds to be segregated and separately accounted for.

(a) All customer funds shall be separately accounted for and segregated as belonging to commodity or option customers. Such customer funds when deposited with any bank, trust company, clearing organization or another futures commission merchant shall be deposited under an account name which clearly identifies them as such and shows that they are segregated as required by the Act and these regulations. Each registrant shall obtain and retain in its files for the period provided in §1.31 a written acknowledgment from such bank, trust company, clearing organization, or futures commission merchant, that it was informed that the customer funds deposited therein are those of commodity or option customers and are being held in accordance with the provisions of the Act and these regulations: Provided, however, that an acknowledgment need not be obtained from a clearing organization that has adopted and submitted to the Commission rules that provide for the segregation as customer funds, in accordance with all relevant provisions of the Act and the rules and orders promulgated thereunder, of all funds held on behalf of customers. Under no circumstances shall any portion of customer funds be obligated to a clearing organization, any member of a contract market, a futures commission merchant, or any depository except to purchase, margin, guarantee, secure, transfer, adjust or settle trades, contracts or commodity option transactions of commodity or option customers. No person, including any clearing organization or any depository, that has received customer funds for deposit in a segregated account, as provided in this section, may hold, dispose of, or use any such funds as belonging to any person other than the option or commodity customers of the futures commission merchant which deposited such funds.

* * * * *

(c) Each futures commission merchant shall treat and deal with the customer funds of a commodity customer or of an option customer as belonging to such commodity or option customer. All customer funds shall be separately accounted for, and shall not be commingled with the money, securities or property of a futures commission merchant or of any other person, or be used to secure or guarantee the trades, contracts or commodity options, or to secure or extend the credit, of any person other than the one for whom the same are held: Provided, however, That customer funds treated as belonging to the commodity or option customers of a futures commission merchant may for convenience be commingled and deposited in the same account or accounts with any bank or trust company, with another person registered as a futures commission merchant, or with a clearing organization, and that such share thereof as in the normal course of business is necessary to purchase, margin, guarantee, secure, transfer, adjust, or settle the trades, contracts or commodity options of such commodity or option customers or resulting market positions, with the clearing organization or with any other person registered as a futures commission merchant, may be withdrawn and applied to such purposes, including the payment of premiums to option grantors, commissions, brokerage, interest, taxes, storage and other fees and charges, lawfully accruing in connection with such trades, contracts or commodity options: Provided, further, That customer funds may be invested in instruments described in §1.25.

6. Section 1.25 is proposed to be amended to read as follows:

§1.25 Investment of customer funds.

(a) Permitted Investments. (1) Subject to the terms and conditions set forth in this section, a futures commission merchant or a clearing organization may invest customer funds in the following instruments (permitted investments):

(i) Obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. government securities);

(ii) General obligations of any State or of any political subdivision thereof (municipal securities);

(iii) Obligations issued by any agency sponsored by the United States (government sponsored agency securities);

(iv) Certificates of deposit issued by a bank (certificates of deposit) as defined in Section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation;

(v) Commercial paper;

(vi) Corporate notes; and

(vii) Interests in money market mutual funds.

(2) In addition, a futures commission merchant or a clearing organization may buy and sell the permitted investments listed in paragraphs (a)(l)(i)-(vii) of this rule pursuant to agreements for resale or repurchase of the instruments, in accordance with the provisions of paragraph (d) of this section.

(b) General Terms and Conditions. A futures commission merchant or a clearing organization is required to manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity and according to the following specific requirements.

(1) Ratings. (i) Initial Requirement. Instruments that are required to be rated by this section must be rated by a nationally recognized statistical rating organization (NRSRO), as that

term is defined in §270.2a-7 of this title. Ratings are required for permitted investments as follows:

(A) U.S. government securities need not be rated;

(B) Municipal securities, government sponsored agency securities, certificates of deposit, commercial paper, and corporate notes, except notes that are asset-backed, must have the highest short-term rating of an NRSRO or one of the two highest long-term ratings of an NRSRO;

(C) Corporate notes that are asset-backed must have the highest rating of an NRSRO; and

(D) Money market mutual funds that are rated by an NRSRO must be rated at the highest rating of the NRSRO or, if the fund is not rated, investments made by the fund must comply with the requirements applicable to direct investments under this section.

(ii) Effect of Downgrade. If an NRSRO lowers the rating of an instrument that was previously a permitted investment to below the minimum rating required under this section, the value of the instrument recognized for segregation purposes will be the lesser of-

(A) The current market value of the instrument; or

(B) The market value of the instrument on the business day preceding the downgrade, reduced by 20 percent of that value for each business day that has elapsed since the downgrade.

(2) Restrictions on Instrument Features. (i) With the exception of money market mutual funds, no permitted investment may contain an embedded derivative of any kind, including but not limited to a call option, put option, or collar, cap or floor on interest paid.

(ii) No instrument may contain interest-only payment features.

(iii) No instrument may provide payments linked to a commodity, currency, reference instrument, index, or benchmark except as provided in paragraph (b)(2)(iv) of this section.

(iv) Variable-rate securities are permitted, provided the interest rates paid correlate closely and on an unleveraged basis to a benchmark of either the Federal Funds target or effective rate, the prime rate, the three-month Treasury Bill rate, or the one-month or three-month LIBOR rate.

(v) Certificates of deposit, if negotiable, must be able to be liquidated within one business day or, if not negotiable, must be redeemable at the issuing bank within one business day, with any penalty for early withdrawal limited to any accrued interest earned.

(3) Concentration. (i) The aggregate investment in U.S. government securities or in money market mutual funds shall not be subject to a concentration limit.

(ii) The aggregate investment in the securities of any one issuer, or related issuers, of government sponsored agency securities shall not exceed 25 percent of the total assets held in segregation by the futures commission merchant or the clearing organization. Securities issued by an entity that directly or indirectly constitute an interest in securities issued by a government sponsored agency shall be combined and treated as the securities of a single issuer for the purpose of determining the concentration limit.

(iii) The aggregate investment in the obligations of any one issuer, or related issuers, of any permitted investments, other than U.S. government securities, money market mutual funds, and government sponsored agency instruments, may not exceed five percent of the total assets held in segregation by the futures commission merchant or the clearing organization.

(4) Time-to-maturity. Except for investments in money market mutual funds, the dollarweighted average of the time-to-maturity of the portfolio, as that average is computed pursuant to §270.2a-7 of this title, may not exceed 24 months.

(5) Investments in Instruments Issued by Affiliates. (i) Except as provided in paragraph (b)(5)(ii) of this section, a futures commission merchant shall not invest customer funds in obligations of an entity affiliated with the futures commission merchant, and a clearing organization shall not invest customer funds in obligations of an entity affiliated with the clearing organization. An affiliate includes parent companies, including all entities through the ultimate holding company, subsidiaries to the lowest level, and companies under common ownership of such parent company or affiliates.

(ii) A futures commission merchant or clearing organization may invest customer funds in a fund affiliated with that futures commission merchant or clearing organization provided that the fund itself does not invest in any instrument issued by the futures commission merchant, clearing organization or affiliate thereof.

(6) Recordkeeping. A futures commission merchant and a clearing organization shall prepare and maintain a record that will show for each business day with respect to each type of investment made pursuant to this section, the following information:

(i) The type of instruments in which customer funds have been invested;

(ii) The original cost of the instruments; and

(iii) The current market value of the instruments.

(c) Money Market Mutual Funds. The following provisions will apply to the investment of customer funds in money market mutual funds (the fund).

(1) The fund must be registered with the Securities and Exchange Commission as a money market mutual fund, in compliance with applicable requirements. Notwithstanding the foregoing, a fund sponsor may petition the Commission for an exemption from this requirement. The Commission may grant such an exemption provided that the fund can demonstrate that it will operate in a manner designed to preserve principal and to maintain liquidity. The application for exemption must describe how the fund's structure, operations and financial reporting are expected to differ from the requirements contained in §270.2a-7 of this title and the risk-limiting provisions for direct investments contained in this section. The fund must also specify the information that the fund would make available to the Commission on an ongoing basis.

(2) The fund must be sponsored by a federally-regulated financial institution, a bank as defined in Section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, except for a fund exempted in accordance with paragraph (c)(1) of this section.

(3) A futures commission merchant or clearing organization shall hold its shares of the fund in a custody account in accordance with §1.26(a). If the futures commission merchant or the clearing organization holds its shares of the fund with the fund's shareholder servicing agent, the sponsor of the fund and the fund itself are required to provide the acknowledgment letter required by §1.26.

(4) The net asset value of the fund must be computed daily by 9 a.m. of each business day and made available to the futures commission merchant or clearing organization by that time.

(5) An interest in a fund must be able to be liquidated by the business day following a request to liquidate by the futures commission merchant or clearing organization.

(6) The agreement pursuant to which the futures commission merchant or clearing organization has acquired and is holding its interest in a fund must contain no provision that would prevent the pledging or transferring of shares.

(d) Repurchase and Reverse Repurchase Agreements. A futures commission merchant or clearing organization may buy and sell the permitted investments pursuant to agreements for resale or repurchase of the securities (repurchase transactions), provided the agreements for resale or repurchase conform to the following requirements:

(1) The securities are specifically identified by coupon rate, par amount, market value, maturity date, and CUSIP number.

(2) Counterparties are limited to a bank as defined in Section 3(a)(6) of the Securities Exchange Act of 1934, a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, a securities broker or dealer, or a government securities broker or government securities dealer registered with the Securities and Exchange Commission or which has filed notice pursuant to Section 15C(a) of the Government Securities Act of 1986.

(3) The transaction is made pursuant to a written agreement signed by the parties to the agreement, which is consistent with the conditions set forth in paragraphs (d)(l)-(d)(11) of this section and which states that the parties thereto intend the transaction to be treated as a purchase and sale of securities.

(4) The term of the agreement is no more than one business day, or reversal of the transaction is possible on demand.

(5) The securities transferred under the agreement are held in a safekeeping account with a bank as referred to in paragraph (d)(2) of this section, a clearing organization or the Depository Trust Corporation in an account that complies with the requirements of §1.26.

(6) The futures commission merchant or the clearing organization may not use securities received under the agreement in another similar transaction and may not otherwise hypothecate or pledge such securities, except securities may be pledged on behalf of customers at another futures commission merchant or clearing organization. Substitution of securities is allowed, provided, however, that:

(i) The qualifying securities being substituted and original securities are specifically identified by date of substitution, market values substituted, coupon rates, par amounts, maturity dates and CUSIP numbers;

(ii) Substitution is made on a "delivery versus delivery" basis; and

(iii) The market value of the substituted securities is at least equal to that of the original securities.

(7) The transfer of securities is made on a delivery versus payment basis in immediately available funds. The transfer is not recognized as accomplished until the funds and/or securities are actually received by the custodian of the futures commission merchant's or clearing organization's customer funds or securities purchased on behalf of customers. The transfer or credit of securities covered by the agreement to the futures commission merchant's or clearing organization's customer segregated custodial account is made simultaneously with the disbursement of funds from the futures commission merchant's or clearing organization's customer segregated cash account at the custodian bank. On the sale or resale of securities, the futures commission merchant's or clearing organization's customer segregated cash account at the custodian bank must receive same-day funds credited to such segregated account simultaneously with the delivery or transfer of securities from the customer segregated custodial account.

(8) A written confirmation to the futures commission merchant or clearing organization specifying the terms of the agreement and a safekeeping receipt are issued immediately upon entering into the transaction and a confirmation to the futures commission merchant or clearing organization is issued once the transaction is reversed.

(9) The transactions effecting the agreement are recorded in the record required to be maintained under §1.27 of investments of customer funds, and the securities subject to such transactions are specifically identified in such record as described in paragraph (d)(1) of this section and further identified in such record as being subject to repurchase and reverse repurchase agreements.

(10) An actual transfer of securities by book entry is made consistent with Federal or State commercial law, as applicable. At all times, securities received subject to an agreement are reflected as "customer property."

(11) The agreement makes clear that, in the event of the bankruptcy of the futures commission merchant or clearing organization, any securities purchased with customer funds that are subject to an agreement may be immediately transferred. The agreement also makes clear that, in the event of a futures commission merchant or clearing organization bankruptcy, the counterparty has no right to compel liquidation of securities subject to an agreement or to make a priority claim for the difference between current market value of the securities and the price agreed upon for resale of the securities to the counterparty, if the former exceeds the latter.

(e) A futures commission merchant shall not be prohibited from directly depositing unencumbered securities of the type specified in this section, which it owns for its own account, into a segregated safekeeping account or from transferring any such securities from a segregated account to its own account, up to the extent of its residual financial interest in customers'

segregated funds; provided, however, that such investments, transfers of securities, and disposition of proceeds from the sale or maturity of such securities are recorded in the record of investments required to be maintained by §1.27. All such securities may be segregated in safekeeping only with a bank, trust company, clearing organization, or other registered futures commission merchant. Furthermore, for purposes of §§1.25, 1.26, 1.27, 1.28 and 1.29, investments permitted by §1.25 that are owned by the futures commission merchant and deposited into such a segregated account shall be considered customer funds until such investments are withdrawn from segregation.

7. Section 1.26 is proposed to be revised to read as follows:

§1.26 Deposit of instruments purchased with customer funds.

(a) Each futures commission merchant who invests customer funds in instruments described in §1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers. Such instruments, when deposited with a bank, trust company, clearing organization or another futures commission merchant, shall be deposited under an account name which clearly shows that they belong to commodity or option customers and are segregated as required by the Act and these regulations. Each futures commission merchant upon opening such an account shall obtain and retain in its files an acknowledgment from such bank, trust company, clearing organization or other futures commission merchant that it was informed that the instruments belong to commodity or option customers and are being held in accordance with the provisions of the Act and these regulations: Provided, however, that an acknowledgment need not be obtained from a clearing organization that has adopted and submitted to the Commission rules that provide for the segregation as customer funds, in accordance with all relevant provisions of the Act and the rules and orders

promulgated thereunder, of all funds held on behalf of customers and all instruments purchased with customer funds. Such acknowledgment shall be retained in accordance with §1.31. Such bank, trust company, clearing organization or other futures commission merchant shall allow inspection of such obligations at any reasonable time by representatives of the Commission.

(b) Each clearing organization which invests money belonging or accruing to commodity or option customers of its clearing members in instruments described in §1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers. Such instruments, when deposited with a bank or trust company, shall be deposited under an account name which will clearly show that they belong to commodity or option customers and are segregated as required by the Act and these regulations. Each clearing organization upon opening such an account shall obtain and retain in its files a written acknowledgment from such bank or trust company that it was informed that the instruments belong to commodity or option customers of clearing members and are being held in accordance with the provisions of the Act and these regulations. Such acknowledgment shall be retained in accordance with §1.31. Such bank or trust company shall allow inspection of such instruments at any reasonable time by representatives of the Commission.

8. Sections 1.27, 1.28 and 1.29 are proposed to be amended by changing the word "obligations" to the word "instruments" each time it appears.

9. Section 1.33 is proposed to be amended by adding a new paragraph (g) to read as follows:

§1.33 Monthly and confirmation statements.

* * * * *

(g) Electronic Transmission of Statements. (1) The statements required by this section, and by § 1.46, may be furnished to any customer by means of electronic media if the customer so requests, Provided, however, that a futures commission merchant must, prior to the transmission of any statement by means of electronic media, disclose the electronic medium or source through which statements will be delivered, the duration, whether indefinite or not, of the period during which consent will be effective, any charges for such service, the information that will be delivered by such means, and that consent to electronic delivery may be revoked at any time.

(2) In the case of a non-institutional customer, a futures commission merchant must obtain the non-institutional customer's signed consent acknowledging disclosure of the information set forth in paragraph (g)(1) of this section prior to the transmission of any statement by means of electronic media.

(3) Any statement required to be furnished to a person other than a customer in accordance with paragraph (d) of this section may be furnished by electronic media.

(4) A futures commission merchant who furnishes statements to any customer by means of electronic media must retain a daily confirmation statement for such customer as of the end of the trading session, reflecting all transactions made during that session for the customer, in accordance with §1.31.

10. Section 1.46 is proposed to be amended by revising paragraph (a), by removing and reserving paragraphs (d)(4)-(d)(7), by removing paragraph (d)(9) and by revising paragraph (e) to read as follows:

§1.46 Application and closing out of offsetting long and short positions.

(a) Application of purchases and sales. Except with respect to purchases or sales which are for omnibus accounts, or where the customer has instructed otherwise, any futures commission merchant who, on or subject to the rules of a contract market:

* * * * *

(d) * * *

(4) - (7) [Reserved].

* * * * *

(9) [Removed].

(e) The statements required by paragraph (a) of this section may be furnished to the customer or the person described in §1.33(d) by means of electronic transmission, in accordance with §1.33(g).

11. Section 1.52 is proposed to be amended by adding a new paragraph (m) to read as follows:

§1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements.

* * * * *

(m) Nothing in this section shall apply to the activities of a derivatives transaction facility or the minimum adjusted net capital requirements it may require of persons operating thereon pursuant to §1.17(a)(2)(iii).

12. Section 1.55 is proposed to be amended by revising paragraphs (d) and (f) to read as follows:

§1.55 Distribution of "Risk Disclosure Statement" by futures commission merchants and introducing brokers.

(d) Any futures commission merchant, or in the case of an introduced account any introducing broker, may open a commodity futures account for a customer without obtaining the separate acknowledgments of disclosure and elections required by this section and by §1.33(g), and by §§33.7, 155.3(b)(2), and 190.06 of this chapter, provided that:

(1) Prior to the opening of such account, the futures commission merchant or introducing broker obtains an acknowledgment from the customer, which may consist of a single signature at the end of the futures commission merchant's or introducing broker's customer account agreement, or on a separate page, of the disclosure statements and elections specified in this section and §1.33(g), and in §§33.7, 155.3(b)(2), and 190.06 of this chapter, and which may include authorization for the transfer of funds from a segregated customer account to another account of such customer, as listed directly above the signature line, provided the customer has acknowledged by check or other indication next to a description of each specified disclosure statement or election that the customer has received and understood such disclosure statement or made such election;

(2) The acknowledgment referred to in paragraph (d)(1) of this section must be accompanied by and executed contemporaneously with delivery of the disclosures and elective provisions required by this section and §1.33(g), and by §§33.7, 155.3(b)(2), and 190.06 of this chapter;

* * *

(f) A futures commission merchant or, in the case of an introduced account an introducing broker, may open a commodity futures account for an institutional customer without furnishing such institutional customer the disclosure statements or obtaining the acknowledgments required under paragraph (a) of this section, §§1.33(g) and 1.65(a)(3), and §§30.6(a), 33.7(a), 155.3(b)(2), and 190.10(c) of this chapter.

* * * * *

Part 3 — REGISTRATION

Subpart A — Registration

13. The authority citation for Part 3 is revised to read as follows:

Authority: 5 U.S.C. 522, 522b; 7 U.S.C. la, 2, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6n, 6o, 6p, 8, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21, 23.

14. Section 3.1 is proposed to be amended by revising paragraphs (a)(1) and (a)(2) to read as follows:

§ 3.1 Definitions.

(a) * * *

(1) If the entity is organized as a sole proprietorship, the proprietor; if a partnership, any general partner; if a corporation, any director, the president, chief executive officer, chief operating officer, chief financial officer, and any person in charge of a principal business unit, division or function subject to regulation by the Commission; if a limited liability company or limited liability partnership, any director, the president, chief executive officer, chief operating officer, chief financial officer, the manager, managing member or those members vested with the management authority for the entity, and any person in charge of a principal business unit, division or function subject to regulation by the Commission; and, in addition, any person occupying a

similar status or performing similar functions, having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the entity's activities that are subject to regulation by the Commission;

(2)(i) Any individual who directly or indirectly, through agreement, holding company, nominee, trust or otherwise, is the owner of ten percent or more of the outstanding shares of any class of stock, is entitled to vote or has the power to sell or direct the sale of ten percent or more of any class of voting securities, or is entitled to receive ten percent or more of the profits; or

(ii) Any person other than an individual that is the direct owner of ten percent or more of any class of securities; or

* * * * *

15. Section 3.10 is proposed to be amended by revising paragraph (a)(1)(i), by redesignating paragraph (a)(2)(i) as paragraph (a)(2), by removing paragraph (a)(2)(ii), and by revising paragraph (d) to read as follows:

§3.10 Registration of futures commission merchants, introducing brokers, commodity trading advisors, commodity pool operators and leverage transaction merchants.

(a) Application for Registration. (1)(i)(A) Except as provided in paragraph (a)(1)(i)(B) of this section, application for registration as a futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant must be on Form 7-R, completed and filed with the National Futures Association in accordance with the instructions thereto.

(B) An applicant for registration as a futures commission merchant or introducing broker that will conduct ~~transactions~~ contracts of sale of a commodity for future delivery or commodity options exclusively on or subject to the rules of a derivatives transaction facility for

institutional customers, and which is registered with the Securities and Exchange Commission as a securities broker or dealer, or is a bank or any other financial depository institution subject to regulation by the United States, may apply for registration by filing with the National Futures Association notice of its intention to undertake ~~transactions~~ contracts of sale of a commodity for future delivery or commodity options exclusively on or subject to the rules of a derivatives transaction facility for institutional customers, together with a certification of registration and good standing with the appropriate authority or of authorization to engage in such transactions by said authority.

* * * * *

(d) Annual Filing. Any person registered as a futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator or leverage transaction merchant in accordance with paragraph (a)(1)(i)(A) of this section must file with the National Futures Association a Form 7-R, completed in accordance with the instructions thereto, annually on a date specified by the National Futures Association. The failure to file the Form 7-R within thirty days following such date shall be deemed to be a request for withdrawal from registration. On at least thirty days written notice, and following such action, if any, deemed to be necessary by the Commission or the National Futures Association, the National Futures Association may grant the request for withdrawal from registration.

16. Section 3.32 is proposed to be amended by revising paragraphs (a)(1)(i), (a)(1)(ii) and (a)(1)(v), by redesignating paragraphs (a)(1)(vi) and (a)(1)(vil) as paragraphs (a)(1)(vil) and (a)(1)(viii), respectively, by adding a new paragraph (a)(1)(vi), by revising paragraph (a)(2) and by revising paragraph (e)(1) to read as follows:

§3.32 Changes requiring new registration; addition of principals.

(a) * * *

(1) * * *

(i) * * *

(A) As an individual, directly or indirectly, through agreement, holding company, nominee, trust or otherwise, becomes the owner of ten percent or more of the outstanding shares of any class of stock or acquires the right to vote or the power to sell or to direct the sale of ten percent or more of the registrant's voting securities;

(B) Any person other than an individual that becomes the direct owner of ten percent or more of any class of a registrant's securities;

(ii) As an individual becomes entitled to receive ten percent or more of the registrant's profits;

* * * * *

(v) Becomes the president, chief executive officer, chief operating officer or chief financial officer of the corporate registrant, or becomes in charge of a principal business unit, division or function subject to regulation by the Commission, or comes to occupy a position of similar status or perform a similar function;

(vi) Becomes a director, president, chief executive officer, chief operating officer, chief financial officer, manager, managing member or a member vested with the management authority for the registrant or becomes in charge of a principal business unit, division or function subject to regulation by the Commission, or comes to occupy a position of similar status or perform a similar function in the case of a limited liability company or limited liability partnership;

* * * * *

(2)(i) If a person becomes a principal of the registrant because of an event described in paragraph (a)(1)(i)(13) of this section, the registrant's registration shall not be deemed to terminate and a new Form 7-R need not be filed: Provided, however, that within twenty days of the occurrence of the event described in paragraph (a)(1)(i)(13) of this section, the registrant must notify the National Futures Association of the name of such added principal on Form 3-R and must file written certifications with the National Futures Association stating:

(A) The ultimate day-to-day control of the registrant remains the same,

(B) The addition of the new principal will not affect the conduct or the day-to-day operations of the registrant, and

(C) The insertion of the new principal into the chain of ownership is not being done for the purpose, and will not have the effect, of limiting any liability of the registrant.

* * * * *

(e)(1) Except where a registrant chooses to file an application pursuant to paragraph (d) of this section, if applicable, in the event of a change as described in paragraph (a)(l)(v) or (a)(1)(vi) of this section, a new registration will not be required if the registrant submits a written notice on Form 3-R to the National Futures Association prior to the date of such change in control (and such change does not occur until the registrant receives written approval from the National Futures Association) and includes with such notice a Form 8-R, completed in accordance with the instructions thereto and executed by the person referred to in paragraph (a)(1)(v) or (a)(1)(vi) of this section. The Form 9-R for such individual must be accompanied by the fingerprints of that individual on a fingerprint card provided for that purpose by the National Futures Association: Provided, however, That a fingerprint card need not be provided under this

paragraph for any individual who has a current Form 8-R on file with the National Futures Association or the Commission.

* * * * *

17. Rule 3.34 is proposed to be removed.

18. Part 3 is proposed to be amended by adding thereto an Appendix B to read as follows:

APPENDIX B — STATEMENT OF ACCEPTABLE PRACTICES WITH RESPECT TO ETHICS TRAINING.

The provisions of Section 4p(b) of the Act (7 U.S.C. 6p(b) (1994)) set forth requirements regarding training of registrants as to their responsibilities to the public. This section requires the Commission to issue regulations requiring new registrants to attend ethics training sessions within six months of registration, and all registrants to attend such training on a periodic basis. Consistent with the will of Congress, the Commission believes that a Core Principle for all persons intermediating transactions in recognized multilateral trade execution facilities is fitness. The awareness and maintenance of professional ethical standards are essential elements of a registrant's fitness. Further, the use of ethics training programs is relevant to a registrant's maintenance of adequate supervision, itself a Core Principle, and a requirement under Rule 166.3.

The Commission recognizes that technology has provided new, faster means of sharing and distributing information. In view of the foregoing, the Commission has chosen to allow registrants to develop their own ethics training programs. Nevertheless, futures industry professionals may want guidance as to the role of ethics training. Registrants may wish to consider what ethics training should be retained, its format, and how it might best be implemented. Therefore, the Commission finds it appropriate to issue this Statement of

Acceptable Practices regarding appropriate training for registrants, as interpretative guidance for intermediaries on fitness and supervision. Commission registrants may look to this Statement of Acceptable Practices as a "safe harbor" concerning acceptable procedures in this area.

The Commission believes that Section 4p(b) of the Act reflects an intent by Congress that industry professionals be aware, and remain abreast, of their continuing obligations to the public under the Act and the regulations thereunder. The text of the Act provides guidance as to the nature of these responsibilities. As expressed in Section 4p(b) of the Act, personnel in the industry have an obligation to the public to observe the Act, the rules of the Commission, the rules of any appropriate self-regulatory organizations or contract markets (which would also include recognized futures exchanges and recognized derivatives transactions facilities), or other applicable federal or state laws or regulations. Further, Section 4p(b) acknowledges that registrants have an obligation to the public to observe "just and equitable principles of trade."

Additionally, Section 4p(b) reflects Congress' intent that registrants and their personnel retain an up-to-date knowledge of these requirements. The Act requires that registrants receive training on a periodic basis. Thus, it is the intent of Congress that Commission registrants remain current with regard to the ethical ramifications of new technology, commercial practices, regulations, or other changes.

The Commission believes that training should be focused to some extent on a person's registration category, although there will obviously be certain principles and issues common to all registrants and certain general subjects that should be taught. Topics to be addressed include:

- An explanation of the applicable laws and regulations, and the rules of self-regulatory organizations or contract markets, recognized futures exchanges and derivatives transaction facilities;

- The registrant's obligation to the public to observe just and equitable principles of trade;
- How to act honestly and fairly and with due skill, care and diligence in the best interests of customers and the integrity of the market;
- How to establish effective supervisory systems and internal controls;
- Obtaining and assessing the financial situation and investment experience of customers;
- Disclosure of material information to customers; and
- Avoidance, proper disclosure and handling of conflicts of interest.

An acceptable ethics training program would apply to all of a firm's associated persons and its principals to the extent they are required to register as associated persons. Additionally, personnel of firms that rely on their registration with other regulators, such as the Securities and Exchange Commission, should be provided with ethics training to the extent the Act and the Commission's regulations apply to their business.

As to the providers of such training, the Commission believes that classes sponsored by independent persons, firms, or industry associations would be acceptable. It would also be permissible to conduct in-house training programs. Further, registrants should ascertain the credentials of any ethics training providers they retain. Thus, persons who provide ethics training should be required to provide proof of satisfactory completion of the proficiency testing requirements applicable to the registrant and evidence of three years of relevant industry or pedagogical experience in the field. This industry experience might include the practice of law in the fields of futures or securities, or employment as a trader or risk manager at a brokerage or end-user firm. Likewise, the Commission believes that registrants should employ as ethics training

providers only those persons they reasonably believe in good faith are not subject to any investigations or to bars to registration or to service on a self-regulatory organization governing board or disciplinary panel.

With regard to the frequency and duration of ethics training, it is permissible for a firm to require training on whatever periodic basis and duration the registrant (and relevant self-regulatory organizations) deems appropriate. It may even be appropriate not to require any such specific requirements as, for example, where ethics training could be termed ongoing. For instance, a small entity, sole proprietorship, or even a small section in an otherwise large firm, might satisfy its obligation to remain current with regard to ethics obligations by distribution of periodicals, legal cases, or advisories. Use of the latest information technology, such as Internet websites, can be useful in this regard. In such a context, there would be no structured classes, but the goal should be a continuous awareness of changing industry standards. A corporate culture to maintain high ethical standards should be established on a continuing basis.

On the other hand, larger firms which transact business with a larger segment of the public may wish to implement a training program that requires periodic classwork. In such a situation, the Commission believes it appropriate for registrants to maintain such records as evidence of attendance and of the materials used for training. In the case of a floor broker or floor trader, the applicable contract market, recognized futures exchange or derivatives transaction facility should maintain such evidence on behalf of its member. This evidence of ethics training could be offered to demonstrate fitness and overall compliance during audits by self-regulatory organizations, and during reviews of contract market, recognized futures exchange or derivatives transaction facility operations.

The methodology of such training may also be flexible. Recent innovations in information technology have made possible new, fast, and cost-efficient ways for registrants to maintain their awareness of events and changes in the commodity interest markets. In this regard, the Commission recognizes that the needs of a firm will vary according to its size, personnel, and activities. No format of classes will be required. Rather, such training could be in the form of formal class lectures, video presentation, Internet transmission, or by simple distribution of written materials. These options should provide sufficiently flexible means for adherence to Congressional intent in this area.

Finally, it should be noted that self-regulatory organizations and industry associations will have a significant role in this area. Such organizations may have separate ethics and proficiency standards, including ethics training and testing programs, for their own members.

Part 4 — COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

Subpart A — Definitions and Exemptions

19. The authority citation for Part 4 continues to read as follows:

Authority: 7 U.S. C. 1 a, 2, 4, 6b, 6c, 61, 6m, 6n, 6o, 12a, and 23.

20. Section 4.10 is proposed to be amended by revising paragraph (e)(1) to read as follows:

§4.10 Definitions.

* * * * *

(e)(1) Principal, when referring to a person that is a principal of a particular entity, shall have the same meaning as the term principal under §3.1(a) of this chapter.

* * * * *

21. Section 4.24 is proposed to be amended by revising paragraphs (f)(1)(v) and (h)(2) to read as follows:

§4.24 General Disclosures required.

* * * * *

(f) * * *

(1) * * *

(v) Each principal of the foregoing persons who participates in making trading or operational decisions for the pool or who supervises persons so engaged.

* * * * *

(h) * * *

(2) A description of the trading and investment programs and policies that will be followed by the offered pool, including the method chosen by the pool operator concerning how futures commission merchants carrying the pool's accounts shall treat offsetting positions pursuant to §1.46 of this chapter, if the method is other than to close out all offsetting positions or to close out offsetting positions on other than a first-in, first-out basis, and any material restrictions or limitations on trading required by the pool's organizational documents or otherwise. This description must include, if applicable, an explanation of the systems used to select commodity trading advisors, investee pools and types of investment activity to which pool assets will be committed;

* * * * *

22. Section 4.34 is proposed to be amended by revising paragraphs (f)(1)(ii) and (h) to read as follows:

§4.34 General Disclosures required.

(f) * * *

(1) * * *

(ii) Each principal of the trading advisor who participates in making trading or operational decisions for the trading advisor or supervises persons so engaged.

* * *

(h) Trading program. A description of the trading program, which must include the method chosen by the commodity trading advisor concerning how futures commission merchants carrying accounts it manages shall treat offsetting positions pursuant to § 1.46 of this chapter, if the method is other than to close out all offsetting positions or to close out offsetting positions on other than a first-in, first-out basis, and the types of commodity interests and other interests the commodity trading advisor intends to trade, with a description of any restrictions or limitations on such trading established by the trading advisor or otherwise.

* * * * *

Part 140 — ORGANIZATION, FUNCTIONS AND PROCEDURES OF THE COMMISSION

Subpart B — Functions

23. The authority citation for Part 140 is proposed to be amended to read as follows:

Authority: 7 U.S.C. 4a, 12a.

24. Section 140.91 is proposed to be amended by adding a new paragraph (a)(7) to read as follows:

§140.91 Delegation of authority to the Director of the Division of Trading and Markets.

(a) * * *

(7) All functions reserved to the Commission in § 1.25 of this chapter.

* * * * *

Part 155 — TRADING STANDARDS

25. The authority citation for Part 155 continues to read as follows:

Authority: 7 U.S.C. 6b, 6c, 6g, 6j and 12a unless otherwise noted.

26. Sections 155.2, 155.3, 155.4 and 155.5 are proposed to be amended by adding the words "or recognized futures exchange" after the words "contract market" each time they appear.

27. Section 155.6 is proposed to be added to read as follows:

§155.6. Trading Standards for the Transaction of Business on Derivatives Transaction Facilities.

(a) A futures commission merchant, or affiliated person thereof, transacting business on behalf of a non-institutional customer on a derivatives transaction facility shall comply with the provisions of §155.3.

(b) No futures commission merchant, introducing broker or affiliated person thereof shall misuse knowledge of any institutional customer's order for execution on a derivatives transaction facility.

PART 166 — CUSTOMER PROTECTION RULES

28. The authority citation for Part 166 is proposed to be amended to read as follows:

Authority: 7 U.S.C. I a, 2, 4, 6b, 6c, 6d, 6g, 6h, 6k, 61, 6o, 7a, 12a, 21 and 23, unless otherwise noted.

29. Section 166.5 is proposed to be added to read as follows:

§166.5. Dispute Settlement Procedures.

(a) Definitions.

(1) The term claim or grievance as used in this section shall mean any dispute that (i) arises out of any ~~transaction~~ contract of sale of a commodity for future delivery or commodity option executed on or subject to the rules of a contract market, a recognized futures exchange or a derivatives transaction facility, (ii) is executed or effected through a member of such facility, a participant transacting on or through such facility or an employee of such facility, and (iii) does not require for adjudication the presence of essential witnesses or third parties over whom the facility does not have jurisdiction and who are not otherwise available. The term claim or grievance does not include disputes arising from cash market transactions that are not a part of or directly connected with any transaction for the purchase or sale of any commodity for future delivery or commodity option.

(2) The term customer as used in this section includes an option customer (as defined in §1.3(j) of this chapter) and any person for or on behalf of whom a member of a contract market, a recognized futures exchange or a derivatives transaction facility or a participant transacting on or through such market, exchange or facility effects a ~~transaction~~ contract of sale of a commodity for future delivery or commodity option on or through such market, exchange or facility, except another member of or participant in such market, exchange or facility.

(3) The term Commission registrant as used in this section means a person registered under the Act as a futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor, or associated person.

(b) Voluntariness. The use by customers of dispute settlement procedures shall be voluntary as provided in paragraph (c) of this section.

(c) Pre-Dispute Arbitration Agreements. No Commission registrant shall enter into any agreement or understanding with a customer in which the customer agrees, prior to the time a claim or grievance arises, to submit such claim or grievance to any settlement procedure except as follows:

(1) Signing the agreement must not be made a condition for the customer to utilize the services offered by the Commission registrant.

(2) If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the cautionary language and provisions specified in this section. A futures commission merchant or introducing broker may obtain such endorsement as provided in §1.55(d) of this chapter for the following classes of customers only:

(i) An institutional customer as defined in §1.3(g) of this chapter;

(ii) A plan defined as a government plan or church plan in section 3(32) or section 3(33) of title I of the Employee Retirement Income Security Act of 1974, or a foreign person performing a similar role or function subject as such to comparable foreign regulation; and

(iii) A person who is a "qualified eligible participant" or a "qualified eligible client" as defined in §4.7 of this chapter.

(3) The agreement may not require the customer to waive the right to seek reparations under Section 14 of the Act and Part 12 of this chapter. Accordingly, the customer must be advised in writing that he or she may seek reparations under Section 14 of the Act by an election made within 45 days after the Commission registrant notifies the customer that arbitration will be demanded under the agreement. This notice must be given at the time when the Commission registrant notifies the customer of an intention to arbitrate. The customer must also be advised that if he or she seeks reparations under Section 14 of the Act and the Commission declines to institute reparation proceedings, the claim or grievance will be subject to the pre-existing arbitration agreement and must also be advised that aspects of the claim or grievance that are not subject to the reparations procedure (i.e., do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the pre-existing arbitration agreement.

(4) The agreement must advise the customer that, at such time as he or she may notify the Commission registrant that he or she intends to submit a claim to arbitration, or at such time as such person notifies the customer of its intent to submit a claim to arbitration, the customer will have the opportunity to elect a qualified forum for conducting the proceeding.

(5) Election of forum. (i) Within ten business days after receipt of notice from the customer that he or she intends to submit a claim to arbitration, or at the time a Commission registrant notifies the customer of its intent to submit a claim to arbitration, the Commission registrant must provide the customer with a list of organizations whose procedures meet Acceptable Practices established by the Commission for customer dispute resolution, together with a copy of the rules of each forum listed. The list must include:

(A) The contract market, recognized futures exchange or derivatives transaction facility, if available, upon which the transaction giving rise to the dispute was executed or could have been executed;

(B) A registered futures association; and

(C) At least one other organization that will provide the customer with the opportunity to select the location of the arbitration proceeding from among several major cities in diverse geographic regions and that will provide the customer with the choice of a panel or other decision-maker composed of at least one or more persons, of which at least a majority are not members or associated with a member of the contract market, recognized futures exchange or derivatives transaction facility or employee thereof, and that are not otherwise associated with the contract market, recognized futures exchange or derivatives transaction facility (mixed panel): Provided, however, that the list of qualified organizations provided by a Commission registrant that is a floor broker need not include a registered futures association unless a registered futures association has been authorized to act as a decision-maker in such matters.

(ii) The customer shall, within forty-five days after receipt of such list, notify the opposing party of the organization selected. A customer's failure to provide such notice shall give the opposing party the right to select an organization from the list.

(6) Fees. The agreement must acknowledge that the Commission registrant will pay any incremental fees that may be assessed by a qualified forum for provision of a mixed panel, unless the arbitrators in a particular proceeding determine that the customer has acted in bad faith in initiating or conducting that proceeding.

(7) Cautionary Language. The agreement must include the following language printed in large boldface type:

THREE FORUMS EXIST FOR THE RESOLUTION OF COMMODITY DISPUTES: CIVIL COURT LITIGATION, REPARATIONS AT THE COMMODITY FUTURES TRADING COMMISSION (CFTC) AND ARBITRATION CONDUCTED BY A SELF-REGULATORY OR OTHER PRIVATE ORGANIZATION.

THE CFTC RECOGNIZES THAT THE OPPORTUNITY TO SETTLE DISPUTES BY ARBITRATION MAY IN SOME CASES PROVIDE MANY BENEFITS TO CUSTOMERS, INCLUDING THE ABILITY TO OBTAIN AN EXPEDITIOUS AND FINAL RESOLUTION OF DISPUTES WITHOUT INCURRING SUBSTANTIAL COSTS. THE CFTC REQUIRES, HOWEVER, THAT EACH CUSTOMER INDIVIDUALLY EXAMINE THE RELATIVE MERITS OF ARBITRATION AND THAT YOUR CONSENT TO THIS ARBITRATION AGREEMENT BE VOLUNTARY.

BY SIGNING THIS AGREEMENT, YOU: (1) MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW; AND (2) ARE AGREEING TO BE BOUND BY ARBITRATION OF ANY CLAIMS OR COUNTERCLAIMS WHICH YOU OR [NAME] MAY SUBMIT TO ARBITRATION UNDER THIS AGREEMENT. YOU ARE NOT, HOWEVER, WAIVING YOUR RIGHT TO ELECT INSTEAD TO PETITION THE CFTC TO INSTITUTE REPARATIONS PROCEEDINGS UNDER SECTION 14 OF THE COMMODITY EXCHANGE ACT WITH RESPECT TO ANY DISPUTE THAT MAY BE ARBITRATED PURSUANT TO THIS AGREEMENT. IN THE EVENT A DISPUTE ARISES, YOU WILL BE NOTIFIED IF [NAME] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION. IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXCHANGE ACT IS INVOLVED AND IF YOU PREFER TO REQUEST A SECTION 14

"REPARATIONS" PROCEEDING BEFORE THE CFTC, YOU WILL HAVE 45 DAYS FROM THE DATE OF SUCH NOTICE IN WHICH TO MAKE THAT ELECTION.

YOU NEED NOT SIGN THIS AGREEMENT TO OPEN OR MAINTAIN AN ACCOUNT WITH [NAME]. SEE 17 CFR 166.5.

(d) Enforceability. A dispute settlement procedure may require parties utilizing such procedure to agree, under applicable state law, submission agreement or otherwise, to be bound by an award rendered in the procedure, provided that the agreement to submit the claim or grievance to the procedure was made in accordance with paragraph (c) of this section or that the agreement to submit the claim or grievance was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(e) Time limits for submission of claims. The dispute settlement procedure established by a contract market, recognized futures exchange or derivatives transaction facility shall not include any unreasonably short limitation period foreclosing submission of customers' claims or grievances or counterclaims.

(f) Counterclaims. A procedure established by a contract market, recognized futures exchanges or derivatives transaction facility under the Act for the settlement of customers' claims or grievances against a member or employee thereof may permit the submission of a counterclaim in the procedure by a person against whom a claim or grievance is brought. The contract market, recognized futures exchanges or derivatives transaction facility may permit such a counterclaim where the counterclaim arises out of the transaction or occurrence that is the subject of the customer's claim or grievance and does not require for adjudication the presence of essential witnesses, parties or third persons over whom the contract market, recognized futures exchanges or derivatives transaction facility does not have jurisdiction. Other counterclaims are permissible

only if the customer agrees to the submission after the counterclaim has arisen, and if the aggregate monetary value of the counterclaim is capable of calculation.

Issued in Washington, D.C. on June 8, 2000, by the Commission.

Jean A. Webb,
Secretary of the Commission

APPENDIX B – ENFORCEABILITY PROBLEMS

In both the Commission's proposal and our markup, the regulations indicate that certain CEA provisions, existing Commission regulations, and new Commission "core principles" shall apply to transactions that are neither futures nor commodity options. (This fact is implicit in the Commission's proposal whereas it is explicit in our markups to minimize the resulting uncertainties.) In reality, however, the legal proposition that the Commission somehow obtains authority over a transaction outside the reach of the CEA by virtue of the fact that a trading facility or clearing organization consents to the regime is subject to doubt. (The Commission would lack authority under current law, for example, to regulate equity securities even if the New York Stock Exchange or National Association of Securities Dealers opted to be regulated by the Commission.) The CEA provisions, regulations, and principles, therefore, may not apply – regardless of how the regulations are worded – if any party successfully argues that a transaction executed on a DTF or cleared on an RCO is neither a future nor a commodity option. For this reason, the proposed regulations promise greater customer protections than the Commission may, as a matter of law, be able to provide.

The following language does not solve this problem, which is inextricably linked to the Commission's approach, but at least discloses to clearing and trading customers the risks they will incur if they rely on the protections that the new regulations are apparently intended to provide:

§37.5 Enforceability

(a) Notwithstanding the exemption in §37.2, sections la, 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) Notwithstanding §37.5(a), the Commission or other relevant persons may be unable as a matter of law to enforce any provisions of this Part 37 or other provisions of this chapter with respect to contracts, agreements or transactions that are (i) not contracts of sale of a commodity for future delivery or commodity option s or (ii) excluded from all or part of the Act by any provision of the Act or other federal law. (*Provided, however*, that the qualification of §37.5(a) by this §37.5(b) shall no longer apply to the limited extent that legislation may be enacted that specifically grants the Commission jurisdiction over any contracts, agreements or transactions traded on a recognized derivatives transaction facility that are excluded from, or otherwise not subject to, the Act.)

§39.5 Enforceability.

(a) In accordance with the proviso in §39. 1 (b)(2), sections 1a, 2(a)(1), 4, 4b, 4c, 4d, 4g, 4i, 4o, 5(7), the rule disapproval procedures of sections 5a(a)(12), 5b, 6, 6b, 6c, 8(a), 8(c), 8a(6), 8a(7), 8a(9), 8c(a), 8c(b), 8(c)(c), 8(c)(d), 9(a), 9(f), 20 and 22 of the Act and §§1.3, 1.20, 1.24, 1.25, 1.26, 1.27 1.31, 1.38, 1.41, 33.10, Parts 15-21, Part 39, and Part 190 of this chapter continue to apply.

(b) Notwithstanding §39.5(a), the Commission or other relevant persons may be unable as a matter of law to enforce any provisions of this Part 39 or other provisions of this chapter with respect to the clearing of contracts, agreements or transactions described in §39.2(c). (*Provided, however*, that the qualification of §39.5(a) by this §39.5(b) shall no longer apply to the limited extent that legislation may be enacted that specifically grants the Commission jurisdiction over any the clearing by a recognized clearing organization of contracts, agreements or transactions that are excluded from, or otherwise not subject to, the Act.)