

DCM Designation Memorandum

November 3, 2004

To: The Commission

From: The Division of Market Oversight
The Division of Clearing and Intermediary Oversight

Consulted: The Office of the General Counsel
The Division of Enforcement
The Office of Information Resources Management
The Office of the Chief Economist

Subject: Application of Chicago Climate Futures Exchange, LLC (“CCFE”) for Designation as a Contract Market pursuant to Sections 5 and 6(a) of the Commodity Exchange Act (“Act” or “CEA”) and Part 38 of Commission regulations.

Recommendation: Staff recommends that the Commission designate CCFE as a contract market, simultaneously approve CCFE’s proposed rules and issue the attached Order.

Responsible Staff: Jane H. Croessmann

I. Background of the Applicant.

By submissions dated September 10, 2004, through October 26, 2004, the Chicago Climate Futures Exchange, LLC (“CCFE” or “Exchange”), a Delaware limited liability company whose sole member (“Owner”) is the Chicago Climate Exchange, Incorporated (“CCX”), applied to the Commodity Futures Trading Commission (“Commission” or “CFTC”) for designation as a contract market for the automated trading of futures and options on futures contracts.¹ The

¹ Although the Commission is currently proposing to revise the presumption of automatic fast-track review of applications for contract market designation and replace it with the presumption that applicants be reviewed pursuant to the statutory 180-day review period (69 FR 53378, September 1, 2004), the CCFE application is being reviewed under the current fast-track procedures of Part 38 of the Commission’s regulations. The 60-day review period began on September 10, 2004, and concludes on November 9, 2004. If CCFE is designated on or before November 9, 2004, it will be the first contract market designated within the 60-day fast-track review period since implementation of the Commodity Futures Modernization Act of 2000.

Exchange anticipates that it would initially offer trading of futures on emissions allowances and offer options on these futures at some later date.

CCX, the sole limited liability company member of CCFE, has been operating as an exempt commercial market, utilizing the IntercontinentalExchange, Inc. (“ICE”) network architecture as its trading platform, since December, 2003.² CCFE’s electronic trading system (“CCFE Trading Platform”) will utilize the same network architecture operated by ICE, as is currently in use for the CCX exempt commercial market. The CCFE Trading Platform will have internet-based access and will be fully anonymous with orders executed impartially by the CCFE Trading Platform. The Exchange will permit block trades and exchange of futures for physical trades in accordance with the Exchange’s rules and procedures.

CCFE has contracted with The Clearing Corporation (“CCorp”), a registered derivatives clearing organization, to carry out clearing and settlement services for the Exchange. In furtherance of its SRO responsibilities for contracts traded on the CCFE trading system, the Exchange also has submitted CCorp rules that establish CCorp as the entity for clearing CCFE contracts.

The Exchange has contracted with the National Futures Association (“NFA”) to assist it in carrying out various self-regulatory responsibilities with respect to, among other things, market, trade practice and financial surveillance, investigative and disciplinary functions, and dispute resolution.

The Exchange has submitted to the Commission a description of its proposed electronic trading system, procedures and rules pertaining to CCFE governance, disciplinary and arbitration programs, trading standards, recordkeeping requirements, and various other materials to meet the

² CCFE notified the Commission of its intent to operate an exempt commercial market pursuant to Section 2(h)(3) of the Act on July 3, 2003. The Division of Market Oversight acknowledged receipt of the notification by letter dated September 9, 2003.

requirements for a board of trade seeking designation as a contract market. The Exchange has also submitted agreements that would establish (1) CCorp as the entity to clear and settle contracts traded on the Exchange, (2) the NFA as the entity to assist CCFE in carrying out self-regulatory responsibilities and (3) ICE as the network architecture provider for the CCFE's Trading Platform. In addition to submitting these written materials, CCFE has provided three demonstrations of CCFE operations at the Commission's Washington D.C. headquarters, at the CCFE office in Chicago and at the NFA office in Chicago on September 28th, September 30th and October 15th, 2004, respectively.

Current Commission policy is to release portions of new applications for contract market designation that have been determined not to cause competitive harm to the applicant nor regulatory concerns on the CFTC website for public comment.³ Those portions of the CCFE application have been posted on the Commission website since September 14th, 2004. No comments have been received regarding the CCFE application.

As set forth in Sections II and III of this memorandum, the CCFE application demonstrates compliance with the Commodity Exchange Act's ("Act") Section 5(b) Designation Criteria, Section 5(d) Core Principles, and Section 5c(b) Common Provisions regarding designation of contract markets and Part 38 of the Commission's regulations. Accordingly, staff recommends that the Commission designate CCFE as a contract market, simultaneously approve the following CCFE Rules: 101-159, 201-211, 301-310, 401-416, 501-520, 601-615, 701-721, 801-804, 901, 1001-1002; and 1101-1105; CCFE Block Trade and Exchange of Future for Physical Procedures; Large Trader Reporting Procedures and Error Trade Resolution Process and issue the attached Order.

³ See 69 FR 44981.

II. Analysis of CCFE’s Contract Market Application, Outsourcing Agreements with CCorp, NFA and ICE and Proposed Rules for Compliance with the Act’s Designation Criteria for Designation as a Contract Market

CONTRACT MARKET CRITERIA FOR DESIGNATION	CCFE PROPOSAL	STAFF ANALYSIS
<p>Sec. 5(a) Applications – “A board of trade applying to the Commission for designation as a contract market shall submit an application to the Commission that includes any relevant materials and records the Commission may require consistent with this Act.”</p>		<p>Acceptable.</p> <p>See Attachments.</p>
<p>Sec. 5(b) CRITERIA FOR DESIGNATION</p>		
<p>Designation Criterion 1 <i>In General</i> – “To be designated as a contract market, the board of trade shall demonstrate to the Commission that the board of trade meets the criteria specified in this subsection.”</p>		<p>Acceptable.</p> <p>See Attachments.</p>
<p>Designation Criterion 2 <i>Prevention of Market Manipulation</i> – “The board of trade shall have the capacity to prevent market manipulation through market surveillance, compliance, and enforcement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 1; CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004) at 1, 5, 6, 9, 10, 12, and 13; CCFE Appendix B-1C (Rulebook) Rule 603 (Market Manipulation or Demoralization) prohibits market manipulation and Chapter 7 (Discipline and Enforcement) Rules 705-721 outline CCFE discipline and enforcement procedures; CCFE Appendix B-3A (Large Trader Reporting Procedures); CCFE Appendix D-1 (Regulatory Services Agreement between CCFE and NFA); CCFE Appendix D-2A (CCFE Market Supervision Procedures); CCFE Appendix D-3 (NFA Compliance Manual for CCFE); and</p>	<p>Acceptable.</p> <p>CCFE will perform market surveillance using its own employees as well as the National Futures Association (NFA), a third-party compliance service provider. The CCFE will be ultimately responsible for enforcing disciplinary rules designed to deter abuses.</p> <p>Employees of the Applicant will conduct real-time monitoring of trading with the assistance of the CCX Help Desk. The CCX help desk (run by ICE) will provide technical support when needed by the CCFE (e.g., take users out of the system, stop trading, etc.).</p> <p>CCFE has contracted with the NFA to provide market and trade-practice surveillance and ongoing surveillance of the financial and operational status of Trading Privilege Holders (“TPHs”). On a T+1 basis, NFA will receive large-trader data and detailed audit-</p>

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	<p>NFA demonstration of trade practice and market surveillance on 09/30/04.</p>	<p>trail data. NFA has established procedures designed to reconstruct trading and to reveal the commission of various trading abuses. The prevention of price manipulation will be accomplished by analyzing positions of large traders, deliverable supplies, and futures and cash prices. NFA will refer any instances of trading abuses or market threats to CCFE for action.</p> <p>The Review Panel, Disciplinary Panel, and Appeals Panel of the CCFE will enforce compliance with the Rules in conjunction with the surveillance services provided by the NFA.</p>
<p>Designation Criterion 3 <i>Fair and Equitable Trading</i> – “The board of trade shall establish and enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and [sic] the capacity to detect, investigate, and discipline any person that violates the rules. The rules may authorize – (A) transfer trades or office trades; (B) an exchange of futures – (i) futures in connection with a cash commodity transaction; (ii) futures for cash commodities; or (iii) futures for swaps; or (C) a futures commission merchant, acting as principle or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded or cleared in accordance with the rules of the contract market or a derivatives clearing organization”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 2. CCFE Appendix A-9 (Responses to Commission Staff’s Questions of October 8, 2004); CCFE Appendix B-1C (Rulebook) Chapter 4 (Trading Procedures and Standards), Chapter 5 (Obligations of TPHs), Chapter 6 (Business Conduct Rules), and Chapter 7 (Discipline and Enforcement); CCFE Appendix C-1A (Description of Electronic Trading and Clearing Systems); CCFE Appendix C-4 (CCFE Trading Platform Access Procedures); CCFE Appendix D-1 (Regulatory Services Agreement between CCFE and NFA); and CCFE Appendix D-3 (NFA Compliance Manual for CCFE).</p>	<p>Acceptable.</p> <p>CCFE has established and will enforce trading rules to ensure fair and equitable trading. All TPHs and Authorized Traders (“ATs”) (collectively, “Participants”) will have equal access to the CCFE Trading Platform, including information regarding prices, bids and offers. Orders will be executed impartially by the CCFE Trading Platform (trade-matching algorithm based on price/time priority) in accordance with the principles set forth in Chapter 4 of the CCFE Rulebook and procedures included in the CCFE Description of Electronic Trading And Clearing Systems (Appendix C-1). Under Rule 614, pre-arranged trades that are not expressly permitted (i.e., EFPS and Block Trades – Rules 411 and 412 respectively) will be prohibited.</p> <p>As its designated Compliance Service Provider, the NFA will perform trade practice and market surveillance and investigative and enforcement functions. The NFA will maintain procedures to detect, investigate and enforce against abuses such as trading ahead, wash trading, money passing, accommodation trades, and other types of market</p>

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		manipulation or fraud.
<p>Designation Criterion 4 Trade Execution Facility – “The board of trade shall (A) establish and enforce rules defining, or specifications detailing, the manner of operation of the trade execution facility maintained by the board of trade, including rules or specifications describing the operation of any electronic matching platform; and (B) demonstrate that the trade execution facility operates in accordance with the rules or specifications.”</p>	<p>CCFE Appendix A-2 (Responses to Commission Staff’s Questions of August 19, 2004); CCFE Appendix C-1A (Description of Electronic Trading and Clearing Systems); CCFE Appendix C-2 (Licensing and Services Agreement between ICE and CCFE); CCFE Appendix C-4 (CCFE Trading Platform Access Procedures); CCFE Appendix C-5 (ICE Security Architecture); CCFE Appendix C-6 (ICE Human Resources and Employee Screening Policy); CCFE Appendix C-7 (ICE Disaster Recovery Overview); CCFE Appendix C-8 (Pass/Fail Checklist from an August 14, 2004 System Test); CCFE Appendix C-9 (ICE SAS 70 Type II report (Independent Service Auditors Report)); and CCFE Appendix C-10 (ICE Change Management Process).</p>	<p>Acceptable.</p> <p>CCFE will use the ICE electronic trading platform. The ICE trading platform has a demonstrated track record for reliably implementing and presenting a trading environment that operates in accordance with its procedures. A key component of their development methodology that ensures compliance with Exchange procedures is the use of a Marketing Requirements Specification phase at the front-end of the system development life cycle.</p> <p>CCFE has provided extensive documentation regarding the development, operation, and maintenance of their electronic trade execution facility. That documentation includes system architecture diagrams and descriptions, security features and procedures, system development life cycle procedures and management, testing procedures, capacity planning practices, disaster recovery plans, and help desk procedures. CCFE also provided a recent favorable audit report performed by an independent service auditor.</p> <p>CCFE will use the same trading engine and data center facilities as is currently used by ICE. The Commission conducted an on-site review of the ICE data center on October 18, 2004 as part of the designation review for CCFE. That on-site review confirmed that the system and its supporting infrastructure, the testing of the system, the staff and operational control facilities supporting the operation, and the physical security and environmental controls provided by the ICE facilities, are acceptable.</p> <p>All technical and operational information obtained by</p>

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		staff supports a conclusion that CCFE’s proposed electronic trading system would comply with the IOSCO principles for screen-based trading.
<p>Designation Criterion 5 <i>Financial Integrity of Transactions</i> – “The board of trade shall establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into by or through the facilities of the contract market, including the clearance and settlement of the transactions with a derivatives clearing organization.”</p>	<p>CCFE Appendix B-1C (Rulebook) Rules: 304 (Eligibility for Trading Privileges), 503 (Minimum Financial and Related Reporting Requirements for Registrants), 504 (Minimum Financial and Related Reporting Requirements for Non-Registrants), 506 (Treatment of Customer Funds and Securities), 507 (Additional Minimum Financial Requirements), and 515 (Customer Margin); CCFE Appendix E-1 (Clearing Services Agreement between CCFE and The Clearing Corporation (CCorp)); CCFE Appendix D-1 (Regulatory Services Agreement between CCFE and NFA); and CCFE Appendix A-4 (Responses to Commission Staff’s Questions of September 17, 2004).</p>	<p>Acceptable.</p> <p>CCFE has entered into a Clearing Service Agreement with CCorp, a Commission-registered DCO. CCorp will provide all clearing services for the contracts traded on CCFE. CCFE Rule 304 requires all TPHs to be either Clearing Members, or, if not, to have in place a financial guarantee from a Clearing Member. Thus, each transaction will be entered by, or guaranteed by, a Clearing Member of CCorp. A TPH’s right to trade on CCFE will be automatically suspended if the guaranteeing Clearing Member revokes its guarantee.</p> <p>CCFE Rules 503 and 504 require Clearing Members and TPHs to comply with minimum financial requirements and all related recordkeeping requirements. The minimum financial requirements for FCMs, which would apply here since all trades will be cleared by FCM Clearing Members, are set forth in Commission Regulation 1.17. Moreover, CCorp will require Clearing Members clearing trades on CCFE to maintain a minimum adjusted net capital of \$7.5 million. Pursuant to the Regulatory Services Agreement between NFA and CCFE, NFA will monitor compliance with minimum financial requirements. NFA daily will monitor ratios indicative of financial state and pays and collects, among other things. CCFE Rule 507 allows CCFE to impose additional minimum financial requirements on TPHs and Clearing Members.</p> <p>CCorp will establish margin requirements for Clearing Members clearing CCFE contracts. CCFE Rule 515 provides that margin requirements for customers of</p>

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		<p>TPHs will be determined by CCFE for each separate contract. Margin requirements will be approximately the greater of 6% of the notional value of the underlying front contract month or the contract's measure of historic price volatility (the largest 99% confidence level in a close-to-close statistical price analysis over periods of 30, 90, and 125 days.) Cash market data regarding emission allowance prices needed in calculating volatility can be obtained from various public daily publications. Margin requirements will be monitored to ensure that they cover at least daily price movements for the contract being margined. Margin will be increased automatically when the contract being margined has a price move of 100% or more of the margin requirement. If the price move equals the daily price limit then the margin will increase by 150%. Margin requirements will at first be equal to almost two day's worth of daily price limit moves. Additional margin will be collected based on product concentration and exposure thresholds. CCFE represents that it and CCorp will work with each other to coordinate the margin requirements for CCFE contracts.</p> <p>CCorp's current established rules covering default fund contributions will apply generally to Clearing Members with respect to clearing contracts traded on CCFE. All Clearing Members clearing contracts executed on CCFE will be required to maintain a \$200,000 minimum contribution to the CCorp's Guaranty Fund. This is in addition to the adjusted net capital requirement. This is also in addition to default fund contributions made with respect to the clearing of contracts traded on other exchanges that are cleared by CCorp. i.e., if a clearing member clears both Eurex US contracts and CCFE contracts, its initial minimum contribution to the Guaranty Fund will be \$400,000. However, the minimum required aggregate balance for the Guaranty Fund is 5% of the maximum daily risk</p>

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		<p>margin requirements of all Clearing Members combined. A description of the calculation of this minimum Guaranty Fund balance is set forth in Application Appendix A-4, Question 2. CCorp’s current Guaranty Fund balance is almost 22 times that required by the formula.</p> <p>CCFE Rule 506 requires TPHs and Clearing Members to comply with all Commission Regulations regarding the segregation of customer funds. These requirements are set forth in Commission Regulations 1.20., et.al..</p>
<p>Designation Criterion 6 <i>Disciplinary Procedures</i> – “The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 3. CCFE Appendix B-1C (Rulebook) Chapter 7 (Discipline and Enforcement), Chapter 3 (Membership and Trading Privileges), Chapter 5 (Obligations of TPHs), Chapter 6 (Business Conduct), and Chapter 9 (Reconsideration of Denial of Trading Privileges); CCFE Appendix D-1 (Regulatory Services Agreement between CCFE and NFA); and CCFE Appendix D-3 (NFA Compliance Manual for CCFE).</p>	<p>Acceptable. CCFE disciplinary procedures are consistent with Commission regulations and interpretive guidance regarding core principles.</p> <p>The Exchange has established its own disciplinary program, which will be implemented with the assistance of the NFA, its Regulatory Service Provider. Chapter 7 of the Rulebook (Discipline and Enforcement) describes the Exchange’s powers, types of preliminary inquiries and investigations, and the procedures for disciplinary actions brought by the Exchange and appeals. Rule 701 provides that a TPH, AT or either of their agents and any other Person within the Exchange’s jurisdiction who is alleged to have violated, or aided and abetted a violation of, any provision of the CEA, Commission Regulations thereunder, or any rule of the Exchange shall be subject to the disciplinary jurisdiction of the Exchange and be subject to sanctions including expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from using Trading Privileges, or any other fitting sanction. This authority extends to employees of TPHs and to former TPHs who committed violations while within the Exchange’s</p>

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		<p>jurisdiction.</p> <p>The procedures include the indicia of due process in that the subjects of any inquiry, investigation or disciplinary proceeding have the right to notice, the right to respond, the right to counsel, the right to challenge the make up of hearing panels (in certain circumstances and for specified reasons), and the right to appeal, among other rights.</p> <p>The NFA can initiate an inquiry either on its own or at the suggestion of the Exchange, but NFA requires the Exchange’s consent to open a full investigation. Likewise, at the conclusion of an investigation, the NFA prepares a report of investigation summarizing its findings and recommending a course of action. This report is presented to the Market Regulation Department of the Exchange and then to a disciplinary review panel, which will determine whether or not to initiate a disciplinary proceeding and on what charges. If a hearing is held, the Market Regulation Department may delegate its prosecutorial function to the NFA, as its regulatory service provider. A disciplinary panel of the exchange, consisting of 5 TPHs will conduct a hearing on the charges.</p>
<p>Designation Criterion 7 <i>Public Access</i> – “The board of trade shall provide the public with access to the rules, regulations, and contract specifications of the board of trade.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 3.</p>	<p>Acceptable.</p> <p>The Applicant states that the Rulebook, all amendments thereto and notices and policies thereunder, as well as the specifications for all contracts traded on CCFE, will be publicly available on CCFE’s website. In addition, CCFE will notify TPHs of any new or modified Rules of CCFE and any other relevant information.</p>
<p>Designation Criterion 8 <i>Ability to Obtain Information</i> – “The board of trade shall establish</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core</p>	<p>Acceptable.</p>

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<p>and enforce rules that will allow the board of trade to obtain any necessary information to perform any of the functions described in this subsection, including the capacity to carry out such international information-sharing agreements as the Commission may require.”</p>	<p>Principles) at 4. CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004) at 7; CCFE Appendix B-1C (Rulebook) Rules 211 (Regulatory Cooperation), 501 (Books and Records), 502 (Inspection and Delivery), and 702 (Inquiries and Investigation); and CCFE Appendix D-1 (Regulatory Services Agreement between CCFE and NFA).</p>	<p>Clearing members and TPHs would be required to make their books and records available for inspection by, and deliver copies thereof as requested by, CCFE upon request. The Division of Market Regulation would have the authority to inspect and request books and records and to request testimony regarding any possible violation of the Rules of the Exchange.</p> <p>CCFE represents that it intends to become a party to the International Information Sharing Memorandum of Understanding and Agreement of March 15, 1996 (Boca Declaration).</p> <p>Further, Rule 211 provides that CCFE may become a party to other relevant information-sharing agreements to assure that it has access to surveillance, investigative, and enforcement data and other information relevant to its self-regulatory programs.</p>

III. Analysis of CCFE’s Contract Market Application, Outsourcing Agreements with CCorp, NFA and ICE and Proposed Rules for Compliance with the Act’s Core Principles for Designation as a Contract Market.

CONTRACT MARKET CORE PRINCIPLES	CCFE PROPOSAL	STAFF ANALYSIS
<p>Sec. 5c(b) Common Provisions Applicable to Registered Entities (1) In General – “A contract market or derivatives transaction execution facility may comply with any applicable core principle through delegation of any relevant function to a registered futures association or another registered entity.” (2) Responsibility – “A contract market or derivatives transaction execution facility that delegates a function under paragraph (1) shall remain responsible for carrying out the function.”</p>		<p>Acceptable.</p> <p>CCFE would remain responsible for compliance with those designation criteria and core principles for which relevant functions would be contracted out.</p>
<p>SEC. 5c(c) NEW CONTRACTS, NEW RULES, AND RULE AMENDMENTS – (1) In General – Subject to paragraph (2), a registered entity may elect to list for trading or accept for clearing any new contract or other instrument, or may elect to approve and implement any new rule or rule amendment, by providing to the Commission (and the Secretary of the Treasury, in case of a contract for sale of a government security for future delivery (or an option on such a contract) or a rule or rule amendment specifically related to such a contract) a written certification that the new contract or instrument or clearing of the new contract or instrument, new rule, or rule amendment complies with this Act (including regulations under this Act). (2) Prior Approval – (A) In General – A registered entity may request that the Commission grant prior approval to any new contract or other instrument, new rule, or rule amendment.</p>		<p>Acceptable.</p> <p>CCFE has requested that the Commission approve its proposed rules (including the proposed Rulebook and Policies and Procedures), in connection with its designation as a contract market. The Divisions recommend such approval pursuant to Section 5c(c)(2)(A) of the Act, since the Policies and Procedures and Rulebook do not violate any provision of the Act or the Commission's regulations.</p>

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<p>Core Principle 1 <i>In General</i> – “To maintain the designation of a board of trade as a contract market, the board of trade shall comply with the core principles specified in this subsection. The board of trade shall have reasonable discretion in establishing the manner in which it complies with the core principles.”</p>		<p>Acceptable.</p>
<p>Core Principle 2 <i>Compliance with Rules</i> – “The board of trade shall monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market.”</p>	<p>CCFE Appendix B-1C (Rulebook), Rules 202 (Certain Powers of the Board), and 210 (Conflicts of Interest), Chapter 7 (Discipline and Enforcement), Chapter 9 (Reconsideration Regarding Denial of Trading Privileges), and Rule 404(e) (Contents of Order); CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004); CCFE Appendix D-3 (NFA Compliance Manual for CCFE); CCFE Appendix D-2A (CCFE Market Supervision Procedures).</p>	<p>Acceptable.</p> <p>CCFE has contracted with NFA to operate its large-trader market surveillance, trade practice surveillance, and financial surveillance programs. The NFA currently performs similar functions for Eurex US (USFE) and HedgeStreet. CCFE Market Regulation staff and the CCX Help Desk will perform market supervision and real-time monitoring of the market.</p> <p>The NFA has established procedures to detect violations and various trading abuses, including the ability to monitor for price manipulations and to monitor large trader positions, deliverable supplies, and futures and cash prices. The NFA has sufficient staff and resources, including its automated surveillance system, to detect and investigate potential rule violations. The NFA has established procedures for regularly reviewing exception reports and utilizing user profiles.</p> <p>The CCFE trading system will automatically create a full and accurate record of all bids and orders entered into the system, all matched trades, and all other entries into the trading system, including orders that do not result in executions. Details of all entries into the trading system, including date and time of such entries and the user ID of the user making the entry, are captured and loaded into an electronic transaction history database.</p>

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		<p>The NFA will have real-time view access to the CCFE’s supervision screens and will receive complete audit trail data for surveillance purposes on a T+1 basis.</p> <p>The CCFE and the NFA have established appropriate procedures to promote the fairness of investigations and to ensure appropriate, thorough, and timely investigative analysis. The CCFE and the NFA also have established acceptable procedures, clear and fair standards, and reasonable timelines for both summary and non-summary disciplinary actions.</p>
<p>Core Principle 3 <i>Contracts Not Readily Subject to Manipulation</i> – “The board of trade shall list on the contract market only contracts that are not readily susceptible to manipulation.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 5.</p>	<p>Acceptable.</p> <p>The Applicant states that trading on or through the CCFE will be limited to futures or options on futures that are not readily susceptible to manipulation. Although CCFE has indicated that they intend to initially trade futures on emission allowances, the Exchange did not submit any specific contracts with its contract market application. CCFE intends to submit contract terms and conditions after it has been approved as a contract market. The Applicant anticipates that most contracts will be listed by self-certification under Commission Regulation § 40.2.</p>
<p>Core Principle 4 <i>Monitoring of Trading</i> – “The board of trade shall monitor trading to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 1; CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004) at 1-2, 7, and 9-11; CCFE Appendix B-3A (Large Trader Reporting Procedures); CCFE Appendix D-1 (Regulatory Services Agreement</p>	<p>Acceptable.</p> <p>CCFE has contracted with the NFA to provide for market monitoring on an on-going basis. The NFA will receive large-trader data on a T+1 basis. NFA has established procedures designed to carry out an adequate surveillance program, including the detection and prevention of price manipulation through the analyses of large-trader data, deliverable supplies, and</p>

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	<p>between CCFE and NFA); CCFE Appendix D-3 (NFA Compliance Manual for CCFE); and CCFE/NFA demonstration of trade practice and market surveillance on 09/30/04.</p>	<p>futures and cash prices. NFA will refer any instances of market threats or abuses and problems with the delivery/settlement process to CCFE for action.</p>
<p>Core Principle 5 <i>Position Limitations or Accountability</i> – “To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the board of trade shall adopt position limitations or position accountability for speculators, where necessary and appropriate.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 5-6; CCFE Appendix B-1C (Rulebook) Rules: 408 (Reportable Positions) and 409 (Position Limits); CCFE Appendix B-3A (Large Trader Reporting Procedures); CCFE Appendix D-1 (Regulatory Services Agreement between CCFE and NFA); CCFE Appendix D-1, Schedule A (Scope of Regulatory Services); and CCFE Appendix D-3 (NFA Compliance Manual for CCFE).</p>	<p>Acceptable.</p> <p>Position limits would be established in rules and contract specifications of CCFE futures and options contracts. Those contracts are not included in the CCFE contract market application. CCFE Rule 409 provides for aggregation standards, and exemptions from position limits for bona fide hedging positions.</p> <p>The Commission should remind the Exchange that position limits or position accountability provisions should be included with the Exchange’s filing to the Commission in connection with the listing of futures and option contracts submitted under the Commission’s certification or approval procedures.</p>
<p>Core Principle 6 <i>Emergency Authority</i> – “The board of trade shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, where necessary and appropriate, including the authority to – “(A) liquidate or transfer open positions in any contract; (B) suspend or curtail trading in any contract; and (C) require market participants in any contract to meet special margin requirements.”</p>	<p>CCFE Appendix B-1C (Rulebook) Rules: 132 (Definition of Emergency), 210 (Conflicts of Interest), and 415 (Emergencies).</p>	<p>Acceptable.</p> <p>The President (or the President’s designee approved by the Board) has the authority to place into immediate effect temporary rules. Among other actions, the President could order the liquidation of contracts, the fixing of the settlement price or liquidation-only trading, suspend or limit trading, extend/shorten the expiration date or month, extend the time of delivery or change delivery points and/or the means of delivery, modify trading hours, impose position or price limits, require market participants to meet special margin requirements, or modify or suspend the rules of the Exchange of the Clearing Corporation. <i>See infra</i> Core Principle 15 (Conflicts of Interest) for further</p>

CONTRACT MARKET CORE PRINCIPLES	CCFE PROPOSAL	STAFF ANALYSIS
		<p>discussion regarding conflicts of interest in decision-making.</p> <p>The President (or the President’s designee approved by the Board) could also take various actions in response to physical emergencies, which would include any circumstance that could have a severe or adverse effect upon physical functions.</p>
<p>Core Principle 7 <i>Availability of General Information</i> – “The board of trade shall make available to market authorities, market participants, and the public information concerning – (A) the terms and conditions of the contracts of the contract market; and (B) the mechanisms for executing transactions on or through the facilities of the contract market.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 3; CCFE Appendix B-1C (Rulebook) Rules 310 (Notices), Chapter 4 (Trading Procedures and Standards), and Rules 503-507 dealing with Financial Requirements; and CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004) at 7.</p>	<p>Acceptable.</p> <p>The Applicant states that the Rulebook, all amendments thereto and notices and policies thereunder, as well as the specifications for all Contracts traded on CCFE, will be publicly available on CCFE’s website. In addition, CCFE will notify TPHs of any new or modified Rules of CCFE and any other relevant information.</p> <p>CCFE states that it intends to become a party to the International Information Sharing Memorandum of Understanding and Agreement of March 15, 1996 (Boca Declaration).</p>
<p>Core Principle 8 <i>Daily Publication of Trading Information</i> – “The board of trade shall make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 6; Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004) at 3; and CCFE Trading System and Compliance Presentation on 9/30/04</p>	<p>Acceptable.</p> <p>CCFE states that it will publish information regarding settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on a timely basis on its website and through one or more market data vendors. CCFE market data will be disseminated from the CCFE trading platform to the International Petroleum Exchange (IPE), a wholly owned subsidiary of the ICE. IPE will then distribute to data vendors CCFE’s market data through its quote vendor feed. CCFE verbally noted that all data will be marketed under CCFE’s name. Like CCFE, IPE uses</p>

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		ICE’s trading platform.
<p>Core Principle 9 <i>Execution of Transactions</i> – “The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 6; CCFE Appendix B-1C (Rulebook) Rules 403 – 405 regarding Handling and Matching of Orders, and 412 (Block Trading); CCFE Appendix A-2 (CCFE Responses to Commission Staff’s Questions of August 19, 2004); CCFE Appendix C-1A (Description of Electronic Trading and Clearing Systems); CCFE Appendix C-2 (Licensing and Services Agreement between ICE and CCFE); CCFE Appendix C-4 (Trading Platform Access Procedures); CCFE Appendix C-5 (ICE Security Architecture); CCFE Appendix C-6 (ICE Human Resources and Employee Screening Policy); CCFE Appendix C-7 (ICE Disaster Recovery Overview); CCFE Appendix C-8 (Pass/Fail Checklist from an August 14, 2004 System Test); CCFE Appendix C-9 (ICE SAS 70 Type II report (Independent Service Auditors Report)); and CCFE Appendix C-10 (ICE Change Management Process).</p>	<p>Acceptable.</p> <p>The contract market will operate in an open and competitive manner. CCFE has provided sufficient documentation and other information for Commission staff to conclude that the CCFE electronic trading system would provide for open, competitive and efficient trading.</p> <p>Orders will be entered into the CCFE Trading Platform in accordance with the procedures set forth in rules 403 and 404 and executed impartially in accordance with the procedures (trade-matching algorithm based on price/time priority) referred to in Rule 405.</p> <p>CCFE will allow for block trades. It will not include the minimum block trade size in its contract specifications. Similar to what other exchanges have done, CCFE will publish its minimum block trade volume level in a notice and post it on its website. CCFE will create a standard Block Trade Confirmation form that will require various aspects of a block trade, e.g., contract, delivery month, quantity, price and, if an option block trade, call or put indication and strike price.</p> <p>The proposed system is currently in use by ICE and IPE, so it is of proven production quality. For changes required to support new interfaces or functionality, sufficient tests have been run to validate success in implementation. Projected system capacity and performance goals have been accommodated in the sizing of the system. Because of the extensible system architecture, adding additional capacity would be relatively easy.</p>

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		<p>The applicant’s testing methodology shows a high level of maturity as evidenced by their use of best practices such as requirements documentation, written test plans, automated testing, automated support for configuration management and issue tracking, and multiple stages of quality assurance reviews.</p> <p>The most recent independent audit of the system shows that the following control objectives are deemed adequate and are in fact operating properly so as to provide the desired outcomes:</p> <ul style="list-style-type: none"> • Protection against unauthorized access • Assurance that data is backed up and validated • Changes to applications are authorized, tested, approved, properly implemented, and documented • Trading rules are properly implemented • Clearing is performed accurately and anonymously • Confirmation reports are accurate, complete, and timely • Trade-matching is accurate, complete, secure, and timely <p>The Commission conducted an onsite review of the data center on October 18, 2004. That review confirmed that all security, reliability, and operational aspects of the data center meet the objectives of the relevant IOSCO principles. The data center is currently in production for ICE and the operations staff is experienced at managing equipment supporting high volume trading.</p>
<p>Core Principle 10 Trade Information – “The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all</p>	<p>CCFE Appendix B-1C (Rulebook) Rules 404 (Order Types and Characteristics), and 403 (Handling of Orders);</p>	<p>Acceptable.</p> <p>Each order must include the originator of the Order</p>

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<p>identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.”</p>	<p>CCFE Appendix C-1A (Description of Electronic Trading and Clearing Systems); CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004); and CCFE Appendix D-3 (NFA Compliance Manual for CCFE).</p>	<p>(including the User Information of the TPH by or on behalf of which the Order is being placed, and an identifier of the Authorized Trader placing the Order), the Contract, the Delivery Month, the bid or ask price, the Order type, the quantity, an account number or identifier, the applicable Customer type indicator under Commission Regulations, and an origin code (showing whether the Order is for the TPH’s house clearing account or the Customer or Non-customer clearing account with the Clearing Service Provider). Orders for Options on Futures must also include the strike price and whether the Order is a call or a put. The CCFE Trading Platform will not accept any Order that does not comply in full with the foregoing requirements.</p> <p>The trading system would automatically capture all details of each trade in a comprehensive electronic audit trail. All activity within the trading system would be stored for a period of five years in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss.</p> <p>The NFA computer surveillance systems would enable NFA to reconstruct cleared market transactions on a T+1 basis and to sort all transaction history data as desired.</p>
<p>Core Principle 11 <i>Financial Integrity of Contracts</i> – “The board of trade shall establish and enforce rules providing for the financial integrity of any contracts traded on the contract market (including the clearance and settlement of the transactions with a derivatives clearing organization), and rules to ensure the financial integrity of any futures commission merchants and introducing brokers and the protection of customer funds.</p>	<p>CCFE Appendix B-1C (Rulebook) Rules: 304 (Eligibility for Trading Privileges), 503 (Minimum Financial and Related Reporting Requirements for Registrants), 504 (Minimum Financial and Related Reporting Requirements for Non-Registrants), 506 (Treatment of Customer Funds and Securities), 507 (Additional Minimum Financial Requirements), and 515 (Customer Margin); CCFE Appendix E-1 (Clearing Services Agreement</p>	<p>Acceptable. <i>See generally</i> Designation Criteria #5, above.</p> <p>CCorp will provide clearing services for CCFE. CCFE Rule 304 requires all TPHs to be either Clearing Members or have in place a financial guarantee from a Clearing Member.</p> <p>Clearing Members and TPHs must comply with</p>

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	<p>between CCFE and Ccorp); CCFE Appendix D-1 (Regulatory Services Agreement between CCFE and NFA); and CCFE Appendix A-4 (Responses to Commission Staff's Questions of September 17, 2004).</p>	<p>minimum financial requirements CCFE Rules 504 and 503. Minimum financial requirements are set forth in Commission Regulation 1.17. CCorp Clearing Members must maintain a minimum \$7.5 million adjusted net capital. NFA will monitor compliance with minimum financial requirements and ongoing financial health of clearing members on a daily basis. CCFE may impose additional minimum financial requirements (Rule 507).</p> <p>Clearing Members must maintain a \$200,000 minimum contribution to the CCorp's Guaranty Fund. This is in addition to the adjusted net capital requirement and to the default fund contributions made with respect to clearing contracts traded on other exchanges cleared by CCorp. However, the minimum required aggregate balance for the Guaranty Fund in total is 5% of the maximum daily risk margin requirements of all Clearing Members combined.</p> <p>CCorp will establish margin requirements for Clearing Members and CCFE will establish margin requirements for customers. Margin must at least equal the greater of 6% of the underlying front contract month or the measure of price volatility of the contract. In any event, margin levels must cover at least daily price movements for the contract being margined. Margin will increase additionally if price moves are a certain percentage of required margin. Margin requirements at the outset of operations will equal an almost a 2-day limit move to account for the expected high volatility of the traded contracts. Additional margin will be collected based on product concentration and exposure levels.</p> <p>CCFE Rule 506 requires TPHs and Clearing Members to comply with all Commission Regulations regarding the segregation of customer funds.</p>

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<p>Core Principle 12 Protection of Market Participants – “The board of trade shall establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants.”</p>	<p>CCFE Appendix B-1C (Rulebook) Rules 10 (Applicable Law), 209 (Confidentiality), 308 (Application of Rules and Jurisdiction), 403 (Handling of Orders), 404 (Order Types and Characteristics), 405 (Matching of Orders), 406 (Average Price System), 407 (Errors of TPHs), Rules 411 (Exchange of Future for Physical), 412 (Block Trading), 413 (Transfer of Position), 501 (Books and Records), 601 (Fraudulent Acts), 604 (Adherence to Law), 605 (Sales Practice), 607 (Use of Trading Privileges), 608 (Acts Detrimental to the Exchange), 609 (Supervision), 610 (Priority of Customers’ Orders), 611 (Trading Against Customer Orders), 612 (Withholding Orders), and 613 (Disclosing Orders); CCFE Appendix D-1 (NFA Regulatory Agreement between CCFE and NFA), Schedule A; CCFE Appendix D-3 (NFA Compliance Manual for CCFE); CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004); and CCFE Appendix D-2A (CCFE Market Supervision Procedures).</p>	<p>Acceptable.</p> <p>TPHs handling customer orders are required to exercise due diligence in the handling and execution of such orders. Wash trades and, except as specifically provided for in the CCFE’s rules, pre-arranged trades are prohibited. Fraudulent acts and manipulations are prohibited, as is conduct inconsistent with just and equitable principles of trade.</p> <p>The CCFE has contracted with the NFA to assist in carrying out self-regulatory responsibilities with respect to trade practice surveillance.</p> <p>The NFA will use an automated system to provide such surveillance. The NFA would monitor for, among other things, trading ahead of customers (direct and indirect), front running, direct and indirect crossing, taking the other side (direct and indirect), prearranged trading, wash trading, money passing (direct and indirect), counterparty trade percentages, marking the close, error account and transfer trade activity, and off-exchange transactions.</p> <p>The NFA will also review trader profiles to detect aberrations from a trader’s normal pattern of trading.</p>
<p>Core Principle 13 Dispute Resolution – “The board of trade shall establish and enforce rules regarding [sic] and provide facilities for alternative dispute resolution as appropriate for market participants and any market intermediaries.”</p>	<p>CFE Appendix A-1 (Chart Demonstrating Compliance with Core Principles and Designation Criteria for Contract Markets) at 6; CCFE Appendix B-1C (Rulebook): Chapter 8 (Arbitration), and NFA Code of Arbitration and NFA Member Arbitration Rules (incorporated by reference).</p>	<p>Acceptable.</p> <p>Arbitration will be carried out in accordance with NFA’s arbitration rules. Any dispute, claim or controversy involving customers will be conducted in accordance with NFA Code of Arbitration (provided that a customer shall not be subject to arbitration</p>

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		<p>without the customer’s prior written consent in accordance with Commission Regulation 166.5(c)). All other disputes, claims or controversies will be conducted in accordance with NFA Member Arbitration Rules.</p>
<p>Core Principle 14 Governance Fitness Standards – “The board of trade shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other persons with direct access to the facility (including any parties affiliated with any of the persons described in this paragraph).”</p>	<p>CCFE Apendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 8; CCFE Appendix B-1C (Rulebook) Rule 206 (Eligibility); CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004); CCFE Appendix A-11 (Responses to Commission Staff’s Questions of October 21, 2004); CCFE Appendix A-12 (Responses to Questions)</p>	<p>Acceptable.</p> <p>CCFE Rule 206 incorporates fitness standards contained in Commission Regulation § 1.63.</p> <p>CCFE will determine the fitness of each prospective member of the Board, any Review Panel, any Disciplinary Panel, Appeals Panel or any other disciplinary committee, arbitration panel or oversight panel of the Exchange as defined in Regulation § 1.63, by referring to the databases maintained by NASD and NFA.</p> <p>CCFE identified its initial Board of Directors in the CCFE Limited Liability Company Agreement. CCFE’s General Counsel, after appropriate due diligence, will submit affidavits that certify the absence of any history of disciplinary offenses for each member of CCFE’s Board of Directors prior to the launch of the exchange.</p> <p>CCFE intends to substantiate the fitness of other governing members to the Commission by certification. CCFE will obtain a certification from each governing member regarding his or her qualifications, including his or her disciplinary history, and CCFE will verify such certifications.</p> <p>Persons subject to fitness standards must notify CCFE of any change in status. In addition, the above-described fitness determination will be repeated on an</p>

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		annual basis for each member of the Board and relevant committees.
<p>Core Principle 15 <i>Conflicts of Interest</i> – “The board of trade shall establish and enforce rules to minimize conflicts of interest in the decision-making process of the contract market and establish a process for resolving such conflicts of interest.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 8; CCFE Appendix B-1C (Rulebook) Rules 201 (Management by the Board), 209 (Confidentiality), 210 (Conflicts of Interest), and 415 (Emergencies); CCFE Appendix F-1A (Certificate of Formation); CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004); and CCFE Appendix A-11 (Responses to Commission Staff’s Questions of October 21, 2004).</p>	<p>Acceptable.</p> <p>CCFE Rule 210(a)(i) provides that no member of the Board, any Review Panel, any Disciplinary Panel, any Appeals Panel or any other “disciplinary committee” or “oversight panel” (both as defined in Commission Regulation § 1.69) of the Exchange will knowingly participate in such body’s deliberations or voting in any matter involving a named party in interest with whom the member has a family, employment or business relationship. Rule 210(a)(ii) requires members who do not choose to abstain from deliberations and voting to notify the General Counsel that they have one of the relationships noted above, and the General Counsel will determine whether the</p>

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		<p>member is subject to the conflicts restriction.</p> <p>Rule 210(b)(i) provides that no member of the Board, any Review Panel, any Disciplinary Panel, any appeals Panel or any other “disciplinary committee” or “oversight panel” (both as defined in Commission Regulation 1.69) of the Exchange will participate in deliberations and voting on “significant” exchange actions in which the member knowingly has a direct and substantial financial interest in the result of the vote. Rule 210(b)(ii) requires that prior to consideration of any significant action, each member of the deliberating body who does not choose to abstain from deliberations and voting will disclose to the General Counsel, or his or her designee, any such conflicts of interests. Rule 210(b)(iii) sets forth a detailed inquiry to be undertaken by the General Counsel to assure objectively that non-abstaining members of a voting body are not subject to a prohibited financial interest.</p> <p>A member may participate in deliberations, but not voting on a matter, in which the member has a substantial financial interest if the members decide that (1) such participation is consistent with the public interest, and necessary for a quorum; or (2) the member possesses unique expertise, knowledge or experience. The minutes for a meeting in which the conflicts determination procedures set forth in Rule 210 apply, will include the names of participating members, the names of members who voluntarily recused or were required to abstain from deliberations or voting (and the reason for the recusal or abstention), position information that was reviewed for each member, and any determination made in accordance with the deliberation exemption.</p> <p>These provisions apply to the President or his or her designee when exercising emergency authority</p>

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		<p>pursuant to Rule 415. See Rule 415(e).</p> <p>CCFE Rule 209(a) limits the use or disclosure of material non-public information gained through the performance of official duties by Board members or any committees established by the Board.</p> <p>CCFE Rule 209(b) provides that no officer, employee or agent of the Exchange will: (1) trade in any commodity interest if such officer, employee or agent has access to material non-public information concerning such commodity interest; or (2)) disclose to any other Person material non-public information obtained in connection with such employee's, officer's or agent's employment, if such employee, officer or agent could reasonably expect that such information may assist another person in trading any commodity interest.</p>
<p>Core Principle 16 <i>Composition of Boards of Mutually Owned Contract Markets</i> – “In the case of a mutually owned contract market, the board of trade shall ensure that the composition of the governing board reflects market participants.”</p>	<p>CCFE Appendix B-1C (Rulebook) Rules 201 (Management by the Board), and 301 (Limited Liability Company Member).</p>	<p>Not Applicable.</p> <p>CCFE is a limited liability company whose sole member is CCX. All equity interests in the Exchange are and at all times will be held by CCX and all voting rights related to such interests will be exercised by CCX in accordance with the Rules of the Exchange.</p>
<p>Core Principle 17 <i>Recordkeeping</i> – “The board of trade shall maintain records of all activities related to the business of the contract market in a form and manner acceptable to the Commission for a period of 5 years.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 8; CCFE Appendix B-1C (Rulebook) Rules: 501 (Books and Records), and 502 (Inspection and Delivery); CCFE Appendix C-1A (Description of Electronic Trading and Clearing Systems); and CCFE Appendix C-9 (ICE SAS 70 Type II report (Independent Service Auditors Report));</p>	<p>Acceptable.</p> <p>CCFE has represented that it will maintain records of all activities related to its business at a secure off-site location for a period of six years and in accordance with Commission Regulation 1.31 Additionally, each TPH and Clearing Member is obliged to maintain all requisite books and records for five years from the date such books and records were prepared and be readily accessible during the first two years of the five-year period.</p>

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		<p>The CCFE system automatically captures details of each transaction (order, cancellation, etc.) in a comprehensive electronic audit trail. Details of all entries into the trading system, including date, time, and user ID are saved to a redundant, local database in real-time and a remote disaster recovery database in near real-time. The database is backed up to tape daily with tapes moved offsite weekly. Backups include at least six years of data.</p>
<p>Core Principle 18 Antitrust Considerations – “Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall endeavor to avoid – “(A) adopting any rules or taking any actions that result in any unreasonable restraints of trade; or (B) imposing any material anticompetitive burden on trading on the contract market.”</p>	<p>CCFE Appendix A-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 8-9; CCFE Appendix A-3 (Responses to Commission Staff’s Questions of August 24, 2004); CCFE Appendix B-1C (Rulebook) Rules 304 (Eligibility for Trading Privileges), 405 (Matching of Orders), 412 (Block Trading), and 514 (System Security); and CCFE Appendix A-11 (Responses to Commission Staff’s Questions of October 21, 2004).</p>	<p>Acceptable.</p> <p>CCFE represents that its Rulebook and business plan have been designed to avoid unreasonable restraints of trade or the imposition of any material anticompetitive burden on trading. Access to CCFE will be available to a broad range and potentially unlimited number of participants, on a fair, equitable and timely basis. CCFE will operate through predetermined electronic algorithms, without discrimination among different users or user groups. Trade information will be disseminated to market participants and the public on a continuous basis.</p> <p>Under the listing agreement entered into between CCFE and ICE, ICE aids CCFE in setting up its trading platform, and promises not to establish its own competing platform for two years. This is a reasonable restraint to allow each party to invest in their joint product. After that time, the contract can be uniformly abrogated by ICE. Thus, after the two years have elapsed, CCFE cannot preclude ICE from entering into this market. Therefore, staff believes that this non-compete provision is not an unreasonable restraint and that it does not contradict Core Principle 18.</p> <p>The Commission should remind the Exchange that the</p>

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		Commission is not approving any service agreements for compliance with Core Principle 18.

IV. Noteworthy Comment

Pursuant to agreement with CCorp, NFA will, among other things, perform certain financial surveillance functions, including reviewing daily pay/collect information, tracking percentage of pay to adjusted net capital for various pay balances, and monitoring daily large trader positions. CCorp will, among other things, employ risk-management measures specific to CCFE including a margin interval of the greater of a 99% confidence interval or 6% of the notional value of the underlying front-month contract which will initially exceed the largest permissible one-day price move for the contracts. Because historic information on price volatility is used to forecast expected one-day price moves and to set margin levels, it should be noted that there is no history of futures trading or prices for the pollution emission allowance contracts CCFE intends to trade.

In futures markets generally, the existence of a liquid market for a particular contract and the ability of an FCM to liquidate positions therein which it may inherit from a defaulting customer are important to the financial integrity of such an FCM and, in turn, its ability to fulfill its obligations to other customers and to the clearing system. The EPA will facilitate the delivery process of these contracts in a manner that makes cash positions known and compensates for any current lack of a developed deep liquid cash market for the contracts as compared to other futures contracts. Collectively CCorp, NFA, and EPA will carry out financial surveillance, monitor situations, and provide information the effect of which should counterbalance any disparate effects on financial integrity, which might be imposed by the initial lack of trading history and prices.

V. Attachments

- A. Application Letter from CCFE to the Commission, dated September 10, 2004
- B. CCFE Application Index
- C. CCFE Rulebook
- D. Designation Letter
- E. Order of Designation

The other background materials are available to the Commission upon request.

Attachment A

Attachment B

Attachment C

Attachment D

Attachment E