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September 9, 2005

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

RE: Proposed Clarifying Amendments for Exempt Markets, Derivative Transaction Execution Facilities and Designated Contract Markets, and Procedural Changes for Derivatives Clearing Organization Registration Applications.

Dear Ms. Webb:

U.S. Futures Exchange, L.L.C (Eurex U.S.) appreciates the opportunity to comment on the amendments to Parts 36--40 of the Code of Federal Regulations proposed by the Commodity Futures Trading Commission (Commission). These proposed amendments are intended by the Commission to "clarify and codify acceptable practices . . . for trading facilities," to "make a number of technical and clarifying corrections and conforming amendments," and to "revise the application and review procedures for registration as a Derivatives Clearing Organization (DCO)." 70 Fed. Reg. 39672, 39673 (July 11, 2005).

Eurex U.S. is an all-electronic futures and options exchange which was designated by the Commission as a U.S. contract market on February 4, 2004.
Eurex U.S. is approximately 80% owned by a U.S. subsidiary of Eurex Frankfurt, AG and approximately 20% by a Delaware limited partnership. Eurex U.S. is recognized to do business in fourteen jurisdictions. Eurex U.S. lists for trading futures contracts and futures options on fixed income securities, futures contracts on U.S. stock indexes and, beginning on September 23, 2005, futures contracts on foreign exchange.

Eurex U.S. commends the Commission's efforts to clarify and update 17 C.F.R. Parts 36--40 and to keep its rules current with its administrative practice. The Commodity Futures Modernization Act of 2000 (CFMA) profoundly altered the regulatory framework that applies to the trading of futures and derivatives products in the United States. The new regulatory framework replaced a system of proscriptive requirements with Core Principles and streamlined administrative procedures in order to balance "the public interests of market and price integrity, protection against manipulation and customer protection with the need to permit exchanges and other trading facilities to operate more flexibly in today's competitive environment." 65 Fed. Reg. 77962 (December 13, 2000). Importantly, the CFMA also intended "to promote innovation for futures and derivatives" and "to enhance the competitive position of United States financial institutions and financial markets." Section 2, CFMA.

The Commission boldly followed the lead of the CFMA in promulgating the implementing rules which often reduced administrative time frames or provided greater flexibility than the CFMA itself required. *See* 66 Fed. Reg. 42256 (August 10, 2001). The CFMA and the Commission's implementation of it have been a resounding success. New entrants to the markets, including among them Eurex U.S., have brought greater competition to the futures industry benefiting the markets and market users generally. This increased competitive vigor also has resulted in significant over-all growth in futures trading subject to the Act's customer and financial protections. In light of this success, proposed amendments to the implementing rules should be examined carefully to determine whether such changes would further the CFMA's objectives and are appropriately calibrated to the identified regulatory problem which they are intended to address.

The Commission's proposal to require electronic submission of all formal filings and notifications required under 17 C.F.R. Parts 36-40 is an example of such a rule amendment. This proposal advances the CFMA's objectives by further streamlining administrative procedures without diminishing regulatory protections to the markets. Providing for electronic submission of filings recognizes the cost savings available when paper copies are no longer required to be filed and reduces the administrative burden associated with filing paper applications and notifications. The Commission is to be commended for its forward thinking in this regard.[1]

Proposed Amendments to Part 38—Designated Contract Markets

Among the proposed amendments to Part 38 (the rules relating to contract markets) the Commission is proposing to delegate to staff the authority to require a contract market to file a written demonstration that the contract market is in compliance with one or more Core Principles. For the reasons explained below, Eurex U.S. opposes the amendment to Commission rule 38.5 as currently proposed.

Commission Rule 38.5 contains two information request provisions. Rule 38.5(a) requires that a contract market provide the Commission with information relating to its operations, including specifically information relating to "data entry and trade details."

[1] The Commission may also wish to consider whether any changes to its procedures or requirements relating to the filing of materials that are subject to a Petition for Confidential Treatment under 17 C.F. R. 145.9 are appropriate in light of the all-electronic filing requirement. In particular, 17 C.F.R. 145.9(d)(4) permits a cover sheet noting the confidential nature of the documents to be securely affixed to those documents. Procedures should be developed assuring that an electronic counterpart not be separated from the underlying documents in the course of the Commission's handling and storage of such electronic filings. These procedures might include instructions that all electronic documents must be opened and inspected for legends that the document is subject to a Petition for Confidentiality before the document can be forwarded and that the forwarding message include a notice that the document is subject to such a Petition.

Rule 38.5(b) requires that upon request by the Commission, a contract market file a demonstration that it is in compliance with one or more Core Principles.[2]

The provision that a contract market upon demand by the Commission demonstrate that it remains in compliance with the provisions of a Core Principle is patterned after the requirement of former Commission Rule 1.50. A request for such a demonstration of compliance under Rule 38.5 must be viewed by both the contract market and the Commission as anything but a routine request for information.[3] Responding to a request for such a demonstration is likely to place a very heavy (and costly) burden on an exchange. Like former Commission Rule 1.50, this authority should be used sparingly, only in truly appropriate circumstances, and should not be confused with the staff's request for information relating to "day-to-day due diligence oversight." *Compare* 70 Fed. Reg. 39672, 39674. For these reasons, only the Commission issued calls under former Rule 150 to require a contract market to demonstrate continuing compliance with the Act, and the Commission should similarly reserve to itself the authority to issue a formal Rule 38.5 demand.

The Commission is also proposing to amend Appendix B to Part 38, Core Principle 2 by including the clarification that trade practice surveillance programs may be carried out through delegation or contracting-out to a third party. The Commission previously addressed these practices in the Preamble to its implementing rules, differentiating between delegations and outsourcing arrangements., 66 Fed. Reg. 42256, 422666 (August 10, 2001). In this regard, Eurex U.S. contracts with the National Futures Association (NFA) for the provision of trade practice surveillance. Eurex U.S. supports the Commission's endorsement in Appendix B of these practices.

However, the Commission should make clear that the specific mention of third-party out-sourcing arrangements in the context of the operation of an exchange's trade practice surveillance program under Appendix B to Part 38, Core Principle 2, is not intended to preclude such arrangements in other contexts. In this regard, contract markets and other registered entities, including DCOs, routinely contract with third parties for the provision of many business functions. For example, Eurex U.S. also contracts with NFA for the provision of financial surveillance services in furtherance of its fulfillment of its self-regulatory responsibilities under Designation Criterion 5. Contract markets routinely contract with IT vendors for various services, including in some instances, provision of the contract market's trade matching platform. *See*, Designation Criterion 4. Moreover, the Commission has previously noted that it "has long recognized the ability of contract

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[2] The information required to be provided under Rule 38.5(c) is required to be filed upon a change of ownership of the contract market and is self-effectuating.

[3] In this regard, the demonstration of compliance submitted to the Commission in response to a Rule 38.5 demand may be used by the Commission in developing the record upon which the Commission determines under Section 5c(d)(1)(A) of the Act to notify a contract market of its violation of a Core Principle. A notice of violation may possibly lead to suspension or revocation of the contract market's designation under Section 6(b) of the Act or to the imposition of a cease and desist order or of a civil money penalty under Section 6b of the Act. Before seeking such remedies, however, the Commission under section 5c(d) of the Act must offer the contract market an opportunity to cure the violation.

markets to meet their self-regulatory obligations by using persons under contract to perform specified duties," and has outlined the principles which must govern such arrangements. *Id.*

Additionally, outsourcing arrangements may be used in the context of the clearing of trades. In light of the CFMA's introduction of registration of clearing organizations separate from the designation of a contract market, the Act unmistakably contemplates that exchanges may meet their obligations under Designation Criterion 5 by out-sourcing clearing functions to an independent clearing organization. *See* Appendix A to Part 38, Designation Criterion 5. Indeed, Eurex U.S. enjoys such a contractual relationship with The Clearing Corporation, an independent clearinghouse and the DCO for all trades executed on Eurex U.S. Moreover, DCOs today may outsource a variety of functions consistent with their fulfillment of statutory requirements. Accordingly, because third-party service agreements are pervasive throughout the futures industry for a wide array of functions and are routinely used by many registered entities and Commission registrants, the Commission should make clear that the inclusion of the specific provision in Appendix B to Part 38, Core Principle 2 relating to delegations and contracting-out of trade practice surveillance functions is not to be interpreted as a limitation on outsourcing arrangements of any other business function by any registered entity or Commission registrant under the policies previously outlined by the Commission. *See* 66 Fed. Reg., *supra* at 422666.

Proposed Amendments to Part 39—Derivatives Clearing Organizations

The Commission is proposing several amendments to Part 39 of its rules relating to the application procedures for registration as a DCO. Specifically, the Commission is proposing to replace the current presumption that applications will be reviewed under a 60-day "fast-track" period with the presumption that applications will be reviewed under the maximum time permitted by the Act, which is 180 days, unless that period is stayed.[4] The Commission is proposing, however, to permit applicants to request "expedited review" within a period of 90 days. In establishing the "expedited review" procedure, the Commission is proposing to exclude the current mechanism whereby an applicant can challenge a decision to terminate "fast-track" review by requesting that the Commission institute a proceeding immediately to deny the proposed application. The Commission is proposing as an additional basis for terminating expedited review, applications that raise "novel or complex issues that require additional time for review." The Commission is proposing to delegate the authority to terminate expedited review to staff. Finally, the Commission is proposing to require that applicants must submit "an executed or executable copy of any agreements or contracts . . . that enable the applicant to comply with the core principles. Final, signed copies of such documents would be required to be submitted prior to registration." 70 Fed. Reg. at 39676.

[4] Under section 6(a) of the Act, the 180 period can be stayed if the application is found to be "materially incomplete." The Commission shall have not less than 60 days to complete its review from resubmission of the supplemented application, potentially resulting in a review period of 240 days. The Commission is proposing to delegate the authority for finding an application to be materially incomplete to staff.

The Commission explains that additional time is necessary because applications "are large and contain technical documents describing operations and operational outsourcing agreements." *Id.* It further notes that the "proposal is responsive to the public interest that the Commission has witnessed to date with respect to DCO applications and is substantially the same as a proposal recently adopted for DCMs and DTEFs." *Id.* Finally, the Commission notes that it is proposing to delete the procedure whereby an applicant can challenge termination of expedited review because such a procedure "has proved to be unnecessary to date. . . ." *Id.*

If adopted, the net effect of these proposed amendments would be to lengthen the review period for applicants for registration as a DCO or to otherwise burden the application process. The success of the CFMA (and the Commission's implementation of it) rests upon the careful balancing of the public interests in promoting market and financial protections, permitting greater operating flexibility to those in the industry and promoting competition and innovation. The proposed amendments to the application procedures would adversely alter that balance with respect to clearing organizations, turning back the clock in the direction of the review procedures which existed prior to enactment of the CFMA. The Commission's implementing rules rightly took into account that an important element in fostering competition in the futures markets was, and is, lowering unnecessary barriers to entry. In this regard, time to market and the certainty of that timing is an important factor in encouraging new entrants. Conversely, unnecessarily extended or indeterminate review periods raise the barrier to new entrants. If adopted, these proposals would reverse the presumptions embodied in the current rules that the Commission is committed to reducing the time taken for its review and to reducing the significant burdens associated with registration. If adopted, these provisions would reverse the very Commission policies which have resulted in the entry into the industry of new DCOs (and markets) and the benefits of competition which they have brought to the futures industry.[5]

Proposed Amendments to Part 40—Provisions Common to Contract Markets, Derivatives Transaction Execution Facilities and Derivatives Clearing Organizations

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[5] The proposal to require executed or executable contracts to be provided as part of the application is an example where a prior flexibility would be lost to new applicants. Where an applicant has not submitted an executed contract prior to the Commission's consideration of its application, under current procedures the Commission could grant registration subject to the condition that the DCO may not begin operation until a final executed copy of the applicable contract is provided. This flexibility, which would be lost under the proposed revisions, may entail significant cost savings to an applicant, particularly when the Commission's review may take up to six months or longer if the proposed procedures are adopted.

Moreover, although Eurex U.S. supports inclusion of an expedited review procedure for review and especially of its provision for a positive Order of the Commission at the conclusion of the review process, deletion of an applicant's right to ask for an immediate Commission hearing to deny the application in response to a determination to terminate expedited review removes any mechanism under which the staff can be held accountable for a decision to terminate expedited review. Procedural fairness suggests that applicants should have an avenue to challenge such an adverse action even if historically they have refrained from using it.

The Commission has proposed a number of revisions to Part 40, including amendments to the dormancy provisions, provisions requiring registered entities to provide information requested by Commission staff relating to the self-certification of a rule or justifying that a self-certified product meets "initially or on a continuing basis" any of the Act's requirements, information requirements for voluntary requests for Commission approval of new products, amendments relating to the procedures for approval of the terms and conditions of agricultural futures and option contracts, and changes to the exceptions to the requirement of certification by contract markets or DCOs for certain routine and non-substantive rule amendments.

A number of these proposed amendments further the goals of the CFMA by increasing the operating flexibility of those in the futures industry or by streamlining administrative procedures. For example, extension of the dormant period for contracts, contract markets or DCOs from six months to twelve months provides greater flexibility to those in the industry without lessening or weakening regulatory protections. And the delegation to staff to approve contract market speculative position limit or position accountability rules will also streamline administrative procedures. Moreover, the proposed inclusion of changes in survey lists of banks, brokers or dealers that provide market information to an independent third party and which are product terms through incorporation by reference in the category of exchange rule changes that need only be reported to the Commission on a weekly basis reduces an unnecessary administrative burden on contract markets. Similarly, inclusion of *de minimis* changes to security indexes in the category of rules that need not be certified or reported to the Commission also reduces an unnecessary administrative burden. The Commission is to be commended for proposing these amendments to its rules.

The Commission is also proposing to add a number of provisions requiring contract markets to respond to staff requests for information when self-certifying new products or rules or rule amendments or when requesting voluntary approval of products. However, as discussed above, requests to demonstrate compliance with the Act should be treated more formally under Rule 38.5 than requests for information related to the routine due diligence review that staff conducts when products or rules are self-certified. The proposed standards governing staff requests related to due diligence review do not clearly differentiate between the two.[6]

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[6] In this regard, the Commission may wish to clarify and make consistent the standards for staff requests for information relating to its due diligence review of: 1) certifications of new products ("evidence, information or data relating to whether the contract meets, initially or on a continuing basis, any of the requirements of the Act or Commission regulations or policies thereunder which may be beneficial to the Commission in conducting a due diligence assessment of the product and the entity's compliance with these requirements"); and, 2) certifications of new contract market rules or rule amendments ("evidence, information or data that may be beneficial to the Commission in conducting a due diligence assessment of the certification filing and the entity's compliance with any of the requirements of the Act.")

Moreover, the Commission may wish to clarify the standard relating to staff requests for information relating to submissions for voluntary requests for Commission approval of new products ("additional evidence, information or data relating to whether the contract meets, initially or on a continuing basis, any

Finally, it should be noted that the authority to request information, if misused, can constitute a significant burden on registered entities even in the context of a self-certification framework, chilling the very innovation that the CFMA seeks to promote. In this regard, the Commission should take care to ensure that the proposed authority vested in staff to make routine requests for information for the purpose of conducting a due diligence review of self-certified rules and products is not used to construct a post-submission review procedure which in essence is the equivalent of the prior-approval framework superceded by the CFMA. Accordingly, requests for additional information for the conduct of due diligence reviews should be informed by Section 5c(a)(2) of the Act, which provides that the acceptable business practices published by the Commission do not constitute the exclusive means of complying with a Core Principle and by Section 5(d)(1) of the Act, which provides that a "board of trade shall have reasonable discretion in establishing the manner in which it complies with the core principles."

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The CFMA and the Commission's implementation of it have resulted in a marked increase in competition in the futures industry. Eurex U.S. is of the opinion that many of the amendments proposed by the Commission in its July 11, 2005 Notice of Proposed Rulemaking will further the objectives and aims of the CFMA, and will have an overall positive affect for the futures industry. Eurex U.S. appreciates the opportunity to comment on these proposed rule amendments and hopes that the Commission finds them useful.

Very truly yours,

Satish Nandapurkar
President &CEO

CC: Chairman Reuben Jeffery, III
Commissioner Walter L. Lukken
Commissioner Sharon Brown-Hruska
Commissioner Fred Hatfield
Commissioner Michael V. Dunn
Mr. Patrick J. McCarty
Mr. James L. Carley
Mr. Richard A. Shilts
Mr. Gregory Mocek
Mr. Donald Heitman
Ms. Lois Gregory

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of the specific requirements of the Act. . . ."). It can be expected that such staff requests for additional information would be for the purpose of ascertaining whether at the time of submission there is a reasonable basis for the Commission to find that the product is likely to meet applicable statutory and regulatory requirements and standards. It follows that the information provision in proposed Rule 40.2(b) would not be understood as providing authority to demand information on a *continuing basis*. After a contract has been approved, requests relating to continuing compliance with the Act should be made under Rule 38.5, the same as for self-certified contracts.