



# FIRST OPTIONS

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OFFICE OF THE SECRETARIAT

August 4, 1998

Jean A. Webb, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

COMMENT

COMMODITY FUTURES  
TRADING COMMISSION  
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Re: Rule Proposal Regarding Recordkeeping

Dear Ms. Webb:

First Options of Chicago, Inc. ("FOC") respectfully submits these comments in response to the Notice of Proposed Rulemaking ("NPR") issued by the Commodity Futures Trading Commission ("CFTC" or "Commission") regarding recordkeeping and the proposed amendment of CFTC Rule 1.31. 63 Fed. Reg. 30,668 (June 5, 1998).

## I. INTRODUCTION

FOC is a registered futures commission merchant ("FCM") and securities broker-dealer, and is a member of the principal domestic and foreign commodities, securities, and options exchanges. FOC averages tens of thousands of transactions per day on the floors of the Chicago Board of Trade and the Chicago Mercantile Exchange, as well as a greater volume of transactions on other commodities, securities, and options exchanges. A large percentage of FOC's retail commodity futures trading business involves electronic orders.

FOC has great interest in the present rulemaking proceeding in light of the huge volume of records it generates and the

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MEMBERS CHICAGO BOARD OPTIONS EXCHANGE, CHICAGO BOARD OF TRADE, CHICAGO MERCANTILE EXCHANGE,  
AMERICAN STOCK EXCHANGE, MIDWEST STOCK EXCHANGE, NEW YORK STOCK EXCHANGE,  
PACIFIC STOCK EXCHANGE AND PHILADELPHIA STOCK EXCHANGE

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number of document requests it regularly receives in the ordinary course of its business. Indeed, on May 12, 1998, FOC filed a Petition with the Commission, seeking to amend CFTC Rule 1.31, 17 C.F.R. § 1.31, to permit use of a variety of qualifying means of electronic recordkeeping for all categories of required records and for the entire required recordkeeping period under the Commodity Exchange Act ("CEA" or "Act") and Commission regulations. FOC consulted with many industry participants and associations in preparing its Petition to amend Rule 1.31, and has reason to believe that there is widespread support for the adoption of broad and flexible electronic recordkeeping provisions. FOC incorporates its Petition herein by reference.<sup>1</sup>

Given recent advances in technology, many means of electronic recordkeeping are viable -- and possibly superior -- alternatives to the recordkeeping systems that FOC and other CFTC registrants currently use. Most registrants store required records on microfiche/microfilm (as permitted), and/or in paper files in on-site storage areas or off-site warehouses. An electronic recordkeeping system that produces or reproduces all required records on CD-ROM, optical tape or disk, or other electronic storage media would enhance the efficiency, accuracy,

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<sup>1</sup> A few weeks after FOC filed its May 12, 1998 Petition, the Commission published, on June 5, 1998, its own proposal to amend Rule 1.31, the subject of these comments. The Commission advised FOC that it will consider FOC's Petition as a comment letter in connection with this subsequent rulemaking proceeding.

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and security of registrants' recordkeeping procedures. As a result, registrants' ability to respond readily and completely to document requests from the Commission and other government agencies and self-regulatory organizations ("SROs") would be improved. Moreover, given the increasing use of electronic order-routing systems, electronically delivered customer confirmations and account statements, and electronically generated records, a compatible electronic recordkeeping system would be efficient and rational.

In recognition of technological developments, in early 1997, the U.S. Securities and Exchange Commission ("SEC") amended its record retention regulations to permit use of electronic storage media.<sup>2</sup> The SEC rules permit electronic recordkeeping for nearly all required records, for the entire period record retention is required, with a broad scope of electronic storage media (including CD-ROM and optical tape), as long as certain conditions regarding reliability, security, and accessibility are satisfied. FOC'S May 12, 1998 Petition requested that the CFTC amend its rules to parallel the SEC's recordkeeping regulations.<sup>3</sup>

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<sup>2</sup> 62 Fed. Reg. 6469 (Feb. 12, 1997) (codified at 17 C.F.R. § 240.17a-4).

<sup>3</sup> Nearly half of all CFTC-registered FCMs are also registered with the SEC as broker-dealers. CFTC Advisory, Alternative Method of Compliance for Monthly, Confirmation, and Purchase-and-Sale Statements, 62 Fed. Reg. 31507, 31510 n.27 (June 10, 1997) (noting that as of March 31, 1997, 113 of 236 FCMs were registered with the SEC). If CFTC recordkeeping rules were coordinated with SEC requirements, persons registered with

## II. SUMMARY OF COMMENTS

FOC supports the Commission's effort to update Rule 1.31 in an attempt to keep pace with technological developments and to permit registrants to use a wider variety of electronic storage media, for a broader category of required records. FOC respectfully suggests, however, that the Commission's proposal should be broader and more flexible, as detailed in Section III below, so that there will be sufficient incentive for industry participants to invest in electronic recordkeeping technology.

The CFTC's proposal, while generally similar to the SEC rules, departs in a few critical areas. There are three issues of particular concern to FOC:

- (1) The CFTC's proposed rule maintains the requirement that trading cards and written orders be kept in hard copy for the entire five-year recordkeeping period. For FOC and many other FCMs, order tickets and trading cards comprise the bulk of their paper record storage volume. There will be little incentive or added efficiency to implement an electronic recordkeeping system if registrants are not permitted to store order tickets and trading cards on electronic media.
- (2) The CFTC's proposed rule, in many instances, demands that registrants provide an "immediate" response to requests for copies of records, indexes, audit system results, and other information. If the term "immediate" is construed literally (as "instantly"), these requirements impose an unwarranted burden upon the recordkeeper. If not construed so strictly, the

(..continued)

both the SEC and CFTC would be permitted to use a single set of recordkeeping procedures to fulfill recordkeeping obligations for both their securities and commodities businesses, and thus avoid inconsistent recordkeeping requirements.

term "immediate" is vague and open to debate. In either event, the Commission ought to be mindful that while electronic recordkeeping systems are very efficient, they still require some time and effort to locate and retrieve responsive documents and information.

- (3) The CFTC proposal would require copies of records to be provided on approved machine-readable media pursuant to CFTC Rule 15.00(1) (which defines the term, somewhat tautologically, as "data processing media approved by the Commission or its designee"), and that records must use a format and coding structure specified in the CFTC's request. This could be problematic from a technical standpoint when documents and images are scanned or other incompatibility issues exist.

Each of these issues will be discussed in turn below.

### III. COMMENTS ON SPECIFIC RULE PROPOSALS

#### A. Order Tickets and Trading Cards

The most objectionable aspect of the CFTC's electronic recordkeeping proposal is the continued requirement that trading cards and written orders be kept in hard copy for the entire five-year recordkeeping period. Order tickets and trading cards comprise the bulk of the paper record storage volume for FOC and many other FCMs. Put simply, if FCMs cannot use electronic technology to slay this paper dragon, there will be little incentive or added efficiency to implement an electronic recordkeeping system, and the benefits of the Commission's proposed rule will be lost.

The volume of paper orders and trading records that FOC is required to maintain is immense. Each day, FOC conducts several

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thousand transactions on the floors of the domestic futures exchanges. FOC stores the paper order tickets and trading cards in large document boxes, and then ships the boxes to an off-site warehouse. FOC usually fills at least two boxes with paper order tickets each day, about 1,800 order tickets per box. FOC stores trading cards in separate boxes, which are organized by the particular futures exchange involved in the transaction. FOC pays approximately a quarter-million dollars in off-site record storage costs each year.

As a large FCM, FOC is subject to repeated requests for documents from the Commission, SROs, and other agencies as a matter of routine oversight. FOC receives about 120 regulatory requests each month (averaging about five to six requests each business day). The nature and size of these regulatory requests varies. Requests may seek one order ticket or records for over one hundred orders; a typical request seeks records for about ten orders.

The costs to respond to a document request for order tickets often exceed the storage costs for the requested records. FOC must pay to retrieve the storage boxes from the off-site warehouse. FOC pays \$22.20 for the off-site warehouse to retrieve a document box and provide standard four-hour delivery (or \$37.95 for "rush" delivery in 90 minutes). FOC pays another \$22.20 to return the box to storage. Accordingly, if FOC receives a request for ten order tickets or trading cards in ten

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different boxes, it costs at least \$444 just to retrieve and return the boxes. A request for order tickets for a particular account during a one-month period, which entails pulling at least one box for each day of trading from storage (i.e., twenty to twenty-three boxes) costs FOC nearly a thousand dollars just to retrieve and return the record storage boxes.

FOC employs eight full-time records clerks and at least one direct supervisor in its records department, whose primary responsibility is to manage document requests from regulatory agencies and to search for records that are responsive to such requests. It can take hours to locate a particular order ticket in a box containing almost two thousand tickets.

Electronic recordkeeping would greatly enhance FOC's ability to respond to regulatory requests in a complete, timely, and less costly manner. While FOC would incur significant "up-front" costs to scan and index records into an electronic record management system, the subsequent savings in time and expense to locate and retrieve records would be substantial and well worth the initial investment.

The Commission has expressed concern that electronically stored handwritten order tickets and trading cards will not be as useful for audit and enforcement purposes. However, the evidentiary value of original order tickets and trading cards is less compelling than the Division of Enforcement may suggest. There is only one reported case in which the Division of

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Enforcement relied on the opinion of an expert document examiner concerning alleged alterations of order tickets to establish trade practice violations. In re Buckwalter, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,782 (Init. Dec. 1985), aff'd in part and rev'd in part, CCH ¶ 24,995 (1991). In Buckwalter, an FBI document examiner opined with "varying degrees of certainty" that certain order tickets were altered and that "there was an agreement between" handwriting on the order tickets and alleged forged signatures on account agreements. Id., (CCH) ¶ 22,782 at 31,267-68. Notably, the document examiner was unable to opine to a reasonable degree of scientific certainty that the handwriting on the account agreements to which he compared the handwriting on the order tickets was, in fact, prepared by the respondent. Id. at 31,266-67.

Given the tremendous cost and burden to store original hard copy order tickets, and the fact that, in 23 years, the Commission has issued only one reported opinion where the handwriting on an order ticket was in issue, FOC believes that the advantages of electronic record storage and retrieval far outweigh the benefits of hard copy storage. Electronic storage alleviates many of the security and retrieval problems inherent in the storage of a large volume of paper records. Paper documents are at greater risk of being misfiled, lost or destroyed. Boxes of documents stored in off-site warehouses are subject to fires, floods, and filing errors. Moreover, the



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search and retrieval of specified records from a warehouse of paper documents is more difficult and time-consuming than the search and retrieval from electronic media or microfiche, which may be more convenient to store and search on-site. Finally, the quality of reproductions from modern electronic storage media is superb. Differences in handwriting and time-stamps are clearly visible.<sup>4</sup>

In proposing recordkeeping amendments, the SEC initially expressed some concern about the use of electronic technology to preserve handwritten records or records containing handwritten text, primarily because from an examinations and enforcement standpoint, optical disk and microfilm/microfiche images arguably make it more difficult to detect forgery and alterations to handwritten text. In adopting the amendments, however, the SEC recognized that its experience since 1970 with the use of microfilm to store handwritten records has been positive. Moreover, few broker-dealers currently keep documents in hard copy or paper format, and many broker-dealers enter most orders directly through electronic systems rather than creating traditional order tickets. Accordingly, the SEC decided that allowing preservation of handwritten records in electronic

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<sup>4</sup> As an exhibit to its May 12, 1998 Petition, FOC submitted a sample original order ticket and a reproduction of the same order ticket, after it had been scanned onto CD-ROM and then downloaded and printed, which showed the exceptional quality of the electronic reproduction.

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storage media would not significantly increase the difficulty of detecting forgery or alterations. 62 Fed. Reg. at 6470-71.

Like the SEC, the Commission should permit CFTC registrants to store handwritten order tickets and trading cards on electronic media. With today's technology, the quality of electronic imagery and reproduction, the increased efficiency in retrieval and production, and the enhanced security of storing electronic media and duplicates, far outweigh any enforcement concerns about maintaining access to the original documents and carbons.

**B. The Practical Implications of "Immediate"**

The CFTC's proposal would demand "immediate" responses to a variety of regulatory requests for electronically stored documents and related indexes and other recordkeeping information. The proposed amendments to Rule 1.31 would require "immediate downloading" of indexes and records, Proposed Rule ("P.R.") 1.31(b)(1)(ii)(D); "immediate ascertain[ment]" of the location of any particular record, P.R. 1.31(b)(2)(v)(A); "immediate" provision of copies of records on approved machine-readable media, P.R. 1.31(b)(3)(i); and "immediate examination" of indexes, audit system results, written operation procedures and controls, and information necessary to access records and indexes, P.R. 1.31(b)(2)(v)(B), 1.31(b)(3)(ii)(A); 1.31(b)(3)(ii)(C); and 1.31(b)(3)(iii)(A). Alternatively, the

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NFA has suggested that registrants retrieve required records in usable form by the next business day. NPR, 63 Fed. Reg. at 30,671.

Even with technological improvements, the CFTC's proposed requirements for "immediate" productions and examinations, and the NFA's "next business day" retrieval, are impractical and unreasonable. Such a short and inflexible response time does not make any allowance for the realities of business and regulatory compliance, such as: review by in-house or outside counsel, the scope of the request (which could vary from one document to hundreds of documents), temporary personnel absences, technical difficulties, or the press of other business or pending regulatory requests. Such broad application of strict time standards is unprecedented. Immediate deadlines would require that all other activity stop if a regulatory request arrives at the door, in the mailbox, or on the fax machine.

If enacted, the CFTC's requirement for "immediate" response to all these regulatory requirements would be a violation waiting to happen.<sup>5</sup> The burden of responding instantly would be a huge deterrent to registrants who otherwise would seek to implement an electronic recordkeeping system.

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<sup>5</sup> To the extent that the CFTC's current rules require registrants "immediately" to provide hard copies of records stored on optical disk or microfilm/fiche, these existing requirements should be modified, as well.

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Notably, neither the existing nor the proposed Commission regulations, nor any CFTC cases or interpretations of which we are aware, define the meaning of "immediately" in terms of a precise timeframe. A 1981 CFTC Notice adopting revisions to the CFTC's recordkeeping and inspection rules includes a discussion of the obligation to furnish books and records "promptly," which is construed to mean "as expeditiously as reasonably can be expected" in light of the circumstances. 46 Fed. Reg. 21, at 21 & n.6 (Jan. 2, 1981). The Commission has recognized that:

[I]n practice a requirement to furnish copies **immediately** in all instances, depending upon the extent or nature of a staff request, could impose an **unwarranted burden** upon the recordkeeper.

Id. at 21 (emphasis added). Thus, the Commission distinguished the requirement to produce "promptly" records stored in hard copy from the recordkeeper's obligation "immediately" to provide a "facsimile enlargement" of records kept on microfilm, but did not elaborate on the practical meaning of "immediate." See id.; see also NPR, 63 Fed. Reg. at 30671.

FOC respectfully suggests that the Commission modify its proposed rule to apply a more reasonable "promptness" standard for production of **all** types of documents from **all** types of storage. This standard would require that requested documents be produced and requested information be made available "promptly," *i.e.*, "as expeditiously as reasonably can be expected" in light

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of the circumstances. Thus, where documents are stored electronically, it could reasonably be expected that they would be produced more expeditiously than hard copies of documents stored in off-site warehouses -- albeit not "instantly" or "immediately."

Indeed, many other agencies, SROs, the Federal Rules of Civil Procedure, and even the Commission's rules of practice for adjudicatory proceedings provide a more reasonable time for compliance with document requests and subpoenas than "immediately." Some examples:

- The SEC rules provide that electronic storage media "have the capacity to **readily** download indexes and records." 17 C.F.R. § 240.17a-4(f)(2)(ii)(D) (emphasis added). The SEC requires the results of the electronic recordkeeping audit system must be "**available**" for examination, and information necessary to access electronic records and indexes must be "provide[d] **promptly** upon request." Id. § 240.17a-4(f)(3)(v)(A)-(vi) (emphasis added). The SEC rules do **not** require that the location of any particular record stored on electronic media be immediately ascertained, nor that indexes, audit results, written operational procedures and controls, and all information necessary to access electronic records and indexes be available for immediate examination. Although the SEC requires that electronic recordkeepers "have available . . . facilities for immediate, easily readable projection or production," and "be ready at all times to provide, and immediately provide," requested facsimile enlargements of electronic records, in context, this requirement seems less burdensome than the CFTC's proposed production standards. Id. § 240.17a-4(f)(3)(i)-(ii).
- The New York Stock Exchange and other securities SROs comprising the Intermarket Surveillance Group have adopted uniform policies and procedures for ensuring timely responses by their members to requests for market surveillance information. The ISG requires all members to answer requests for customer and proprietary trading ("bluesheet") information within **ten business days** of the

date of the request. NYSE-INFM No. 88-44 (Dec. 30, 1988) (stating that all SROs will comply with the 10-day timeliness standard in NYSE Rule 410A).

- Similarly, the Chicago Board of Trade rules provide that clearing members must provide information and required records to the Board or its committees. The rules provide that if the requested documents are one year old or less, they must be produced within five business days, and if the requested documents are more than one year old and less than five years old, they must be produced within **ten business days**. CBOT Rule 545.01.
- Under the Federal Rules of Civil Procedure, a subpoena must "**allow a reasonable time for compliance**," or it must be quashed or modified. Fed. R. Civ. P. 45(c)(3)(A) (emphasis added). Courts have found that a "reasonable time" is more than one week. See Donoghue v. County of Orange, 848 F.2d 926, 931 (9<sup>th</sup> Cir. 1988); Mann v. University of Cincinnati, 824 F. Supp. 1190, 1202 (S.D. Ohio 1993) (ruling that one week's notice seeking disclosure of medical files was unreasonable), aff'd on other grounds, 152 F.R.D. 119 (S.D. Ohio 1993), 114 F.3d 1188 (1997).
- Document subpoenas may be issued in Commission adjudicatory proceedings only if the Administrative Law Judge is satisfied that the request "**is not unreasonable, oppressive, excessive in scope or unduly burdensome**." 17 C.F.R. § 10.68(a)(3) (emphasis added). See also id. § 10.68(c) (procedures providing up to seven days for persons to file motions to quash or modify a subpoena).
- Similarly, many federal agencies require persons within their jurisdictions to maintain and produce certain records, and permit a reasonable time for compliance with such record requests. For example, the Environmental Protection Agency has several recordkeeping and inspection provisions in connection with various pollution control statutes and regulatory schemes, which generally require persons to provide access to and copy records upon request "**at reasonable times**" or "**upon reasonable notice**." E.g., 42 C.F.R. §§ 1318, 6927(a), 6991d(a), 7414(a), 9604(e)(2) (emphasis added).

The CFTC rules should permit a reasonably prompt response time of at least ten days to produce records stored on electronic

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media. Otherwise, it is conceivable that recordkeepers could be required to respond more quickly to a routine regulatory request under Rule 1.31 than to a subpoena duces tecum in a Commission adjudicatory proceeding. Furthermore, the rules should permit registrants to request additional time to respond if the request requires production of voluminous documents or if other circumstances warrant an extension.

**C. Technical Compatibility Issues**

The CFTC proposal would require copies of records to be immediately provided on "approved machine-readable media" as defined in CFTC Rule 15.00(1), and would further require recordkeepers to use a format and coding structure specified in the CFTC's request. P.R. 1.31(b)(3)(i).

First, there is insufficient certainty or specificity to the Commission's proposed rule. CFTC Rule 15.00(1) defines the term "approved machine-readable media" as "data processing media approved by the Commission or its designee." Thus, registrants have little advance notice of whether a particular media is or will be approved by the Commission.

Moreover, under this proposal, the Commission could, for example, specify that documents be produced in an ASCII format. NPR, 63 Fed. Reg. at 30669 n.16. Such format specifications could be problematic from a technical standpoint when documents and images are scanned or other incompatibility issues exist.

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For example, document *images* may be stored in a "TIF" file format, which cannot be converted into an ASCII or similar text-based format that uses schemes for arranging bits in groupings of bytes.

To address these issues, the rules should permit (but not require) registrants to provide the requested documents in hard-copy reproductions that have been downloaded and printed from electronic storage media. At a minimum, registrants should be permitted to provide such paper reproductions if their electronic recordkeeping system is incompatible with the format requested by the Commission.

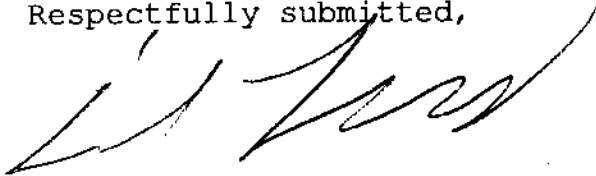
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Thank you for your consideration of these Comments. FOC would welcome the opportunity to work the Commission and staff to modify the proposed rules to accommodate the realities of business and technology. The goal ought to be the development of electronic recordkeeping procedures that are secure, reliable, and practical, so that the Commission and registrants will mutually benefit from the efficiencies of new technology without being unnecessarily deterred by unduly conservative regulatory requirements.



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Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. Barclay", written in a cursive style.

David J. Barclay  
General Counsel and  
Senior Vice President