



September 6, 2005

VIA EMAIL: [secretary@cftc.gov](mailto:secretary@cftc.gov)

Ms. Jean A. Webb, Secretary  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1055 21<sup>st</sup> Street N.W.  
Washington, D.C. 20581

**Re: Request for Commission Product and Rule Approval and Request to Amend the Commission's Order Designating HedgeStreet as a Contract Market**

Dear Secretary Webb:

Pursuant to Section 5c(c) of the Commodity Exchange Act (the "Act") and Commission Regulation 38.4(a), 40.3 and 40.5, HedgeStreet, Inc ("HedgeStreet") hereby requests approval of the following amendments to HedgeStreet's Rules.

- In order to introduce i) a market that allows members of the Clearing Corporation ("CCorp") to become members of HedgeStreet in order to trade *iHedgelets*<sup>1</sup> on their own behalf or on behalf of their customers, and ii) *iHedgelets*, which are contracts that are similar to the Fixed Payout and Variable Payout Hedgelets that are currently offered on HedgeStreet except for the differences described herein, HedgeStreet proposes to add several new terms to Rule 1.1 and to add and amend Rules 3.1-3.3; 3.5; 4.3-4.4; 5.3-5.8; 5.11-5.14; 5.20; 6.1-6.4; 8.1-8.2; 9.1-9.2; 9.7; 10.1; 10.4; and 10.7. As required by Regulation 40.5(a)(1)(ii), following is the test of the proposed rule changes. Text to be added to HedgeStreet's Rules currently in effect is underlined; text to be deleted is stricken through:**

## CHAPTER 1 DEFINITIONS

### RULE 1.1 DEFINITIONS

When used in these Rules:

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<sup>1</sup> HedgeStreet uses the term "*iHedgelet*" to define the contracts to be traded on the intermediated market throughout this Commission Regulation 40.5 submission and corresponding documents. However, for marketing purposes, HedgeStreet may change the term "*iHedgelet*" to another naming convention leaving the manner in which these contracts are described herein materially unchanged.



(a) “Authorized Trader” means an individual or individuals employed by a Member who is authorized by that Member to have direct access to HedgeStreet, provided the Member maintains supervisory authority over such individual(s) trading activities.

(b) (a)–“Cap” means the maximum rate, level, amount, measure or other value of the Underlying of a Variable Payout Hedgelet Contract or Variable Payout iHedgelet Contract that may be the Expiration Value or the Closing Trade Value. If the actual rate, level, amount, measure, or other value of the Underlying meets or exceeds the Cap on the Expiration Date, the Cap will be the Expiration Value.

(c) (b)–“Class” means all Hedgelets or iHedgelets of the same Type with the same Underlying.

(d) “Clearing Corporation” (“CCorp”) means the derivatives clearing organization designated by HedgeStreet, to clear transactions effected by Clearing Members on the Market.

(e) “Clearing Member” means any Member that is also a CCorp Participant of the Clearing Corporation authorized to clear and settle iHedgelets executed on the Market.

(f) “CCorp Participant” means a Person that has been approved by the Clearing Corporation to clear and settle “exchange contracts” traded on an “exchange market”, as both terms are defined pursuant to the rules of the Clearing Corporation, but not a member of HedgeStreet.

(g) (e)–“Closing Trade Value” means the rate, level, amount, measure, or other value of the Underlying of a Variable Payout Hedgelet Contract or Variable Payout iHedgelet Contract at which the Contract or iHedgelet is closed in a Member’s account.

(h) “Customer” has the meaning set forth in Commission Regulation 1.3(k).

(i) (d)–“Dollar Multiplier” means the monetary amount by which the rate, level, amount, measure, or other value of an Underlying of a Variable Payout Hedgelet Contract or Variable Payout iHedgelet Contract is multiplied to determine the Settlement Value.

(j) “Eligible Contract Participant” has the meaning set forth in CEA Section 1(a)(12).

(k) (e)–“Expiration” or “Expiration Date” means the date established by these Rules on which the Expiration Value of each Hedgelet Contract or iHedgelet Contract is determined.

(l) (f)–“Expiration Value” means the rate, level, amount, measure, or other value of the Underlying at Expiration.

(m) (g)–“Financial Institution” means a financial institution as that term is defined in 31 CFR 103.11(n) that is required to comply with the regulations issued by the United States Department of Treasury under the Bank Secrecy Act including, but not limited to, the anti-money laundering program and customer identification program rules.



(n) **“Fixed Payout iHedgelet”** means the right to receive a fixed Settlement Value, not to exceed \$10,000 per contract, from the Clearing Corporation on the Settlement Date dependent upon whether you are holding a long position or short position in a Fixed Payout iHedgelet. If you are holding a long position in a Fixed Payout iHedgelet, you have the right to receive a fixed Settlement Value from the Clearing Corporation on the Settlement Date, if, and only if, the Fixed Payout iHedgelet’s Payout Criteria encompasses the Expiration Value at Expiration. Conversely, if you are holding a short position in a Fixed Payout iHedgelet, you have the right to receive a fixed Settlement Value if, and only if, the Fixed Payout iHedgelet’s Payout Criteria does NOT encompass the Expiration Value at Expiration. A Fixed Payout iHedgelet Contract is distinguishable from a Fixed Payout Hedgelet Contract not only on its notional size but also in that Fixed Payout iHedgelet Contracts may be traded only by Clearing Members and cleared and settled only by the Clearing Corporation, whereas Fixed Payout Hedgelet Contracts may be traded by any Member and are cleared and settled by HedgeStreet.

(o) ~~(h)~~ **“Fixed Payout Hedgelet Contract”** means the right to receive \$10 from HedgeStreet on the Settlement Date if, and only if, the Hedgelet Contract’s Payout Criterion encompasses the Expiration Value at Expiration.

(p) ~~(i)~~ **“Floor”** means the minimum rate, level, amount, measure, or other value of the Underlying of a Variable Payout Hedgelet Contract or Variable Payout iHedgelet Contract that may be the Expiration Value or the Closing Trade Value. If the actual rate, level, amount, measure or other value of the Underlying meets or falls below the Floor on the Expiration Date, the Floor will be the Expiration Value.

(q) ~~(j)~~ **“Hedgelet Contract,” “Hedgelet,” or “Contract”** means a Fixed Payout Hedgelet Contract or a Variable Payout Hedgelet Contract.

(r) ~~(k)~~ **“Hedgelet Pair” or “Pair”** means two Fixed Payout Hedgelet Contracts representing all mutually exclusive, collectively exhaustive Payout Criteria.

(s) **“iHedgelet Contract”, “iHedgelet” or “Contract”** means a Fixed Payout iHedgelet Contract or a Variable Payout iHedgelet Contract that may only be traded by Clearing Members and cleared and settled by the Clearing Corporation..

(t) ~~(l)~~ **“Last Trading Day”** means the last date on which a Member may trade a Contract or iHedgelet on the Market.

(u) ~~(m)~~ **“Long Variable Payout Hedgelet Contract”** means (i) the right to receive at the time the Contract is closed or on the Settlement Date any positive number resulting from subtracting the Opening Trade Value from (A) the Closing Trade Value, if the Variable Payout Hedgelet Contract was closed by an offsetting transaction before Expiration, or (B) the Expiration Value, if the Variable Payout Hedgelet Contract was held to Expiration, and then multiplying the resulting figure by the Dollar Multiplier and (ii) the obligation to pay at the time the contract is closed or on the Settlement Date any positive number resulting from subtracting from the Opening Trade Value (A) the Closing Trade Value, if the Variable Payout Hedgelet Contract was closed by an offsetting transaction before Expiration, or (B) the Expiration



Value, if the Variable Payout Hedgelet Contract was held to Expiration, and then multiplying the resulting figure by the Dollar Multiplier.

(v) ~~(n)~~—“**Market Maker**” means a Member that is granted the privileges in exchange for assuming certain responsibilities as set forth in Chapter 4 of these Rules for the purpose of creating liquidity for certain Classes of Contracts or iHedgelets.

(w) ~~(o)~~—“**Member**” means ~~an individual or entity~~ a Person which has been approved by HedgeStreet as a Clearing Member or a Non-Clearing Member to trade on the Market and which is bound by these Rules as they may be amended from time to time.

(x) “**Membership Agreement**” means the agreement between the Member and HedgeStreet authorizing the Member to trade on or otherwise provide access to HedgeStreet. The Member must acknowledge and agree to be bound by all of the terms and conditions contained in the Membership Agreement, including, but not limited to the HedgeStreet Rules and any other documentation HedgeStreet may require.

(y) “**Non-Clearing Member**” means a Member other than a Clearing Member.

(z) “**Person**” means an individual, sole proprietorship, corporation, limited liability company, partnership, trust, or any other entity.

(aa) ~~(p)~~—“**Opening Trade Value**” means the rate, level, amount, measure, or other value of the Underlying of a Variable Payout Hedgelet Contract or Variable Payout iHedgelet at which the Contract or iHedgelet is opened in a Member’s account.

(bb) ~~(q)~~—“**Payout Criterion**” of a Hedgelet Contract or iHedgelet Contract means the Expiration Value or range of Expiration Values that will cause that Hedgelet Contract or iHedgelet Contract to be “in-the-money.”

(cc) ~~(r)~~—“**Redemption**” or “**Selling Both**” means selling a Hedgelet Pair to HedgeStreet for \$10 less any Redemption fees specified elsewhere in these Rules or on the HedgeStreet website.

(dd) “**Regulatory Agency**” means any government body, including the Commission and Securities and Exchange Commission, and any organization, whether domestic or foreign, granted authority under statutory or regulatory provisions to regulate its own activities and the activities of its members, and includes HedgeStreet, any other clearing organization or contract market, any national securities exchange or clearing agency, the National Futures Association (“NFA”) and the National Association of Securities Dealers (“NASD”).

(ee) ~~(s)~~—“**Series**” means all Hedgelets or iHedgelets of the same Class having identical terms, including Payout Criterion and Expiration Date.



(ff) ~~(t)~~—“**Settlement Date**” means the date on which money is paid to the account of a Member who has the right to receive money pursuant to a Fixed Payout Hedgelet or iHedgelet Contract or a Variable Payout Hedgelet or iHedgelet Contract held until Expiration, and on which money is paid from the account of a Member who is obligated to pay money pursuant to a Variable Payout Hedgelet Contract held until Expiration. Unless otherwise specified in these Rules, the Settlement Date is the same day as the Expiration Date.

(gg) ~~(u)~~—“**Settlement Value**” means the amount paid to the accounts of holders of in-the-money Contracts or iHedgelets. The Settlement Value of a Fixed Payout Hedgelet Contract is \$10. The Settlement Value of a Variable Payout Hedgelet Contract is determined as described in the definition for Long and Short Variable Payout Hedgelet Contracts. The Settlement Value of iHedgelets will be determined by the Clearing Corporation in accordance with its rules.

(hh) ~~(v)~~—“**Short Variable Payout Hedgelet Contract**” means (i) the right to receive at the time the Contract is closed or on the Settlement Date any positive number resulting from subtracting from the Opening Trade Value (A) the Closing Trade Value, if the Variable Payout Hedgelet Contract was closed by an offsetting transaction before Expiration, or (B) the Expiration Value, if the Variable Payout Hedgelet Contract was held to Expiration, and then multiplying the resulting figure by the Dollar Multiplier and (ii) the obligation to pay at the time the Contract is closed or on the Settlement Date any positive number resulting from subtracting the Opening Trade Value from (A) the Closing Trade Value, if the Variable Payout Hedgelet Contract was closed by an offsetting transaction before Expiration, or (B) the Expiration Value, if the Variable Payout Hedgelet Contract was held to Expiration, then multiplying the resulting figure by the Dollar Multiplier.

(ii) ~~(w)~~—“**Source Agency**” means the agency that publishes the Underlying economic indicator and/or Expiration Value for any Hedgelet Contract or iHedgelet.

(jj) ~~(x)~~—“**Speculative Position Limits,**” or “**Position Limit**” means the maximum position, either net long or net short, in one Series or a combination of various Series of a particular Class that may be held or controlled by one Member as prescribed by HedgeStreet and/or the CFTC Commission.

(kk) ~~(y)~~—“**Subscription**” or “**Buying Both**” means purchasing a Hedgelet Pair from HedgeStreet for \$10 less any Subscription fees specified elsewhere in these Rules or on the HedgeStreet website.-

(ll) ~~(z)~~—“**Type**” means the classification of i) a Hedgelet as a Fixed Payout Hedgelet ~~Contract~~ or a Variable Payout Hedgelet Contract or ii) an iHedgelet as a Fixed Payout iHedgelet or Variable Payout iHedgelet.

(aa) ~~(mm)~~—“**Underlying**” means the index, rate, risk, measure, instrument, differential, indicator, value, contingency, occurrence, or extent of an occurrence the Expiration Value of which determines whether (and, in the case of a Variable Payout Hedgelet Contract or iHedgelet, to what extent) a Hedgelet Contract or iHedgelet is in-the-money.



~~(bb)~~–~~(nn)~~ **“Variable Payout Hedgelet Contract”** means a Long Variable Payout Hedgelet Contract and/or a Short Variable Payout Hedgelet Contract that may be traded by any Member and is cleared and settled by HedgeStreet.

~~(oo)~~ **“Variable Payout *i*Hedgelet Contract”** means a Short Variable Payout Hedgelet and/or a Long Variable Payout Hedgelet that may be traded only by Clearing Members and is cleared and settled by the Clearing Corporation.

## CHAPTER 2 MARKET GOVERNANCE

RULES 2.1 –2.3 [unchanged]

RULE 2.4 EMERGENCY RULES

(a) – (b) [unchanged]

(c) For purposes of this rule, an “emergency” is;

(i) – (ii) [unchanged]

(iii) any circumstance that may materially affect the performance of the Hedgelet Pairs originated by, or the Contracts or *i*Hedgelet traded on, HedgeStreet;

(iv) – (vii) [unchanged]

(viii) any other unusual, unforeseeable, and adverse circumstance which, in the opinion of the governing board, requires immediate action and threatens or may threaten such things as the fair and orderly trading in, or the liquidation of or delivery pursuant to, Hedgelet Pairs, *i*Hedgelets or Contracts traded on HedgeStreet.

(d) – (f) [unchanged]

RULES 2.5 – 2.8 [unchanged]

## CHAPTER 3 MEMBERS

RULE 3.1 ~~APPLICATIONS, CLASSIFICATIONS, AND PRIVILEGES~~ ELIGIBILITY AND APPLICATION PROCEDURES

(a) To be eligible to become a ~~HedgeStreet~~ Non-Clearing Member:



(i) if you are ~~an individual~~ a natural person, you must:

(1) reside in the United States and,

(2) have an account or accounts with a Financial Institution that you will use to fund your HedgeStreet account at the HedgeStreet settlement bank and to receive funds from your HedgeStreet account, and you must certify that you are old enough to enter into a legally enforceable contract, that you have read and understand the HedgeStreet Risk Disclosure Statement and Membership Agreement, that you agree to be bound by these Rules, and that you will trade only for yourself and will not trade as an intermediary for any other person or entity;

(3) certify that you are old enough to enter into a legally enforceable contract,

(4) certify that you have read and understand the HedgeStreet Risk Disclosure Statement and Membership Agreement,

(5) agree to be bound by these Rules, and

(6) agree to only trade for yourself and will not trade as an intermediary for any other person or entity;

(ii) if you are an entity, you must

(1) be organized in the United States,

(2) (ii) if you are an entity, you must be organized in the United States, have an account or accounts with a Financial Institution that you will use to fund your HedgeStreet account at the HedgeStreet settlement bank and to receive funds from your HedgeStreet account, and you must certify that you are validly organized, in good standing, and authorized by your governing body and, if relevant, documents of organization, to trade commodities, futures and options contracts, that you have read and understand the HedgeStreet Risk Disclosure Statement and Membership Agreement, that you agree to be bound by these Rules, and that the individual(s) authorized to trade your account will trade only for you and will not trade for him/herself or as an intermediary for any other entity or person.

(3) certify that you are validly organized, in good standing, and authorized by your governing body and, if relevant, documents of organization, to trade commodities, futures and options contracts,

(4) designate Authorized Traders to trade your account,

(5) designate at least one officer who is responsible for supervising all activities of your employees relating to transactions effected on HedgeStreet or subject to HedgeStreet Rules and provide any information HedgeStreet may request regarding such officer(s),



(6) certify that you have read and understand the HedgeStreet Risk Disclosure Statement and Membership Agreement.

(7) agree to be bound by these Rules, and

(8) agree that the individual(s) authorized to trade your account will trade only for you and will not trade for him/herself or as an intermediary for any other Person.

(iii) you must complete and submit the HedgeStreet membership application, which includes the Membership Agreement.

(iv) (b) ~~In order to become a Member, you must complete and submit the HedgeStreet on-line membership application, provide HedgeStreet with any other information HedgeStreet may request, and you must fund your HedgeStreet account by transferring to the customer segregated funds account at HedgeStreet's settlement bank an initial deposit of no less than \$100 in funds from your account at a Financial Institution. If you are a Member applicant but not an individual, you must designate an individual or individuals who are authorized to trade in your account.~~ and

(v) you must provide HedgeStreet with any other information HedgeStreet may request.

(b) HedgeStreet may investigate any Member applicant, Authorized Trader designate, or other Person associated with an applicant.

(c) Submission of your membership application to HedgeStreet constitutes your agreement to be bound by these Rules and other policies of HedgeStreet.

(d) To be eligible to become a HedgeStreet Clearing Member, you must:

(i) satisfy all of the Non-Clearing Member eligibility criteria set forth in Rule 3.1, except that you need not satisfy Rule 3.1(a)(i)(2), (a)(ii)(2), and (a)(iv), unless you intend to trade Contracts other than iHedgelets;

(ii) have adequate financial resources and credit as determined by HedgeStreet and the Clearing Corporation;

(iii) be a CCorp Participant in good standing of the Clearing Corporation;

(iv) if you are a futures commission merchant registered with the Commission ("FCM"), submit to HedgeStreet a letter confirming that you maintain all Customer funds deposited with you in appropriately labeled customer segregated funds accounts separated from funds of Non-Customers, as required by Commission regulations; and





(v) meet any other criteria or complete any additional applications that HedgeStreet and/or the Clearing Corporation may request.

(e) HedgeStreet may in its sole discretion approve, deny, or condition any Member application as HedgeStreet deems necessary or appropriate.

### RULE 3.2 PRIVILEGES

~~(a)(d)~~—If your application as a Non-Clearing Member is approved by HedgeStreet and the HedgeStreet settlement bank confirms to HedgeStreet that you have deposited with it the funds required in ~~paragraph (b) of this Rule 3.1(a)(iv)~~, you will be a Non-Clearing Member of HedgeStreet and will have the following privileges, which HedgeStreet may revoke, amend, or expand in accordance with, or by amending, these Rules:

- (i) to maintain a HedgeStreet account;
- (ii) to Subscribe for Hedgelet Pairs from HedgeStreet using the funds in your HedgeStreet account;
- (iii) to Redeem Hedgelet Pairs in your HedgeStreet account to HedgeStreet;
- (iv) to buy Non-iHedgelet Contracts on the Market using the funds in your HedgeStreet account;
- (v) to sell Non-iHedgelet Contracts in your HedgeStreet account on the Market;
- (vi) to view “real-time” the same best bids to buy and offers to sell the Contracts traded on the Market as are available to all other Members;
- (vii) to receive access to the Market via ~~the FIX Gateway~~ a dedicated private circuit at your request, as long as you are willing to pay any and all fees or charges incurred for such access;
- (viii) to view the current trading volume and open interest for the Contracts traded on the Market; and
- (ix) to view all non-secure parts of the HedgeStreet website, including these Rules, and descriptions of the Hedgelet Pairs and Contracts traded on the Market as well as all secure parts of the HedgeStreet website outlined above in Rule ~~3.13.2(d)(i) – (vii)~~.

~~(e) — HedgeStreet may in its sole discretion approve, deny, or condition any Member application as HedgeStreet deems necessary or appropriate.~~



~~(f) If you are a Member that is an individual, you may not maintain and/or trade more than one HedgeStreet account. If you are a Member that is an entity, your authorized representative(s) may not maintain and/or trade more than one HedgeStreet account.~~

(b) If your application as a Clearing Member is approved by HedgeStreet, you will be a Clearing Member of HedgeStreet and will have the following Clearing Member privileges, which HedgeStreet may revoke, amend, or expand in accordance with, or by amending, these Rules:

(i) to buy iHedgelets for your own account or the account of your Customers, subject to these Rules and the rules of the Clearing Corporation; and

(ii) to sell iHedgelets for your own account or the account of your Customers, subject to these Rules and the rules of the Clearing Corporation.

(iii) to view “real-time” the same best bids to buy and offers to sell iHedgelets traded on the Market as are available to all other Clearing Members;

(iv) to receive access to the Market via the HedgeStreet website or a dedicated private circuit;

(v) to view the current trading volume and open interest for the Contracts traded on the Market;  
and

(vi) to view all non-secure parts of the HedgeStreet website, including these Rules, description of iHedgelets traded on the Market as well as all secure parts of the HedgeStreet website.

(c) If you are a Clearing Member and would like to become a Non-Clearing Member, you will be required to satisfy all of the requirements defined in Rule 3.1(a) – (c) as well as abide by all Rules that apply to Non-Clearing Members.

### RULE 3.3. ~~RULE 3.2~~ – MEMBER OBLIGATIONS

(a) As a Member, you and/or your ~~authorized representative~~ Authorized Trader(s) must comply with these Rules, relevant provisions of the Commodity Exchange Act, and relevant Commission regulations. You must also cooperate promptly and fully with HedgeStreet, its agents, and ~~or the Commission~~ any other Regulatory Agency in any investigation, call for information, inquiry, audit, examination, or proceeding. Additionally, you must update your e-mail address within 24 hours after it has changed and update all other information provided in your application for membership within five days after that information has changed. If you fail to satisfy these obligations, HedgeStreet may revoke or suspend your privileges in full or in part. You may also be subject to civil or criminal prosecution.

(b) As a Member, you consent to allow HedgeStreet to provide all information HedgeStreet has about you, including your trading activity, to ~~the Commission or any other regulatory or self-regulatory body~~ any



Regulatory Agency, law enforcement authority, or judicial tribunal, including (as may be required by information sharing agreements or other contractual, regulatory, or legal provisions) foreign ~~regulatory or self-regulatory bodies~~ Regulatory Agencies, law enforcement authorities, or judicial tribunals.

(c) As a Member, you and/or your ~~authorized representative~~ Authorized Trader(s) are required to review the “Exchange Notices” section of the HedgeStreet website to make yourself aware of material changes to these Rules or other notices that may affect your rights and obligations as a Member of HedgeStreet.

(d) As a Member, you must immediately notify HedgeStreet in writing upon becoming aware:

(i) that you, any of your officers or any of your Authorized Traders has had trading privileges suspended, access to, or membership or clearing membership in, any Regulatory Agency denied;

(ii) that you, any of your officers or any of your Authorized Traders has been convicted of, pled guilty or no contest to, or entered a plea agreement to, any felony in any domestic, foreign or military court;

(iii) that you, any of your officers or any of your Authorized Traders has been convicted of, pled guilty or no contest to, or entered a plea agreement to a misdemeanor in any domestic, foreign or military court which involves:

(1) embezzlement, theft, extortion, fraud, fraudulent conversion, forgery, counterfeiting, false pretenses, bribery, gambling, racketeering, or misappropriation of funds, securities or properties; or

(2) any transaction in or advice concerning futures, options on futures, leveraged transactions or securities;

(iv) that you, any of your officers or any of your Authorized Traders has been subject to, or associated with a firm that was subject to regulatory proceedings before any Regulatory Agency;

(v) that you, any of your officers or any of your Authorized Traders is currently a party to any investigation or proceeding, the resolution of which could result in an event described in Rule 3.3(d)(i)-(iv);

(vi) of any other material change in any information contained in the Member’s membership application;

(vii) of any failure to maintain segregated funds as required by the Commission when the Member is a Clearing Member;



(viii) of becoming subject to early warning reporting under Commission Regulation 1.12 when the Member is a Clearing Member, and;

(ix) of becoming the subject of a bankruptcy proceeding or being unable to meet any financial obligation as it becomes due.

(e) As a Member, you must diligently supervise all activities of your employees and/or agents, including all Authorized Traders, relating to transactions effected on HedgeStreet. Any violation of these Rules by any employee and/or agent, including Authorized Trader of a Member shall constitute a violation of the Rules by such Member.

(f) If you are a Clearing Member that is not an FCM, you must at all times maintain a net worth<sup>2</sup> at or in excess of \$50,000, provided that, such amount is not below the financial requirements of CCorp relating to CCorp Participant qualifications, in which case, CCorp financial requirements shall be controlling. If you are a Clearing Member that is also an FCM, you must comply with the financial requirements set forth by the Commission, NFA and other contract markets.

(g) As a Clearing Member, you must only handle, maintain and/or solicit Customer orders, accounts or funds if you are properly registered with the NFA in accordance with the CEA and Commission Regulations adopted thereunder to conduct futures-related business with the public.

(h) As a Clearing Member, you must submit statements of financial condition at such times and in such manner as shall be prescribed from time to time.

(i) As a Clearing Member, you must use due diligence in receiving and handling orders from Customers, entering such orders onto HedgeStreet on behalf of such Customers, responding to inquiries from Customers about their orders and reporting back to Customers the execution of such orders.

(j) As a Clearing Member, you must confirm any trades entered on behalf of a Customer to such Customer no later than the business day following the day upon which the transaction was executed. Such confirmation shall i) be in writing, ii) show the Hedgelet bought or sold, iii) show the amount, the price, and iv) the expiration date.

(k) As a Clearing Member, you must establish and enforce internal controls, policies and procedures to reasonably ensure that each order received from a Customer is entered on HedgeStreet prior to any order of the same Series being entered at the same price for;

(i) any proprietary account of the Clearing Member;

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<sup>2</sup> For purposes of these rules, "Net Worth" shall have the same meaning as "net asset value" pursuant to Commission Regulation 4.10(b).



(ii) any account in which the Authorized Trader(s) has an interest, or;

(iii) any account over which a Clearing Member or its Authorized Trader(s) have discretionary authority.

(l) Prior to entering an order for a Customer that is not an Eligible Contract Participant, a Clearing Member must first provide such Customer with the HedgeStreet Risk Disclosure Statement.

(m) Each Clearing Member must make and file reports in accordance with Commission Regulations in a manner and form and at such times as may be prescribed by the Commission.

(n) Each Clearing Member must make and file reports with HedgeStreet at such times, in such manner and form, and containing such information as HedgeStreet may prescribe from time to time.

(o) Each Clearing Member, upon a request of HedgeStreet or Regulatory Agency, must promptly respond to any requests for information that may be requested from time to time.

(p) Each Clearing Member may invest Customer Funds as long as such funds are invested pursuant to Commission Regulation 1.25.

(q) Each Clearing Member must prepare, maintain and keep current those books and records required by the rules of HedgeStreet, the CEA and/or the Commission's Regulations. Such books and records shall be open to inspection and promptly provided to HedgeStreet and/or the Commission or the U.S. Department of Justice upon request.

RULE 3.4 ~~RULE 3.3~~—[except for renumeration, this rule is unchanged]

RULE 3.5 ~~RULE 3.4~~—AUTHORIZED REPRESENTATIVE TRADERS

(a) Members other than natural persons must apply for authorization for all ~~representative~~ Trader(s) who will access their accounts. Only ~~Member representatives~~ Authorized Traders authorized by HedgeStreet and the Member may enter and execute transactions on the Market. Before ~~Member representative(s)~~ an Authorized Trader may enter orders or execute trades on the Market, ~~they~~he/she must acknowledge having read and understood these Rules and agree to comply with these Rules.

(b) A Member may be required to submit evidence of the authority of an Authorized Trader to act on behalf of the Member and such other information about any Authorized Trader as HedgeStreet may request. A person may be conditionally approved as an Authorized Trader of a Member subject to any conditions HedgeStreet may consider appropriate in the interests of promoting a fair and orderly market.

(c) HedgeStreet may withdraw or suspend the registration of any Authorized Trader of any Member if HedgeStreet determines that;



(i) an Authorized Trader has caused the Member to fail to comply with the Rules of HedgeStreet;

(ii) an Authorized Trader is not properly performing the responsibilities of an Authorized Trader of a Member or Market Maker;

(iii) an Authorized Trader has failed to comply with the conditions set forth in paragraph (b) of this Rule; or

(iv) it is the best interests of maintaining a fair and orderly market to do so.

(d) If HedgeStreet suspends the registration of any Authorized Trader, the Member must ensure that the suspended Authorized Trader does not submit any quotes or orders into the HedgeStreet system.

(e) The registration of an Authorized Trader will be withdrawn upon the written request of the Member for which an Authorized Trader is registered. Such written request shall be submitted in a manner prescribed by HedgeStreet. Until such written request is received, or an Authorized Trader's registration is suspended or withdrawn pursuant to paragraph (c) of this Rule, a Member will be responsible for all order entry and trading activity of such Authorized Trader(s).

#### RULE 3.6 ~~RULE 3.5~~—DUES, FEES, AND EXPENSES PAYABLE BY MEMBERS

(a) – (d) [unchanged]

(e) HedgeStreet or its settlement bank will also deduct from your account expenses incurred in connection with your trading or account activity, such as fees for wire transfers, check processing via e-~~ValueCheck~~ electronic check. All such fees will be charged in an amount to be reflected from time to time on HedgeStreet's website.

(f) [unchanged]

### CHAPTER 4 MARKET MAKERS

RULE 4.1 [unchanged]

#### ~~RULE 4.2~~—MARKET MAKER REPRESENTATIVES

~~(a) Like other Members that are not natural persons, quotations and orders for entity Market Makers may be submitted to HedgeStreet only by the Market Maker's authorized representative(s), and such authorized representative(s) may not trade for his or her own account or the account of any other Member.~~

~~(b) A Market Maker may be required to submit evidence of the authority of an authorized representative to act on behalf of the Market Maker and such other information about any authorized~~



~~representative as HedgeStreet may request. A person may be conditionally approved as an authorized representative of a Market Maker subject to any conditions HedgeStreet may consider appropriate in the interests of promoting a fair and orderly market.~~

~~(c) HedgeStreet may withdraw or suspend the registration of any authorized representative of any Market Maker if HedgeStreet determines that;~~

~~(i) an authorized representative has caused the Market Maker to fail to comply with the Rules of HedgeStreet;~~

~~(ii) an authorized representative is not properly performing the responsibilities of an authorized representative of a Market Maker;~~

~~(iii) an authorized representative has failed to comply with the conditions set forth in paragraph (b) of this Rule; or~~

~~(iv) it is the best interests of maintaining a fair and orderly market to do so.~~

~~(d) If HedgeStreet suspends the registration of any authorized representative, the Market Maker must ensure that the suspended authorized representative or representatives do not submit any quotes or orders into the HedgeStreet system.~~

~~(e) The registration of an authorized representative will be withdrawn upon the written request of the Market Maker for which an authorized representative is registered. Such written request shall be submitted in a manner prescribed by HedgeStreet. Until such written request is received, or an authorized representative's registration is suspended or withdrawn pursuant to paragraph (c) of this Rule, a Market Maker will be responsible for all order entry and trading activity of such authorized representative(s).~~

RULE 4.2 ~~RULE 4.3~~—[except for renumeration, this rule is unchanged]

RULE 4.3 ~~RULE 4.4~~—BENEFITS OF BECOMING A MARKET MAKER

(a) Market Makers will have access to HedgeStreet via ~~the FIX~~ a dedicated private circuit for an additional fee to be determined by HedgeStreet on a case-by-case basis. HedgeStreet will provide a guaranteed throughput per day with a specified peak amount of orders that may be traded per second to all Market Makers.

(b) [unchanged]

(c) Market Makers that are Non-Clearing Members shall have the ability to engage in the process of Subscription On Demand as defined in Rule 5.4(c).

(d) [unchanged]



RULE 4.4 ~~RULE 4.5~~—OBLIGATIONS OF MARKET MAKERS

(a) General – Transactions of Market Makers should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and Market Makers shall not make bids or offers or enter into transactions that are inconsistent with such a course of dealings. Ordinarily, Market Makers shall be obligated to do the following:

(i) trade for the proprietary account of the ~~market maker only~~ customer accounts may not be traded on HedgeStreet Market Maker only if the Market Maker is a Non-Clearing Member since Non-Clearing Members may only trade for their own account(s).

(ii) maintain two-sided displayed quotes at a predefined spread (“Spread”) for a Series of Contracts for a certain period of time throughout the trading day. In ordinary market conditions, quotes must be made within a maximum Spread. This Spread will be set at the time a Series is opened for trading and will be set in accordance with the maximum loss a Market Maker may incur by quoting within the Spread. In fast market conditions, Market Makers will be permitted to widen their Spreads to a level that will be set at the time a Series is opened for trading.

(b) [unchanged]

(c) Like other Non-Clearing Members of HedgeStreet, a Market Maker that is a Non-Clearing Member may not place an order unless it has the funds in its HedgeStreet account necessary to fulfill its obligations under that order.

**CHAPTER 5 METHOD FOR MEMBERS TO SUBSCRIBE FOR AND REDEEM HEDGELET PAIRS AND TRADE HEDGELET CONTRACTS**

RULE 5.1 [unchanged]

RULE 5.2 MEMBER ACCESS TO HEDGESTREET

(a) [unchanged]

(b) ~~After your membership application has been approved by HedgeStreet and you have deposited the requisite amount of funds into your account as specified under Rule 3.1(b), you become a Member.~~ As a Member, you will be able to access the Market, execute trades, and otherwise access information regarding, or perform functions in, your account using your ID and unique password.

(c)– (e) [unchanged]





(f) You are responsible for contracting with an Internet service provider and/or obtaining a dedicated private circuit through which you will access the HedgeStreet ~~website~~ Market and for having a backup service provider and/or dedicated private circuit if you think it is necessary. ~~You~~ If your sole connection with the Market is via the internet, you are also responsible for maintaining an Internet connection speed adequate for your needs. HedgeStreet will not be responsible in any way for any orders delayed or trades missed or not executed in a timely fashion because of failure of your Internet service provider and/or dedicated private circuit or slowness of your Internet connection speed and/or dedicated private circuit. No communication from you will be deemed to have been received by HedgeStreet until that communication is logged by the HedgeStreet server.

RULE 5.3 SUBSCRIPTION FOR AND REDEMPTION OF FIXED PAYOUT HEDGELET PAIRS BY NON-CLEARING MEMBERS

(a) – (c) [unchanged]

RULE 5.4 TRADING NON-HEDGELET CONTRACTS

(a) You will be able to trade Fixed Payout Hedgelet Contracts on the Market by entering bids to purchase or offers to sell those Contracts and to trade Variable Payout Hedgelet Contracts by entering values or levels of the Underlying at which you are willing to open or close a Long Variable Payout Hedgelet Contract or a Short Variable Payout Hedgelet Contract. After logging into the secure portion of the HedgeStreet website, you will input your orders into the HedgeStreet trading system.

(b) When your order is matched by an order from another Member(s);

(i) If your order is to sell one or more Fixed Payout Hedgelet Contracts for an account, HedgeStreet will check ~~your~~ the account to ensure ~~you have~~ that it has the number of Contracts you are attempting to sell. ~~If you do~~ the account does not have the necessary Fixed Payout Hedgelet Contracts ~~in your account~~, HedgeStreet will cancel your order prior to trade execution. ~~If you do have~~ the account does have the necessary Fixed Payout Hedgelet Contracts ~~in your account~~, HedgeStreet will execute the trade. Upon trade execution, HedgeStreet will: (1) debit the account ~~of the~~ buyer(s) buying and credit the account ~~of the seller(s) of~~ selling the Contract; (2) adjust the Contracts ~~in your account and the account of the other Member(s)~~ the accounts in accordance with the matched trade; and (3) inform you by electronic mail that the trade has been executed.

(ii) If your order is to purchase one or more Fixed Payout Hedgelet Contracts, HedgeStreet will check ~~your~~ the account to ensure you have the funds necessary to complete the purchase. ~~If you do~~ the account does not have the necessary funds ~~in your account~~, HedgeStreet will cancel your order prior to trade execution. ~~If you do~~ the account does have the necessary funds ~~in your account~~, HedgeStreet will execute the trade. Upon trade execution, HedgeStreet will: (1) debit the account ~~of the buyer(s) buying~~ and credit the account ~~of the seller(s) of~~ selling the Contract; (2) adjust the Contracts ~~in your account and the account of the other Member(s)~~ the accounts in accordance with the matched trade; and (3) inform you by electronic mail that the trade has been executed.



(iii) If your order is to enter into one or more Variable Payout Hedgelet Contracts for which ~~you do~~the account does not have an offsetting position ~~in your account~~, HedgeStreet will check ~~your~~the account to ensure ~~you~~the account does have enough funds to cover ~~your~~the maximum loss under the Variable Payout Hedgelet Contract(s) you are attempting to enter into. If ~~you do~~the account does not have the necessary funds ~~in your account~~, HedgeStreet will cancel your order prior to trade execution. If ~~you do~~the account does have the necessary funds ~~in your account~~, HedgeStreet will execute the trade. Upon trade execution, HedgeStreet will: (1) debit the funds from ~~your~~the account in an amount necessary to cover the maximum loss, (2) ~~credited~~credit those funds to the HedgeStreet settlement account, and (3) place the Variable Payout Hedgelet Contracts that were the subject of the order into ~~your~~the account and notify you by electronic mail that the trade has been executed. The maximum amount that ~~you can lose~~be lost under a Long Variable Payout Hedgelet Contract (and, therefore, the amount that will be debited from your account and then paid into the HedgeStreet settlement account) is determined by subtracting the Floor from the Opening Trade Value and then multiplying the resulting figure by the Dollar Multiplier. The maximum amount that you can lose under a Short Variable Payout Hedgelet Contract is determined by subtracting the Opening Trade Value from the Cap and then multiplying the resulting figure by the Dollar Multiplier.

(iv) If the transaction involves entering into one or more Variable Payout Hedgelet Contracts for which ~~you have~~there is an offsetting position in ~~your~~the account (for example, entering into a Short Variable Payout Hedgelet Contract of a Series when ~~you have~~there is a Long Variable Payout Hedgelet Contract of that same Series in ~~your~~the account), upon execution of the trade HedgeStreet will: (1) close the offsetting position in ~~your~~the account; (2) debit the HedgeStreet settlement account in the amount of (A) any gains realized by the offsetting transaction; and (B) any funds that were debited from ~~your~~the account at the time the Variable Payout Hedgelet Contract(s) that is being closed was entered into and that were not also used to pay any losses on such Contract(s); (3) credit those amounts to your account; and (4) notify you by electronic mail that the trade has been executed.

(c) Notwithstanding anything to the contrary in Rule 5.4(b)(i), each Market Maker that is a Non-Clearing Member shall have the ability to enter sell orders on the market without having the Fixed Payout Hedgelet Contracts to be sold in its account at the time the order is matched with a buy order of another Member. When a Market Maker sell order is matched with a buy order from another Member, HedgeStreet will check the Market Maker's account to determine whether the Market Maker has the number of Contracts necessary to fill the sell order.

(i) – (ii) [unchanged]

(1) – (2) [unchanged]

(d) [unchanged]



#### RULE 5.5 TRADING iHEDGELETS BY CLEARING MEMBERS

(a) Every iHedgelet executed on the Market must be effected for the account of or through a Clearing Member authorized by the Clearing Corporation and HedgeStreet to act as a Clearing Member for the Class of iHedgelet.

(b) As a Clearing Member, you will be able to trade Fixed Payout iHedgelet or Variable Payout Contracts on the Market for your account or the account of your Customers by entering bids and offers at prices in which you are willing to open or close such Contracts. After logging onto the secure portion of the HedgeStreet Market, you will input your orders into the HedgeStreet trading system. When your order is matched, it will be reported to the Clearing Corporation. The rules of the Clearing Corporation will govern all matched trades.

(c) Each Clearing Member must require each Customer to execute an agreement including at least the following acknowledgements and agreements, which the parties may not modify in any material respect:

THERE ARE NO EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS PROVIDED BY THE CLEARING CORPORATION ("CCORP") TO SUBSCRIBERS OF THE HEDGESTREET ("HS") SYSTEM RELATING TO ANY OF THE SERVICES OR FACILITIES PROVIDED BY CCORP, INCLUDING BUT NOT LIMITED TO THE WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE OR USE.

EXCEPT AS MAY OTHERWISE BE SPECIFICALLY AGREED WITH CCORP, IN NO EVENT SHALL CCORP OR ANY OF ITS GOVERNORS, DIRECTORS, OFFICERS OR EMPLOYEES, BE FINANCIALLY RESPONSIBLE FOR, OR OTHERWISE GUARANTEE THE PAYMENT OR RETURN BY CCORP OR ANY THIRD PARTY OF ANY ORIGINAL MARGIN OR COLLATERAL DEPOSIT, VARIATION MARGIN, OPTION PREMIUM, SETTLEMENT AMOUNT OR DELIVERY OBLIGATION IN RESPECT OF ANY HS CONTRACT. NEITHER CCORP NOR ANY OF ITS GOVERNORS, DIRECTORS, OFFICERS OR EMPLOYEES SHALL BE LIABLE TO ANY PERSON FOR ANY LOSSES, DAMAGES, COSTS OR EXPENSES (INCLUDING, BUT NOT LIMITED TO, LOSS OF PROFITS, LOSS OF USE, DIRECT, INDIRECT, INCIDENTAL OR CONSEQUENTIAL DAMAGES) ARISING FROM ANY FAILURE OR MALFUNCTION, OR ANY FAULT IN DELIVERY, DELAY, OMISSION, SUSPENSION, INACCURACY OR TERMINATION, OR ANY OTHER CAUSE, IN CONNECTION WITH THE FURNISHING, PERFORMANCE, MAINTENANCE, USE OF OR INABILITY TO USE ALL OR ANY PART OF THE SERVICES PROVIDED BY CCORP TO HS OR TO CCORP PARTICIPANTS. THE FOREGOING SHALL APPLY REGARDLESS OF WHETHER A CLAIM ARISES IN CONTRACT, TORT, NEGLIGENCE, STRICT LIABILITY OR OTHERWISE.

#### RULE 5.6 MARGIN

(a) Clearing Members shall collect sufficient margin from its Customers in an amount no less than 100 percent of the premium amount of a transaction.



(b) Clearing Members shall abide by all rules and policies of CCorp, including, without limitation, all rules relating to margin requirements.

(c) No Clearing Member shall extend any credit or give any rebate or gratuity of any kind to any Person for the purpose of circumventing or evading margin requirements.

#### RULE 5.7 ~~RULE 5.5~~ ORDER ENTRY

(a) You will enter orders to purchase Hedgelet Pairs or trade Contracts by electronic transmission over the Internet or a dedicated private circuit, and HedgeStreet will maintain an electronic record of your order entries.

(b) [unchanged]

(c) You will enter an order to trade one or more Contracts by indicating to HedgeStreet in the manner required by HedgeStreet including, but not limited to: (i) order type (i.e., buy or sell); (ii) the Series of Contract; (iii) the price at which you want to buy or sell the Contract; ~~and~~ (iv) the number of Contracts you want to buy or sell; and (v) if you are a Clearing Member; (A) whether the trade is for your account or the account of your Customer and; (B) if you are trading Variable Payout iHedgelet Contracts for your account or the account of your Customers, whether the trade is an opening or closing transaction.

(d) [unchanged]

(e) HedgeStreet's trading system will keep an electronic record of all Subscriptions and Redemptions for Hedgelet Pairs, all orders to trade Contracts, and all executed Contract trades, ~~and the record.~~ The records kept by HedgeStreet will include all of the terms identified in paragraphs (b) - (e) of this Rule as well as the date and time, to the nearest tenth of a second, that the transaction was completed, to the nearest tenth of a second for all Subscriptions and Redemptions and executed Contract trades, and to the nearest second for all orders to trade Contracts.

#### RULE 5.8 ERRORS IN HANDLING ORDERS BY CLEARING MEMBERS

(a) If a Clearing Member (or an Authorized Trader of the Clearing Member), fails to execute an order or under buys or under sells on an order (collectively "Unfilled Order"), the Clearing Member shall execute the order or remainder of the order in the market to correct the error made as a result of the Unfilled Order ("Filled Order"). If the Filled Order is executed at a worse price than the Customer should have received but for the Unfilled Order, the Clearing Member may allocate the Filled Order to its error account and assign the opposite side of the order to its error account at the price the Customer was entitled. If the Filled Order is executed at a more favorable price the Customer is entitled to the better price.

(b) If a Clearing Member executes i) an order in the wrong Type, Class and/or Series and/or ii) an order on the wrong side of the market (e.g. enters a buy order instead of a sell order or enters a sell order instead of a buy order) (collectively, "Erroneous Execution"), and the Erroneous Execution has been placed in the Clearing



Member's error account, the Erroneous Execution may be corrected by executing the order with the correct terms ("Corrected Execution"). If the Corrected Execution is executed at a worse price due to the Erroneous Execution, the Clearing Member shall make an adjustment by check in a sufficient amount to ensure that the Customer receives the better price.

(c) If a Clearing Member over buys or over sells on an order in an attempt to correct an Unfilled Order or Erroneous Execution, the Customer is not entitled to any of the excess. A Clearing Member that has established an excess position due to an attempt to correct an Unfilled Order or Erroneous Execution must place such excess position in the error account of the Clearing Member or Authorized Trader responsible for the error. Any profits resulting from the liquidation of the trades placed in the error account belong to the Clearing Member or the Authorized Trader, and may be retained or disbursed at the discretion of the Clearing Member or the Authorized Trader.

#### RULE 5.9. ~~RULE 5.6~~—DISPUTED ORDERS

(a) If you believe that an order to Subscribe for or Redeem a Hedgelet Pair or to trade one or more Contracts or iHedgelets was incorrectly executed or rejected by HedgeStreet you may request review of the order by providing the confirmation number for the order and stating the grounds for your disagreement with the handling of the order.

(b) – (f) [unchanged]

#### RULE 5.10. ~~RULE 5.7~~—ACCEPTABLE ORDERS

(a) You If you are a Non-Clearing Member, you may only enter limit orders to trade Contracts on the Market.

(b) [unchanged]

#### RULE 5.11 BLOCK TRADES

(a) Clearing Members acting on their own behalf or on behalf of their Customers, may enter into privately negotiated transactions with respect to any Class of iHedgelet Contract approved by HedgeStreet for such purpose (hereinafter referred to as "Block Trades") provided that all of the following conditions of this Rule 5.11 are met.:

(b) Each party to a Block Trade must be a Clearing Member or its Customer that qualifies as an Eligible Contract Participant, provided that, if the Block Trade is entered into on behalf of a Customer by a commodity trading advisor (registered with NFA) ("NFA"), or any investment advisor registered as such with the Securities and Exchange Commission that is exempt from CTA registration under the CEA or Commission regulations, in either case with total assets under management exceeding US \$25 million, the Customer need not be an Eligible Contract Participant.



(c) A Clearing Member may not take the opposite side of a Block Trade with a Customer without such Customer’s prior written consent, which may be in the form of a blanket consent to all transactions effected after such consent is given.

(d) A Clearing Member may effect a Block Trade on behalf of a Customer only if the Clearing Member has received an order to do so from the Customer. Such order must be recorded and time-stamped with the time the order is placed and the time the order is executed.

(e) Each buy or sell order underlying a Block Trade must:

(i) explicitly state that it is to be, or may be, executed by means of a Block Trade; and

(ii) be for at least the applicable minimum threshold (“Block Size”)<sup>3</sup> as specified in the chart below:

<u>Contract</u>	<u>Minimum Block Size<sup>1</sup></u>

(f) the price at which the Block Trade is executed must be “fair and reasonable” in light of:

(i) the size of the Block Trade;

(ii) the price and size of other transactions in the same Contract at the relevant time;

(iii) the price and size of transactions in other relevant markets, including, without limitation, the underlying cash and futures market (if applicable) at the relevant time, or

(iv) the circumstances of the market or the parties to such block trades.

(g) Immediately upon agreeing to enter into a Block Trade transaction, or upon the opening of the Market, if the transaction is agreed to be entered into by the parties at a time when the Market is closed, the

<sup>3</sup> HedgeStreet has not included in this submission the series of iHedgelets that will be eligible to engage in block trading nor the relevant minimum size requirements for any of these instruments. Such designations will be submitted separately to the Commission.



Clearing Member who is the Block Trade seller (or whose Customer is the Block Trade seller) shall report the details of the Block Trade on the screen. The report shall include the name of the selling Clearing Member, the name of the buying Clearing Member, the Contract, Contract month, price and quantity of the transaction. Within five (5) minutes of reporting the details of the Block Trade, the Clearing Member who is the Block Trade buyer (or whose Customer is the Block Trade buyer) shall confirm such Block Trade on the screen. Block Trades must be reported to HedgeStreet within five minutes of the Time of Execution. Time of Execution means the time the agreement is entered into between the buyer and the seller. The report must include the Contract, Contract month, price and quantity of the transactions. HedgeStreet shall immediately publish that Block Trade report onto the Market.

(h) Each time a Clearing Member arranges a Block Trade on the Market, the Clearing Member has the responsibility of ensuring that the execution of such Block Trade promotes a fair and orderly Market. Upon the request of HedgeStreet and/or NFA, a Clearing Member must provide satisfactory evidence that a Block Trade was arranged in accordance with these Rules.

#### RULE 5.12 TRANSFER TRADES

(a) A Clearing Member may transfer a trade in iHedgelets from one account to another account i) within the same Clearing Member or ii) to another Clearing Member, provided that the transfer would not result in a change in beneficial ownership in any iHedgelet, unless the transfer is made in order to:

(i) correct an error in a previously executed transaction, provided that the Clearing Member is able to provide evidence of such error in a form prescribed by HedgeStreet;

(ii) reflect a change in ownership occurring by operation of law due to the death or bankruptcy of a Person having an ownership interest in such iHedgelet or,

(iii) facilitate a merger, consolidation, disposition of a line of business, reorganization, or similar event effecting such Person.

(b) A Clearing Member that transfers an iHedgelet trade shall notify HedgeStreet and CCorp of the transfer in a manner and form prescribed by HedgeStreet and CCorp.

(c) Transfers of Clearing Member or Customer trades shall be made at the historic price at which such transactions were executed.

#### RULE 5.13 CROSS TRADES

(a) No Member shall enter into a Cross Trade unless the following conditions are satisfied:

(i) The Member arranging the Cross Trade must be a Clearing Member;



(ii) If a Customer order is on one side of the transaction, the Customer must give consent to enter into such Cross Trade (which may be in the form of a blanket consent);

(iii) During pre-negotiations and in executing Cross Trades for a Customer, the Clearing Member ensures that;

(1) such Clearing Member acts with due skill, care and diligence, and

(2) the Customer's interests are not prejudiced.

(iv) When a Customer order is on one side of the Cross Trade, then the Customer order must be submitted first onto the Market.

(v) If both parties agree to execute the transaction above the existing bid price and below the existing offer price, the Cross Trade may be executed immediately on the market. In the absence of a bid and an offer price in the relevant iHedgelet Series, then the Clearing Member seeking to execute a Cross-Trade must;

(1) Enter an order onto the Market;

(2) Allow the order to remain on the Market for 10 seconds, provided that, if the market in the Series is illiquid or the order represents the first transaction in a Series, the order shall remain on the Market for 60 seconds, and

(3) The Clearing Member may immediately enter the opposite order after the 10 second or 60 second period has expired, in accordance with Rule 5.13(a)(v)(2).

(vi) A Clearing Member must not enter a bid and/or an offer onto the Market in an attempt to circumvent Rule 5.13(v).

#### RULE 5.14 GIVE-UPS

(a) A Give-Up occurs when a CCorp Participant executes a trade ("Executing Participant") on behalf of another CCorp Participant ("Carrying Participant") and subsequently transfers the trade to the Carrying Participant.

(b) The Executing Participant must i) indicate that the transaction is being executed as a Give-Up prior to order entry, and ii) indicate the Carrying Participant.

(c) The Executing Participant must submit Give-Up transactions to CCorp for clearing and, remains responsible for the clearing and settlement of such Give-Up transaction as determined by the rules of CCorp.





RULE 5.15~~RULE 5.8~~ PRIORITY OF ORDERS

[except for renumbering, this rule is unchanged]

RULE 5.16~~RULE 5.9~~ FILLING ORDERS TO TRADE CONTRACTS

[except for renumbering, this rule is unchanged]

RULE 5.17~~RULE 5.10~~ MODIFICATION AND CANCELLATION OF ORDERS

[except for renumbering, this rule is unchanged]

RULE 5.18~~RULE 5.11~~ VIEWING THE MARKET AND EXECUTED ORDERS

[except for renumbering, this rule is unchanged]

RULE 5.19~~RULE 5.12~~ HOURS FOR THE SUBSCRIPTION AND REDEMPTION OF HEDGELET PAIRS AND TRADING HEDGELET CONTRACTS

[except for renumbering, this rule is unchanged]

RULE 5.20~~RULE 5.13~~ PROHIBITED TRANSACTIONS AND ACTIVITIES

(a) ~~You~~If you are a Non-Clearing Member, you are prohibited from entering orders on the Market if there are insufficient funds or Contracts in your account to satisfy such orders if they are executed. Subject to the conditions set forth in Rule 9.2(f) and Rule 9.6, if you violate this Rule, the following penalties shall apply:

Number of Per Incident Violations Within a Calendar Year	Penalty
1	\$10 fee deducted from your account
2	\$10 fee deducted from your account, and you will be required to re-certify that you have read and agree to be bound by this Rule 5.13(a).
3	\$15 fee deducted from your account, and you will be required to give a satisfactory explanation as to why the Rule violation occurred, or your trading privileges will be suspended for 30 days
4	\$20 fee deducted from your account and suspension of your trading privileges for 30 days (regardless of explanation)
5	\$25 fee deducted from your account and suspension of your trading privileges for 6 months (regardless of explanation)
6	\$30 fee and revocation of trading privileges (regardless of



	explanation)
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(b) You are prohibited from attempting to enter into any trade on the Market that has been directly or indirectly prearranged except in accordance with conditions and procedures under which such transactions may be permitted under these Rules. In other words, you may not agree with another Member that one of you will enter a trade and the other will attempt to match that trade by timing the orders or otherwise except when such agreements are executed in accordance with these Rules.

(c) You are prohibited from attempting to enter into or entering into any trade on the Market that does not result in a change in beneficial ownership, that is designed to unnaturally inflate trading volume, that in any way attempts to circumvent the Market's order processing, trade ordering, and trade execution systems, or otherwise to circumvent exposure of the order to open and competitive bidding on the Market, or that has some other illegitimate purpose.

(d) You are prohibited from entering into any trade designed or used to cause any price for a Contract other than a true and bona fide price to be reported, registered, or recorded by the Market.

(e) You are prohibited from knowingly entering or causing to be entered, bids or offers onto the Market other than in good faith for the purpose of executing bona fide transactions.

(f) (e) You are prohibited from trading in, transferring, assigning, or otherwise disposing of Hedgelet Pairs or Contracts other than as provided for in these Rules.

(g) (f) You are prohibited from agreeing to transfer or from transferring the benefit of any position in any Hedgelet Pair or Contract to another person other than through a transaction executed through the Market except in accordance with the conditions and procedures under which such transactions may be permitted under these Rules.

(h) (g) You are prohibited from trading for a person or entity other than yourself or the Member for whom you are an authorized representative Authorized Trader.

(i) (h) You are prohibited from engaging in any activity that presents a risk of harm to HedgeStreet, its members, Members, Customers or the public.

(j) (i) You are prohibited from engaging in any activity that adversely affects the integrity of the Market or its underlying systems.

(j) You are prohibited from failing to abide by an arbitration decision or award handed down under Chapter 10 of these Rules.

(k) You are prohibited from intentionally providing erroneous or fraudulent information to HedgeStreet on your membership application or otherwise.



(l) You are prohibited from violating or failing to timely comply with the terms of any agreement between you and HedgeStreet or the Clearing Corporation, or any order or arbitration decision or award of HedgeStreet, NFA or the Clearing Corporation.

(m) (4)—You are prohibited from engaging in any activity that is intended to, or has the effect of, manipulating the market in violation of Sections 6(c) and 9(a)(2) of the CEA and from engaging in any other activity that would violate the CEA or the Commission’s Regulations.

(n) If you are a Clearing Member, you are prohibited from entering any bids, offers or transactions on the Market when you have, or should know that you are subject to early warning reporting requirements under Commission Regulation 1.12, are subject to a proceeding in bankruptcy or are otherwise unable to pay your obligations as they become due, without the prior written approval of HedgeStreet.

(o) You are prohibited from knowingly carrying an account, entering an order or effecting any transactions for any employee of HedgeStreet or the Clearing Corporation without the prior written consent of the employer.

(p) You are prohibited from directly or indirectly guaranteeing the execution of an order to buy or sell a Contract on HedgeStreet, or any of its terms, including quantity and price unless such order has been executed or reported on the Market.

(q) You are prohibited from handling, maintaining or soliciting any Customer orders, accounts or funds unless you are a Clearing Member that is properly registered with the NFA in accordance with the CEA and Commission Regulation adopted thereunder to conduct futures-related business with the public.

#### RULE 5.21~~RULE 5.14~~—SPECULATIVE POSITION LIMITS

(a) HedgeStreet has imposed Speculative Position Limits on certain Classes of Contracts as defined in Chapter 12 of these Rules. Any Member who exceeds a Speculative Position Limit shall be deemed in violation of this Rule ~~5.14.5.21~~. In addition, any Member entering bids or offers, if accepted, causing the Member to exceed the applicable Speculative Position Limit shall be in violation of this Rule.

(b) [unchanged]

(c) In addition to the restrictions and requirements imposed in Section ~~5.14.5.21~~(a) and (b), the first violation of a Speculative Position Limit by a Member shall result in a letter of warning to be issued by the HedgeStreet Compliance Department to the Member.

(d) In addition to the restrictions and requirements placed in Section ~~5.14.5.21~~(c), any subsequent violation of a Speculative Position Limit within the preceding 12 months by a Member shall result in the issuance of a second letter of warning to the Member and the suspension or revocation of membership privileges in accordance with Chapter 9 of these Rules.



(e) [unchanged]

**CHAPTER 6 SETTLING ~~HEDGELET~~NON-~~i~~HEDGELET PAIR SUBSCRIPTIONS AND REDEMPTIONS, ~~CONTRACT~~NON-~~i~~HEDGELET TRADES, NON-~~i~~HEDGELET CONTRACTS AT EXPIRATION, AND MEMBER WITHDRAWAL REQUESTS**

**RULE 6.1 SETTLING ~~HEDGELET~~NON-~~i~~HEDGELET PAIR SUBSCRIPTIONS AND REDEMPTIONS AND ~~CONTRACT~~NON-~~i~~HEDGELET TRADES**

(a) [unchanged]

(b) All funds in Member accounts and in the HedgeStreet settlement account will be maintained in an account at the HedgeStreet settlement bank that is designated as a customer segregated funds account under the CEA and the Commission's Regulations. Because those funds will be commingled at the settlement bank, transfers among Member accounts and transfers between Member accounts and the HedgeStreet settlement account will not be transmitted to the settlement bank. Such records will only be maintained on the HedgeStreet system. ~~However, once~~Once every settlement bank business day, HedgeStreet will send to its settlement bank by batch mode electronic transmission instructions for the settlement bank to transfer fees credited by HedgeStreet to the HedgeStreet proprietary account on its system from the customer segregated funds account at the funds as necessary for settlement bank to the HedgeStreet proprietary account at the settlement bank.

(c) [unchanged]

**RULE 6.2 SETTLING ~~i~~HEDGELETS FOR CLEARING MEMBERS**

(a) Settlement of ~~i~~Hedgelet trades and expirations will be conducted in accordance with the by-laws and rules of the Clearing Corporation.

**RULE 6.3~~RULE 6.2~~ SETTLING ~~NON-~~i~~HEDGELET~~ CONTRACTS AT EXPIRATION**

(a) [unchanged]

(b) On the Settlement Date;

(i) HedgeStreet will notify all members which Contract is in-the-money and which Contract is out-of-the-money.

(ii) HedgeStreet will immediately settle the Fixed Payout Hedgelet Contracts by debiting HedgeStreet's settlement account in an amount equal to \$10.00 multiplied by the total number of outstanding in-the-money Fixed Payout Hedgelet Contracts and credit those funds to the accounts of the



Members holding the in-the-money Fixed Payout Hedgelet Contracts at a rate of \$10.00 per such Contract.

(iii) HedgeStreet will immediately settle the Variable Payout Hedgelet Contracts by (A) debiting HedgeStreet's settlement account in an amount equal to (1) any gains realized by Members plus (2) any blocked funds that were debited from Members' accounts at the time the Variable Payout Hedgelet Contracts that are expiring were entered into that are not used to pay any losses on such Contract(s) and (B) crediting those amounts, respectively, to ~~the Member~~ accounts of (1) ~~Members who~~ that realized such gains, in each case in the amount of such gains realized by each ~~Members~~ such account, and (2) ~~Members~~ from ~~whose accounts~~ which such blocked funds were taken, in each case in the amount of such blocked funds that was not required to pay losses experienced by such accounts on such Contracts.

(iv) HedgeStreet will delete all Contracts of the expiring Series from ~~the Member~~ accounts of ~~Members~~.

(c) [unchanged]

#### RULE 6.4~~RULE 6.3~~—SETTLING MEMBER WITHDRAWAL REQUESTS FOR ACCOUNTS HELD AT HEDGESTREET

[except for renaming and renumbering, this rule is unchanged]

#### **CHAPTER 7 ADJUSTMENTS NECESSITATED BY MATERIAL CHANGES IN THE UNDERLYING**

[unchanged]

#### **CHAPTER 8 INVESTMENT OF MEMBER ACCOUNT FUNDS**

##### RULE 8.1 INVESTMENT OF NON-CLEARING MEMBER FUNDS HELD AT HEDGESTREET

Member funds on deposit with HedgeStreet and funds in the HedgeStreet settlement account (i.e., the account containing the funds paid by Members to purchase Fixed Payout Hedgelet Pairs from HedgeStreet and which are to be used to pay Members holding in-the-money Fixed Payout Hedgelet Contracts at expiration) will be segregated as customer funds in accordance with the Commission's Regulations. HedgeStreet may invest such funds subject to the limitations and conditions set forth in Commission Regulation 1.25. HedgeStreet will pay interest to Members' accounts at a floating rate to be determined by HedgeStreet on funds in Members' HedgeStreet accounts in excess of an amount to be determined by HedgeStreet. HedgeStreet will retain all profit from investment of Member funds not paid to Members in accordance with the preceding sentence.



## RULE 8.2 INVESTMENT OF CLEARING MEMBER FUNDS HELD AT THE CLEARING CORPORATION

Clearing Member funds and the funds of Clearing Member Customers on deposit at the Clearing Corporation will be deposited and invested in accordance with the Clearing Corporation's policies and rules.

### **CHAPTER 9 RULE ENFORCEMENT**

#### **RULE 9.1 MONITORING THE MARKET**

HedgeStreet's trading system will record and store for a period of not less than 5 years in a searchable, read-only database a record of all data entered into the HedgeStreet trading system, including the Member's identity and the information in Rule ~~5.5.5.7~~. Programs are run on this data by HedgeStreet and by an organization with which HedgeStreet has entered into an agreement to provide certain market surveillance, ~~and~~ trade practice surveillance, financial surveillance and investigatory services, and those programs will alert HedgeStreet or its market/trade practice surveillance services provider when potentially unusual trading activity takes place. HedgeStreet or its services provider will initiate investigations upon receipt of notice of unusual trading activity, and HedgeStreet and/or its service provider will review and further investigate any reports of such activity provided by its market surveillance services provider. HedgeStreet will also investigate any time it has other reason to believe that inappropriate activity of any sort is taking place on the Market or its website.

#### **RULE 9.2 INVESTIGATIONS, HEARINGS, AND APPEALS**

(a) HedgeStreet has a compliance department consisting of one or more compliance officers. In addition, HedgeStreet may enter into agreements with one or more investigatory service providers in order to perform the specified functions assigned by these Rules to HedgeStreet compliance officers. Compliance officers investigate unusual trading activity or other activity that compliance officers have reasonable cause to believe could constitute a violation of these Rules. HedgeStreet has a Disciplinary Committee that determines whether disciplinary action should be brought against a Member based on the findings of compliance officers. HedgeStreet also retains hearing officers, who adjudicate findings by compliance officers that are disputed by Members. Hearing officers and compliance officers may not communicate regarding a matter brought before the hearing officer without informing the Member who is the subject of the communication of its substance and allowing the Member an opportunity to respond. Compliance officers and hearing officers may compel testimony, subpoena documents, and require statements under oath from any Member or its authorized representative. Compliance officers, hearing officers, and employees or agents of HedgeStreet working under their supervision, may not be a Member or an authorized representative of a Member or trade, directly or indirectly, in any commodity interest traded on or subject to the rules of any registered contract market.

(b) Upon the conclusion of any investigation by a compliance officer, the officer will draft a document detailing the facts that led to the opening of the investigation, the facts that were found during the investigation, and the compliance officer's analysis and conclusion. If the compliance officer concludes that there is reasonable cause to believe a Member has violated HedgeStreet's Rules or other applicable statutes or regulations, the compliance officer will present his/her analysis and conclusions to the HedgeStreet Disciplinary



Committee for review and final determination as to whether disciplinary proceedings should commence against the Member. If the Disciplinary Committee determines that disciplinary proceedings should be brought against the Member, the compliance officer will submit by electronic mail to the Member whose activity is the subject of the investigation a report that will include:

- (i) the reason the investigation was begun;
- (ii) the charges or a summary of the charges;
- (iii) the response, if any, or a summary of the response;
- (iv) a summary of the investigation conducted;
- (v) findings and conclusions as to each charge, including which of these Rules the Member or its authorized representative violated, if any; and
- (vi) the penalty, if any, proposed by the ~~compliance officer~~ Disciplinary Committee.

(c) The Member whose activity is the subject of the investigation may contest the ~~compliance officer~~ Disciplinary Committee's findings by forwarding a response to those findings by electronic mail to the compliance officer within 15 days. The Member has a right to examine the evidence relied upon by the compliance officer and Disciplinary Committee. The Member's response must contain a detailed response to the findings and conclusions as to each charge and any other information the Member thinks is relevant.

(d) If the findings of the ~~compliance officer~~ Disciplinary Committee are not contested by the Member, HedgeStreet will deem those findings admitted by the Member and impose the penalty (if any) proposed by the ~~compliance officer~~ Disciplinary Committee. The Member will be notified of the imposition of any penalty by electronic mail.

(e) If the findings of the ~~compliance officer~~ Disciplinary Committee are contested, the compliance officer's report and the Member's response will be submitted to a HedgeStreet hearing officer. The hearing officer will conduct a telephonic hearing with the compliance officer and the Member within 20 days of receipt of the Member's response contesting the ~~compliance officer~~ Disciplinary Committee's finding and/or proposed sanction and, within 20 days after that hearing, issue findings, which will be delivered to the Member by electronic mail. Prior to the hearing, the parties may (but need not) submit proposed findings, briefs, and exhibits (including affidavits), and during the hearing the parties may present witnesses. The telephonic hearing will be recorded, and all information submitted by the parties (including the compliance officer's report and the Member's response) as well as the recording of the hearing, will be preserved by the hearing officer, along with the hearing officer's findings, as the record of the proceedings (the "hearing record"). The findings of the hearing officer will contain the following information:

- (i) a brief description of the allegations;



- (ii) a brief summary of the evidence received;
  - (iii) findings and conclusions;
  - (iv) a declaration of any penalty to be imposed on the Member as the result of the findings and conclusions;
  - (v) the effective date and duration of that penalty; and
  - (vi) a statement that the Member has the right to appeal any adverse decision by the hearing officer to the HedgeStreet board of directors, but must do so within 15 days.
- (f) [unchanged]

RULES 9.3 – 9.6 [unchanged]

RULE 9.7 ACTIONS RESPECTING NON-MEMBERS

(a) If HedgeStreet has reason to believe that any non-Member is conducting trading activities in violation of the CEA or that would be a violation of these Rules if the non-Member were a Member, HedgeStreet may require any Clearing Member that acts on behalf of the non-Member, to appear, produce documents and testify, at a HedgeStreet Compliance Department interview or investigation, or a disciplinary proceeding before a hearing officer.

(b) If it is determined at the conclusion of the disciplinary proceeding that the actions of the non-Member violate the CEA or would violate these Rules if the non-Member were a Member, the hearing officer may:

- (i) order any Clearing Member to liquidate all or any portion of such non-Member's positions;
- (ii) order that no Clearing Member accept new positions on behalf of any such non-Member;
- (iii) deny or terminate access of such non-Member to the Market; or
- (iv) order such other action as the hearing officer deems necessary or advisable to prevent the actions that may violate the CEA or would violate these Rules if the non-Member were a Member.

RULE 9.8. ~~RULE 9.7~~ REPRESENTATION BY COUNSEL

[except for renumbering, this rule is unchanged]





## CHAPTER 10 LIMITATION OF LIABILITY; TIME PERIOD IN WHICH TO BRING ACTIONS; GOVERNING LAW; ARBITRATION

### RULE 10.1 LIMITATION OF LIABILITY

(a) AS A MEMBER YOU AGREE THAT NEITHER HEDGESTREET, THE CLEARING CORPORATION, NOR ~~HS~~THEIR RESPECTIVE OFFICERS, DIRECTORS, AGENTS AND/OR EMPLOYEES (COLLECTIVELY REFERRED TO AS “HEDGESTREET PARTIES”) SHALL HAVE ANY RESPONSIBILITY FOR COMPLIANCE BY MEMBER WITH ANY LAW OR REGULATION GOVERNING MEMBER’S CONDUCT. MOREOVER, YOU ALSO AGREE THAT NO HEDGESTREET PARTY SHALL BE LIABLE IN ANY MANNER WHATSOEVER FOR ANY LOSS OR DAMAGE SUSTAINED BY MEMBER, INCLUDING ANY CONSEQUENTIAL LOSS, LOSS OF PROFIT OR LOSS OF TRADING OPPORTUNITY, AS A RESULT OF ANY ACTUAL OR PROPOSED TRANSACTIONS OR AS A DIRECT OR INDIRECT RESULT OF ANY SERVICES PROVIDED BY HEDGESTREET PARTIES (INCLUDING, WITHOUT LIMITATION, ANY FAILURE IN HEDGESTREET’S SYSTEMS OR ANY INACCURATE INFORMATION PROVIDED BY A HEDGESTREET PARTY), UNLESS THE RELEVANT HEDGESTREET PARTY IS DETERMINED BY FINAL RULING OF AN ARBITRATION PROCEEDING TO HAVE ACTED OR FAILED TO ACT IN A MANNER THAT IS GROSSLY NEGLIGENT, RECKLESS, OR FRAUDULENT. FOR THE AVOIDANCE OF DOUBT, NOTHING IN THIS RULE IS INTENDED TO LIMIT THE LIABILITY OF ANY PERSON AS MAY BE PROVIDED IN THE CEA, THE REGULATIONS OF THE COMMISSION, OR BY ACTS OF WILLFUL OR WANTON MISCONDUCT OR FRAUD.

(b) [unchanged]

(c) AS A MEMBER, YOU AGREE THAT ANY ACTION YOU BRING ~~A~~AGAINST HEDGESTREET PARTY WILL BE GOVERNED BY ILLINOIS LAW, WITHOUT REGARD TO STATUTES, PRECEDENT, LEGAL DOCTRINE, OR CONTRACTUAL PROVISIONS THAT WOULD REQUIRE THE APPLICATION OF THE LAWS OF A DIFFERENT JURISDICTION.

(d) [unchanged]

RULES 10.2 – 10.3 [unchanged]

### RULE 10.4 ARBITRATION OF CLEARING MEMBER-CUSTOMER DISPUTES

Any dispute, controversy, or claim brought against any Clearing Member by any Customer arising out of or relating to transactions on HedgeStreet shall be submitted to binding arbitration in Cook County, Illinois, before, and according to the arbitration rules of National Futures Association, or in the case of any Customer which is an ECP, such other self-regulatory organization as the parties may agree; provided, however, that the submission of such dispute to arbitration shall be voluntary on the part of any Customer which is not an ECP. The decision of the arbitrator or arbitrators or court of law, will be final, and judgment upon that decision may be entered in any court of competent jurisdiction. The failure by any Clearing Member to comply with any



decision issued by the arbitrator or arbitrators in resolving any such dispute shall constitute a violation of these Rules, unless the decision is the subject of pending judicial review.

RULE 10.5.~~RULE 10.4~~—FAILURE TO ABIDE BY ARBITRATION DECISION

[except for renumbering, this rule is unchanged]

RULE 10.6.~~RULE 10.5~~—CHANGE IN ARBITRATION PROCEDURE

[except for renumbering, this rule is unchanged]

RULE 10.7. DISPUTES INVOLVING CLEARING OF iHEDGELETS

Notwithstanding anything to the contrary in these Rules, any disputes arising from or connection with the clearance of iHedgelets shall be resolved pursuant to the procedures set forth in the Clearing Corporation's rules and policies.

CHAPTERS 11 – 12 [unchanged]

[end of Rulebook]

\* \* \* \* \*

**2. Proposed effective date of proposed rule change, action taken to adopt the proposed rule change, and Rules of HedgeStreet that authorize the adoption of the proposed rule change, as required by Regulation 40.5(a)(1)(iii):**

As provided by Commission Regulation 40.5(b), HedgeStreet proposes that these rule changes take effect forty-five days after its receipt by the Commission. The proposed rule change was approved by HedgeStreet's Rule Committee and Instrument Committee, as designated by the HedgeStreet Board of Directors in accordance with HedgeStreet Rules 2.1 and 2.5(a) at a meeting held September 2, 2005. The action of the Rule Committee and Instrument Committee to adopt the proposed rule changes was authorized by the Board of Directors pursuant to HedgeStreet Rule 2.5(a).

**3. Explanation of the operation, purpose, and effect of the proposed rule change, including, if applicable, a description of the anticipated benefits to market participants or others, any potential anticompetitive effect on market participants or others, how the proposed rules fit into HedgeStreet's framework of self-regulation, and any other information that HedgeStreet believes may be beneficial to the Commission in analyzing the proposed rule change, as required by Regulation 40.5(a)(1)(iv):**

**BACKGROUND**



HedgeStreet is currently designated as a contract market (“DCM”) and registered as a derivatives clearing organization (“DCO”) with the Commodity Futures Trading Commission (the “Commission”) offering small contract sizes directly to the general public on a fully collateralized basis (“Non-Intermediated Market”). HedgeStreet’s activities as both a DCO and DCM currently preclude intermediation on its market, rather it currently has only one class of members who interact directly with the exchange on behalf of themselves. HedgeStreet’s activities as a DCO are currently limited to clearing fully collateralized cash-settled futures and option contracts listed for trading on the contract market, HedgeStreet, Inc. “Fully collateralized” is defined in HedgeStreet’s amended DCO order of registration that it must hold, at all times, sufficient funds of each HedgeStreet Member to cover the maximum possible loss that may be sustained by such Member upon liquidation of any or all HedgeStreet contracts to which such Member is a party.

HedgeStreet currently lists two types of contracts on its market: a fixed payout hedgelet (“FPH”) contract and a variable payout hedgelet (“VPH”) contract. The FPHs are long cash-settled, binary European-style options. A “Pair” of FPH contracts consists of two independently trading FPHs with a Payout Criteria that are mutually exclusive of each other but that together cover all possible values of the underlying interest. Each FPH contract in the Pair has a defined “Payout Criterion” representing a range of possible values for the FPH’s underlying interest. If the value of the underlying interest is within the payout criterion at expiration of the FPH, the FPH will settle for \$10. If the value of the underlying interest is outside the payout criterion at expiration, the FPH will settle for \$0. Thus, it will always be the case that one of the FPH in a Pair will settle in the money for \$10 and the other FPH in the Pair will settle out of the money for \$0. The VPHs, on the other hand, are essentially futures contracts with a cap and a floor. Unlike FPHs, VPHs are not issued in Pairs nor is a premium price paid for a VPH because it is not an option. Instead, just like any other futures contract, a VPH is entered into at a value or level agreed upon by the long and the short. However, unlike traditional futures contracts, the risk margin collected at the time a VPH is entered into is 100%, and HedgeStreet therefore has no credit exposure to any Member in respect of VPHs. Therefore, no variation margin payments are made during the life of the VPH, and risk margin that is not needed to pay the settlement value when the VPH is closed or expires is returned to the trader at that time.

HedgeStreet is now proposing that it be permitted to establish essentially a new market (“iMarket”) that introduces i) a new class of members that can trade for their own accounts or the accounts of their customers (“Clearing Members”) on the HedgeStreet market, ii) an alternative margining methodology other than full collateralization pursuant to an arrangement with the Clearing Corporation (“CCorp” and, iii) larger size contract that are fundamentally similar to both the FPH and VPH contracts (“iHedgelets”) in order to attract large institutional members onto HedgeStreet.

## **HOW THE NEW iMARKET WILL WORK**

### ***The iMarket Generally***

The new iMarket will be a market in which members of the CCorp that are also Clearing Members of HedgeStreet may trade iHedgelets for their proprietary account(s) and/or on behalf of qualified Customers. Qualified Customers will be Customers of Clearing Members who are approved to trade futures in accordance



with the Clearing Member's requirements as a member of CCorp. Clearing Members will therefore act as both executing and clearing brokers for their Customers.

#### Types of Contracts Offered on the iMarket

HedgeStreet intends to offer two types of contracts on the iMarket. The first type of contract will have similar characteristics to the FPH contract and the second type of contract will have similar characteristics to the VPH. The only differences between the instruments currently trading on HedgeStreet and iHedgelets are the following: i) both types of iHedgelets could have a notional value in any amount between \$0 - \$10,000 in comparison to the \$0 and \$10 notional value of the contracts traded on the Non-Intermediated Market, ii) the Settlement Value for the Fixed Payout iHedgelet could be a fixed amount between \$0 - \$10,000 with such fixed amount being dependent upon the notional value of the contract while the Settlement Value for the variable payout iHedgelet could range in value between \$0-\$10,000; iii) all iHedgelets will be cleared and settled by CCorp; iv) iHedgelets may be traded on margin subject to the rules of HedgeStreet and the CCorp, and v), Fixed Payout iHedgelets will not come in Yes/No pairs as the same results will be expressed with such iHedgelets by either going long or short a single Fixed Payout contract. Thus, Clearing Members may enter into either long or short positions in both types of iHedgelet contracts.

#### Examples of iHedgelets

**Fixed Payout iHedgelet** – Currently, HedgeStreet offers Hedgelet Pairs that are comprised of two contracts: a Yes contract and a No contract where a member may only take a long position in either contract. To illustrate, suppose HedgeStreet currently lists a Pair whereby each contract in the Pair will have a separate Payout Criteria that represents whether the price of Gold will be greater than \$433.50 on September 1, 2005; one contract represents the position that, yes, Gold will be greater than \$433.50 (the call contract) while the other contract represents that, no, Gold will not be greater than \$433.50 (the put contract). If the price of Gold is greater than \$433.50 on September 1, 2005, the holder of the call contract will be in the money and receive a payout of \$10. Conversely, if the price of Gold is less than or equal to \$433.50, the put contract will be in the money. In the new iMarket, there will only be one contract that represents both sides of the market by the trader either going long or short the contract. To further illustrate and expanding on the example above, suppose Trader A goes long the iHedgelet contract that states Gold will be greater than \$433.50 on September 1, 2005 and pays \$400 (his maximum loss). Trader A will be in the money on the settlement day if Gold is greater than \$433.50 on September 1, 2005 and receive a fixed settlement value based on the notional value of the contract. However, if Trader B goes short this same contract and pays \$600 (her maximum loss), Trader B will be in the money on the settlement date if Gold is equal to or less than \$433.50 on September 1, 2005 and receive a fixed settlement value based on the notional value of the contract. Assuming the notional value of the contract is \$1,000, the in-the money contract holder will be paid \$1,000 on the settlement date while the out of the money contract holder will receive \$0 on the settlement date.

**Variable Payout iHedgelet** – Currently, HedgeStreet offers VPH contracts that are comprised of one contract where a member may take either a long or short position in such contract. For example, a Gold VPH contract may have a Payout Criteria that has a Floor of \$432.05 and a Cap of \$452.05 with any \$2 change in the price of Gold, representing a \$1 move in the contract. If Trader A goes long the VPH contract and pays her maximum



loss and holds the contract until expiration date, she will receive a varying payout if the price of Gold is greater than the Floor price (\$432.05) on the settlement date. Conversely, if Trader B goes short the same VPH contract and pays her maximum loss and holds the contract until the expiration date, she will receive a varying payout if the price of Gold is less than the Cap (\$452.05) on the settlement date. In the new *iMarket*, the variable payout *iHedgelets* will behave in much the same way except that the notional value will be larger in size, thus creating a larger varying settlement value.

Though HedgeStreet has not provided the terms and conditions for any *iHedgelets* in this submission, HedgeStreet intends to certify that the contracts to be traded on the exchange comply with the Commodity Exchange Act and the regulations adopted thereunder.

#### Clearing and Settlement of *iHedgelets*

As indicated above, HedgeStreet's activities as a DCO are limited to clearing and settling fully collateralized contracts on behalf of its current members. HedgeStreet has therefore entered into a clearing services agreement ("CSA"<sup>4</sup>) with CCorp in order for CCorp to clear and settle *iHedgelets* on the HedgeStreet *iMarket*. CCorp, formally the Board of Trade Clearing Corporation, is a registered clearing organization with the Commission and is authorized to clear and settle contracts in a less restrictive manner than on a fully collateralized basis.

#### Market and Trade Surveillance Program of the *iMarket*

HedgeStreet has entered into a Regulatory Services Agreement ("RSA") with the National Futures Association ("NFA") in order to perform certain regulatory services for its non-intermediated market. HedgeStreet and NFA have an executable amendment to the current RSA in order to expand the terms of the RSA so that NFA will conduct necessary trade practice surveillance, financial surveillance and market surveillance to detect abuses that may occur on intermediated markets.<sup>5</sup> In addition to the surveillance NFA currently conducts on behalf of HedgeStreet, NFA will monitor for such activities as Trading Ahead, Taking the Other Side, Front Running, Crossing, Error Account Activity, and Off-Exchange Large Block Trading

### **RULE CHANGES**

In order to introduce the *iMarket*, HedgeStreet proposes adding several new defined terms and rules that incorporate intermediation, *iHedgelets*, the role of the Clearing Corporation, and the responsibility of Clearing Members in entering transactions on the market for themselves or for their Customers on the new HedgeStreet market.

#### DEFINED TERMS - RULE 1.1

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<sup>4</sup> HedgeStreet has provided the CSA to the Commission under a request of confidential treatment pursuant to Commission Regulation 145.9.

<sup>5</sup> HedgeStreet has provided a final executable draft of the RSA for the *iMarket* under a request of confidential treatment pursuant to Commission Regulation 145.9.



### Participants in the iMarket

The term “Clearing Corporation” has been added to define the DCO that will be clearing and settling all of the iHedgelet contracts on behalf of CCorp Participants. The term “CCorp Participant” has been added in order to define members of CCorp that are not members of HedgeStreet. “Clearing Member” has been added to define those HedgeStreet Members that are also Clearing Participants in good standing with CCorp. “Authorized Trader” has been added in order to introduce brokers and traders of Clearing Members as well as individuals who trade on behalf of entities that are members of the Non-Intermediated Market. All Members are responsible for the trading activities of Authorized Traders that effect, either directly or indirectly, the HedgeStreet Market. The term Non-Clearing Member has been added in order to define those HedgeStreet Members that trade Hedgelet Contracts on a fully-collateralized basis prior to order execution on the Non-Intermediated Market. The definition of the term “Member” was modified in order to incorporate both Clearing Member and Non-Clearing Member into the definition of Member since some of the HedgeStreet Rules apply to both types of Members. The term “Customer” has been added since Clearing Members, that are properly registered with NFA to conduct futures business with the public may enter orders on the iMarket for themselves or their Customers. The term “Eligible Contract Participant” or “ECP” has been added in order to i) limit the scope of those participants that may engage in block trading in accordance with HedgeStreet Rules and ii) allow an ECP to have the flexibility to choose an arbitration forum other than NFA as agreed upon between the Member and ECP Customer. “Person” has been added in order to clarify certain definitions in HedgeStreet’s rules such as the definition of Member and Transfer Trades. The term “Regulatory Agency” has been added in order to broaden the scope of Clearing Member obligations since many Clearing Members may be regulated by various Regulatory Agencies.

### Contracts

The term “Fixed Payout iHedgelet” and “Variable Payout iHedgelet” have been added in order to introduce the instruments to be traded on the new iMarket and cleared and settled by CCorp. Fixed and Variable Payout iHedgelets will operate similarly to the current Fixed Payout and Variable Payout Hedgelets that trade on the Non-Intermediated market as described above in this section 3, except that the former have i) a notional value in any amount between \$0 - \$10,000 and not between \$0 and \$10 as is the case on the Non-Intermediated Market, ii) the Settlement Value for the Fixed Payout iHedgelet could be a fixed amount between \$0 - \$10,000 with such fixed amount being dependent upon the notional value of the contract while the Settlement Value for the variable payout iHedgelet could range in value between \$0-\$10,000; iii) all iHedgelets will be cleared and settled by CCorp; iv) iHedgelets may be traded on margin subject to the rules of HedgeStreet and the CCorp, v), iHedgelets will not come in Yes/No pairs since the same results are expressed with iHedgelets by either going long or short a single contract and, vi) Clearing Members may enter into either long or short positions in iHedgelet contracts. The definition of “Settlement Value” was amended in order to incorporate iHedgelets. The definition of the term “Type” was amended in order to add two additional Types to the definition which are the Fixed Payout iHedgelet and Variable Payout iHedgelet.

### Miscellaneous

The term “Membership Agreement” was added in order to define the purpose of this agreement so Members understand their obligations upon agreeing to all of the terms in the Membership Agreement.

## CHAPTER 3 – MEMBERS



With the introduction of the intermediation and iHedgelets, HedgeStreet will have more than one type of Member that can trade on HedgeStreet. Therefore, HedgeStreet has divided this Chapter to reflect the application process, the privileges and obligations for each type of HedgeStreet Member.

### *RULE 3.1 ELIGIBILITY AND APPLICATION PROCEDURES*

Rule 3.1 delineates the eligibility and application requirements for both Non-Clearing Members and Clearing Members. Except for reorganizing the rules in this section, the Rules surrounding the eligibility and application of Non-Clearing Members have remained the same, except for the addition of Rule 3.1(a)(ii)(4) which requires an entity Non-Clearing Member to appoint Authorized Trader(s) to trade on behalf of the Member and Rule 3.1(a)(ii)(5) which requires that a supervisor be appointed for all entity member accounts. Both Rules were added in order to ensure that only Authorized Trader(s) are permitted to trade on HedgeStreet as well as ensure that the activities of such Authorized Traders are appropriately supervised by such Non-Clearing Members. New Rule 3.1(d) has been added to define the eligibility and application requirements of Clearing Members. Rule 3.1(d)(i) stipulates that Clearing Members must abide by all Non-Clearing Member Rules except for those relating to the manner in which Non-Clearing Members fund their account and the initial deposit requirement of \$100. Rule 3.1(d)(ii) was added in order to inform Clearing Members that they are required to maintain adequate financial resources and credit, especially for those Clearing Members that are registered with the NFA and are permitted to maintain Customer accounts. Rule 3.1(d)(iii) was added in order to inform Clearing Members that they must be a CCorp Participant before they are eligible to become a Clearing Member of HedgeStreet. Rule 3.1(d)(iv) was added in order to require Clearing Members that are FCMs to present a letter confirming that it maintains a customer segregated funds account in accordance with Commission regulations. Rule 3.1(d)(v) was added in order to inform Clearing Members that HedgeStreet and CCorp have the right to request further information or impose further eligibility requirements if either deems it necessary or appropriate.

### *RULE 3.2 PRIVILEGES*

Rule 3.2 delineates the privileges granted to both Non-Clearing Members and Clearing Members. Except for reorganizing the rules in this section to accommodate the introduction of Clearing Members and to define the types of contracts (Non-iHedgelet Contrats) a Non-Clearing Member may trade on the Market in Rules 3.2(a)(iv) and (v), the Privileges of Non-Clearing Members have remained the same. Please note that in Rule 3.2(vii), we changed FIX Gateway to a more technically correct term “a dedicated private circuit.” This new term has been incorporated in other sections throughout the draft rulebook. New Rule 3.2(b) has been added to define the privileges of Clearing Members. Rule 3.2(b)(i) and (ii) has been added to define the types of contracts (iHedgelets) a Clearing Member may trade on the Market. In order for a Clearing Member to have the privileges granted to Non-Clearing Members, HedgeStreet has added new Rule 3.2(c) requiring that such Clearing Members satisfy all of the requirements defined in 3.1(a) – (c) as well as abide by all of the Rules that apply to Non-Clearing Members, including, but not limited to, the inability to engage in intermediation on the Non-Intermediated Market.

### *RULE 3.3 MEMBER OBLIGATIONS*



Rule 3.3 defines member obligations for both Non-Clearing Member and Clearing Members. Rule 3.3(a)-(c) were only amended in order to incorporate two new defined terms of Authorized Trader and Regulatory Agency. New Rule 3.3(d) expressly requires that Members immediately notify HedgeStreet if they are aware of any negative information relating to such Member or Member's Authorized Trader's regulatory and/or disciplinary status that is inconsistent with the information provided to HedgeStreet during the membership application process. Rule 3.3(e) was added to require Members to supervise their employees and/or agents that engage in any activity on HedgeStreet as well as notify such Members that they are responsible for such employee and agent activity. HedgeStreet has added additional obligations that shall apply solely to Clearing Members. Many of these new rules have been incorporated in order to ensure proper protection of customer funds, accounts and transactions that Clearing Members that are properly registered with NFA to conduct futures-related business with the public in accordance with the CEA and Commission regulations must abide by. For example, Rule 3.3(f) was added in order to establish minimum financial standards that must be maintained by Clearing Members in order to protect, among other things, customer funds held at FCM Clearing Members. Rule 3.3(g) was added in order to ensure that no Clearing Member maintains Customer accounts or handles Customer orders or funds unless such Clearing Member is properly registered with NFA to engage in futures related business in accordance with the CEA and Commission Regulations. Rule 3.3(h) requires Clearing Members to submit financial statements in a manner described by HedgeStreet in order to assist NFA in conducting initial and on-going financial surveillance of Clearing Members on behalf of HedgeStreet. Rule 3.3(i) requires authorized Clearing Members to use due diligence in handling Customer orders. Rule 3.3(j) requires authorized Clearing members to provide written Customer confirmations in a timely fashion. Rule 3.3(k) requires that Clearing Members give priority to Customer orders, specifically in situations where the Clearing Member or its Authorized Traders may be holding an order for its own benefit or interest in conflict with the best interests of the Customer. Rule 3.3(l) requires authorized Clearing Members to provide a copy of the Risk Disclosure Statement to Customers that are not ECP in accordance with the CEA and Commission Regulations. Rule 3.3(m) requires Clearing Members to submit reports to the Commission as proscribed under the CEA and Commission Regulations. Such reports include, but are not limited to, Regulation 16 Clearing Member Reports as well as Regulation 17 large trader reports. Rule 3.3(n) requires Clearing Members to provide any reports that HedgeStreet may require in order to perform its self-regulatory function. Rule 3.3(p) permits authorized Clearing Members to invest Customer funds as long as such funds are invested in accordance with Commission Regulation 1.25. Rule 3.3(q) notifies all Clearing Members that they must maintain books and records in accordance HedgeStreet Rules, the CEA and/or Commission Regulations.

#### *RULE 3.5 AUTHORIZED TRADERS*

There have been no substantive changes made to the Authorized Trader rules except for the fact that i) the term "Authorized Representative" and "Market Maker Representative" have been combined and changed to the new term "Authorized Trader" and ii) the rules regarding Authorized Traders have been moved from former Rule 4.2 (Market Maker Representatives) to amended Rule 3.5 (Authorized Representatives) .

#### *RULE 3.6 DUES, FEES AND EXPENSES PAYABLE BY MEMBERS*





There have been no substantive changes made to Rule 3.6. HedgeStreet only changed the term “E-ValuCheck” to the more generic term of “electronic check.”

#### RULE 4.3 BENEFITS OF BECOMING A MARKET MAKER

HedgeStreet amended Rule 4.3(c) in order to make clear that Subscription On Demand is only available to Market Makers that are Non-Clearing Members. There is not Subscription or Redemption available on the iMarket since Fixed Payout iHedgelets will not be issued in Pairs.

#### RULE 4.4 OBLIGATIONS OF MARKET MAKERS

HedgeStreet amended Rule 4.4(a)(i) in order to make clear that Market Makers that are Non-Clearing Members may only trade for their proprietary accounts and not on behalf of any Customer. HedgeStreet also amended Rule 4.4(c) in order to make clear that Market Makers that are Non-Clearing Members must abide by the full-collateralization requirement prior to placing orders on the Market.

#### RULE 5.3 SUBSCRIPTION FOR AND REDEMPTION OF FIXED PAYOUT HEDGELET PAIRS BY NON-CLEARING MEMBERS

HedgeStreet amended the title of Rule 5.3 since Hedgelet Pairs are not available for trading on the iMarket

#### RULE 5.4 TRADING NON-iHEDGELET CONTRACTS

HedgeStreet amended the title of Rule 5.4 in order to distinguish between trading Hedgelets on the Non-Intermediated Market and iHedgelets on the iMarket. Rule 5.4(b)(i) – (iv) were amended for clarification purposes only. Rule 5.4(c) was amended to clarify the point that only Non-Clearing Member Market Makers may engage in Subscription On Demand since Hedgelet Pairs are only available on the Non-Intermediated Market.

#### RULE 5.5 TRADING iHEDGELETS BY CLEARING MEMBERS

HedgeStreet added new Rule 5.5 in order to describe the manner in which Clearing Members will enter orders on the iMarket. Rule 5.5(b) was amended in order to clarify the point that a Clearing Member may enter into long or short positions of both Fixed and Variable Payout iHedgelets. CCorp contractually required HedgeStreet to draft Rule 5.5(c) requiring the Clearing Members include the limitation of liability and no warranties language to any agreements such Clearing Members have with Customers.

#### RULE 5.6 MARGIN

HedgeStreet added new Rule 5.6 in order to define the manner in which Clearing Members may extend margin to their Customers. HedgeStreet Rule 5.6(a) requires that Clearing Members collect 100% percent of the transaction price from their Customers. Rule 5.6(c) has been added in order to ensure that a Clearing Member



does not attempt to guarantee any Person against a loss by in order to evade HedgeStreet's and/or CCorp's margin requirements in accordance with the Act.

#### RULE 5.7 ORDER ENTRY

HedgeStreet amended Rule 5.7(c) in order to stipulate the information required when Clearing Members enter orders for either their own accounts or the accounts of their Customers. Currently, HedgeStreet requires that an order be fully collateralized prior to trade execution. In addition, Non-Clearing Members may only trade for their own accounts. On the *iMarket*, however, full-collateralization is not required prior to order entry and Clearing Member will enter orders on behalf of their Customers if such Clearing Members are properly registered in accordance with the Act and Commission Regulations. Therefore, HedgeStreet is requiring in this proposed rule that the Clearing Member indicate whether i) an order is an opening or closing transaction for purposes of determining the requisite amount of variation margin that will be collected during a trading day by CCorp as well as performing open interest calculations and ii) an order is being entered on behalf of such Clearing Member or for their Customers in order to detect such trade practice violations such as front running or trading ahead.

HedgeStreet amended Rule 5.7(e) in order to accurately reflect the manner in which the HedgeStreet trading system, as originally designed, maintains records of orders entered on the Market.

#### RULE 5.8 ERRORS IN HANDLING ORDERS BY CLEARING MEMBERS

HedgeStreet added new Rule 5.8 in order to ensure the proper handling of orders that were entered erroneously onto the *iMarket* by a Clearing Member or its Authorized Traders. In order to ensure proper monitoring of Clearing Member error accounts, NFA has agreed to monitor error account activity of Clearing Members in accordance with the RSA to ensure compliance with Rule 5.8 as well as any unusual activity in such error accounts. Rule 5.8(a) explains the manner in which Clearing Members should handle unfilled orders or orders that were executed at quantities below the amount requested by the Customer. Upon notification of the error, the Clearing Member will be required to enter the correct order on the market in accordance with the Customer's instructions. If the order is executed at a worse price than the Customer should have received but for the error, the Clearing Member may assign the opposite side of the order to its error account in order to give the Customer the price at which she should have received if the order had been timely executed. If the order is executed at a more favorable price, the Customer is entitled to the better price. Rule 5.8(b) explains the manner in which Clearing Members should handle order that were executed with the incorrect Type, Class and or Series, or just entered on the wrong side of the market. The Clearing Member may put the error in its error account and then execute a new transaction with the correct terms. If the order is executed at a worse price than the Customer should have received but for the error, the Clearing Member should make a monetary adjustment by writing a check in a sufficient amount to ensure the Customer is made whole. Rule 5.8(c) explains the manner in which Clearing Members should handle orders that were i) executed in excess of the amount requested by the Customer or, ii) executed or not executed in accordance with the Customer instructions. The Customer is not entitled to any of the excess quantity that may result and such excess must be placed into the Clearing Member's error account. Any profit that may be credited in the Clearing Member error account upon



liquidation of any excess position may be distributed at the discretion of the Clearing Member or Authorized Trader.

#### Non-Competitive Transactions

HedgeStreet will vigorously promote the competitive execution of transaction by requiring that all trades be executed on the *iMarket*. However, under certain rare exceptions, HedgeStreet will allow for certain non-competitive transaction as long as such transactions are executed in accordance with HedgeStreet Rules, the Act and the Commission regulations adopted thereunder. Therefore, HedgeStreet is proposing Rules 5.11 – 5.13 in order to allow non-competitive trading under certain narrow exceptions stipulated below.

#### *RULE 5.11 BLOCK TRADES*

HedgeStreet added new Rule 5.11 in order to permit Clearing Members to enter Block Trades on the Market in accordance with this HedgeStreet Rule. HedgeStreet believes that the integrity of prices and price discovery on the *iHedgelet* market is best promoted by ensuring that trades that can be executed in the normal course without causing market disruption and unfair execution to the parties to the trade be executed outside the block trading mechanism while trades that do not meet this description be eligible for block trading.

Rule 5.11(b) was added to ensure that each party to the Block Trade be an ECP, unless certain conditions are met as defined in the rule. Rule 5.11(c) was added to require Clearing Members to obtain Customer authorization before taking the other side of a Block Trade in order to ensure that the Customer is aware of any potential conflicts of interest that are present when entering into such Block Trades with the Clearing Member. Rule 5.11(e) was added in order to identify the information that is required in order to enter into a Block Trade on HedgeStreet, including an express indication that the transaction is being entered as a Block Trade. Rule 5.11(e)(ii) was added to implement a minimum Block size that must be satisfied prior to executing a Block Trade on the Market<sup>6</sup>. Rule 5.11(f) was added requiring Clearing Members to only enter into Block Trades at prices that are fair and reasonable in order to protect the integrity of price and price discover and do not cause market disruption. Rule 5.11(g) was added in order to stipulate the manner in which such trades should be entered onto the Market by Clearing Members. This rule requires once both parties have agreed to the terms of the Block Trade, the seller is to immediately enter the details of the Block Trade onto the screen. The “immediate” requirement has been added to ensure that i) Clearing Members enter such Block Trades as quickly as possible to prevent the market price from moving away from the participants to the Block Trade potentially compromising the “fair and reasonable” standard required in Rule 5.11(f) and ii) the Market place is notified of the execution of such Block Trade in a timely fashion. HedgeStreet incorporated Rule 5.11(h) in order to place the responsibility on the Clearing Member that it must only enter block trades that promote a fair

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<sup>6</sup> HedgeStreet has not included in this submission the series of *iHedgelets* that will be eligible to engage in block trading nor the relevant minimum size requirements for any of these instruments. Such designations will be submitted separately to the Commission in accordance with the CEA and Commission Regulations adopted thereunder.



and orderly market. Such Clearing Member will be required to provide evidence, if requested to do so by HedgeStreet or NFA<sup>7</sup>, that such Block Trade could not have been effectively executed on the market.

#### RULE 5.12 TRANSFER TRADES

HedgeStreet added new Rule 5.12 in order to allow for transfer trades to different beneficial owners on an exception basis only in very limited circumstances; in order to; i) correct justifiable errors conducted by Clearing Members on the market (Rule 5.12(a)(i)) or ii) to facilitate a change in ownership of the Contracts directed by operation of law (Rule 5.12(a)(ii) and (iii)). Rule 5.12(b) requires that the Clearing Member timely notify HedgeStreet and CCorp of such transfer trade to ensure accurate reporting of such transactions. HedgeStreet limited the instances in which transfer of positions could occur in order to drastically limit the amount of ex-pit transactions that occur outside of the Market. However, certain rare events may occur that require for positions to be transferred among different beneficial owners.

#### RULE 5.13 CROSS TRADES

HedgeStreet added new Rule 5.13 in order to allow for Clearing Members that may be holding both buying and selling orders for execution on the market for different principles to enter into cross trades as long as all of the conditions defined in this Rule 5.13 are met. Rule 5.13(a)(i) requires that only Clearing Members may enter and execute Cross Trades on the Market. Rule 5.13(a)(ii) requires that a Customer must consent to allowing his/her order to be on one side of a cross trade to ensure that the Customer is aware that the Clearing Member or Authorized Trader is agreeing to execute a transaction outside of the competitive marketplace and that potential conflicts may be present. Rule 5.13(a)(iii) requires that the Clearing Member protect the Customer's interests and use due care when negotiating and executing Cross Trades on behalf of such Customers. In order to ensure the priority of Customer orders, Rule 5.13(a)(iv) requires that if a Customer order is on one side of the Cross Trade, the Customer Order is entered onto the Market first. The first part of Rule 5.13(a)(v) allows the immediate execution of the Cross Trade if the price at which both parties agreed are done at the current market price. However, the second part of this Rule states that if there is no current market price for the particular iHedgelet, the Clearing Member must (1) enter an order on the Market and (2) let it rest for the requisite period of time in the order book to allow the order to be subject to competitive execution before entering the opposite side of the Cross Trade. Rule 5.13(a)(v)(3) allows the Clearing Member to enter the opposite side of the Cross Trade as long as the requisite amount of time stipulated in 5.13(a)(v)(2) has expired. Rule 5.13(a)(vi) has been added in order to reinforce the requirement that the Clearing Member must enter all Cross Trades at either the market price or, give both sides of the Cross Trade an opportunity to be subject to competitive execution if no market price is available.

#### RULE 5.14 GIVE-UPS

HedgeStreet has added new Rule 5.14 in order to define rules for engaging in Give-Up transactions. Rule 5.14(a) defines the term "Give-Up" and requires that only Clearing Participants may engage in Give-Up

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<sup>7</sup> Pursuant to the executable copy of Schedule A of the RSA with NFA, NFA will review select block trades executed on HedgeStreet to determine whether they were executed in accordance with HedgeStreet's block trading rules.



transactions. Rule 5.14(b) states certain record keeping requirements when entering Give-Up transactions. Rule 5.14(c) defines the reporting obligation and responsibility of the Executing Participant to CCorp for Give-Up transactions.

#### *RULE 5.20 PROHIBITED TRANSACTIONS*

HedgeStreet has added as well as amended certain rules that were previously in this Rule 5.20 due to the introduction of intermediation on the market as well as the ability to have a margining methodology other than full-collateralization prior to order execution on the *iMarket*. Rule 5.20(a) has been amended to apply the prohibition of entering orders on the Market without having sufficient cash or contracts in a member's account prior to order entry only to Non-Clearing Members. Since all transactions executed on the *iMarket* are cleared and settled pursuant to the rules of the Clearing Corporation, Clearing Members are not required to trade on a fully-collateralized basis prior to order entry or trade execution. Rule 5.20(b) has been amended in order to allow Clearing Members to enter into, on an exception basis only, certain non-competitive transactions in accordance with HedgeStreet rules, such as block trades, cross trades and transfer trades. Non-Clearing Members are not permitted to enter into such non-competitive trading exceptions. Rule 5.20(e) has been added in order to ensure that all bids and offers are entered onto the *iMarket* are done in good faith in order to maintain a fair and orderly market and not for any other purpose. Rule 5.20(g) has been amended to enable Clearing Members to enter into Transfer Trades on an exception basis and in accordance with HedgeStreet Rule 5.12 in order to facilitate errors executed by Clearing Members on behalf of Customers or to reflect a change in ownership occurring by operation of law. Rule 5.20(h) has been amended in order to allow for intermediation of *iHedgelets* on the *iMarket*, but maintain the preclusion of intermediation by Non-Clearing Members or their Authorized Traders on the Non-Intermediated Market. Since the Non-Intermediated Market does not allow Non-Clearing Members to trade on behalf of Customers, Rule 5.20(i) has been amended in order to include the prohibition of all Members, both Clearing Members and Non-Clearing Members, from engaging in activity that presents a risk of harm toward Customers of Clearing Members as well as any other Member or the public. Rule 5.20(l) has been added in order to obligate Members to abide by any agreement of the Clearing Corporation or HedgeStreet, or arbitration decision or award stipulated by HedgeStreet, NFA or the Clearing Corporation. Because Clearing Members may be registrants with the NFA, such as Futures Commission Merchants, authorized to handle Customer funds, Rule 5.20(n) has been added requiring such Clearing Members to maintain certain financial requirements in accordance with HedgeStreet Rules and Commission Regulations as well as precluding such Members that undergo serious financial difficulty from entering bids or offers on the Market without HedgeStreet prior written approval. Rule 5.20(o) has been added in order to obligate Clearing Members to inform HedgeStreet or the Clearing Corporation if such Members are aware that an employee of HedgeStreet or CCorp attempts to open or trade for an account in direct violation of HedgeStreet and CCorp Rules as well as Commission Regulations. Rule 5.20(p) has been added in order to preclude Clearing Members from guaranteeing an execution of an order given by a Customer prior to such order being executed on the Market. Rule 5.20(q) has been added prohibiting Clearing Members that are not properly registered in accordance with the Act and Commission Regulations to engage in futures related business with the public from, directly or indirectly, handling Customer funds, orders, or accounts.

#### *RULE 6.1 SETTLING NON-iHEDGELET PAIR SUBSCRIPTIONS AND REDEMPTIONS AND NON-iHEDGELET TRADES*



The title of Rule 6.1 was amended in order to distinguish between contracts that are cleared and settled by HedgeStreet as opposed to the clearing and settling of *iHedgelets* that are cleared and settled by the Clearing Corporation. The amendments made to Rule 6.1(b) were done in for clarification purposes only.

*RULE 6.2 SETTLING iHEDGELETS FOR CLEARING MEMBERS*

Rule 6.2 was added in order to distinguish between *iHedgelets*, that are cleared and settled by CCorp, and Contracts that are cleared and settled by HedgeStreet.

*RULE 6.3 SETTLING NON-iHEDGELET CONTRACTS AT EXPIRATION*

The title to Rule 6.3 was amended in order to distinguish between the process by which non-*iHedgelet* contracts are settled as opposed the process of settling *iHedgelet* contracts. The amendments made in Rule 6.3(b)(iii) and (iv) were done for clarification purposes only.

*RULE 6.4 SETTLING MEMBER WITHDRAWAL REQUESTS FOR ACCOUNTS HELD AT HEDGESTREET*

The title of Rule 6.4 was amended in order to distinguish between the manner in which Member withdrawals from a HedgeStreet account are handled as opposed to the manner in which withdrawals are handled on behalf of Clearing Members.

*RULE 8.1 INVESTMENT OF MEMBER FUNDS HELD AT HEDGESTREET*

This title was added in order to distinguish the manner in which HedgeStreet invests and pays interest on Member funds as opposed to Clearing Member funds that are maintained at CCorp.

*RULE 8.2 INVESTMENT OF CLEARING MEMBER FUNDS HELD AT THE CLEARING CORPORATION*

Rule 8.2 was added in order to distinguish the manner in which CCorp invests Clearing Member funds as opposed to Non-Clearing Member funds maintained at HedgeStreet.

*RULE 9.1 MONITORING THE MARKET*

Rule 9.2(a) was amended for clarification purposes only.

*RULE 9.2 INVESTIGATIONS, HEARINGS AND APPEALS*

Rule 9.2(a) was amended in order inform Members that HedgeStreet may enter into an agreement with a third party service provider, such as NFA, to assist with certain functions conducted by a compliance officer of HedgeStreet as may be necessary from time to time. In addition, this Rule 9.2(a) was amended to introduce the establishment of a Disciplinary Committee that will make the final determination as to whether disciplinary action should be brought against a particular Member based on the investigations and final analysis of the



compliance officer. Rule 9.2(b) has been amended requiring the Compliance Officer to present his/her analysis and conclusions of a particular investigation to the Disciplinary Committee for final review and determination as to whether disciplinary action should be taken against a particular Member or Members. The rest of the amendments to this Rule 9.2 were done in order to incorporate the Disciplinary Committee into the investigatory process.

#### RULE 9.7 ACTIONS RESPECTING NON-MEMBERS

Since authorized Clearing Members may trade on behalf of Customers that are not members of HedgeStreet, Rule 9.7 was added in order to address activities of non-Members that may violate the CEA and/or HedgeStreet Rules. Rule 9.7(a) notifies a Clearing Member that it may be required to present certain information relating to the activities of the non-Member in order for a proper investigation to be performed by HedgeStreet. Rule 9.7(b) defines certain actions that may be required to be taken by a Clearing Member pursuant to a decision by HedgeStreet or a hearing officer that the non-Member engaged in activities that violates the CEA and/or HedgeStreet Rules.

#### RULE 10.1 LIMITATION OF LIABILITY

Rule 10.1(a) was amended in order to incorporate CCorp into HedgeStreet's limitation of liability clause as it applies to its Members. Rule 10.1(c) was amended in order to correct a typographical error.

#### RULE 10.4 ARBITRATION OF CLEARING MEMBER-CUSTOMER DISPUTES

Rule 10.4 was added in order to facilitate the handling of disputes arising between Clearing Members and their Customers. All such disputes will be handled pursuant to the arbitration rules of the NFA, provided that, i) if the Customer is an ECP, the Customer may choose another self-regulatory organization as agreed upon between the parties or, ii) if the Customer is not an ECP, the submission of such dispute to NFA shall be voluntary in accordance with Commission Regulation 166.5.

#### RULE 10.7 DISPUTES INVOLVING CLEARING OF iHEDGELETS

Rule 10.7 was added in order to notify Clearing Members that disputes arising from the clearing of iHedgelet contracts shall be handled in accordance with the rules and procedures of CCorp.

#### **4. Text of any HedgeStreet Rule the application of which is affected, directly or indirectly, by the proposed rule change, and description of that effect as required by Regulation 40.5(a)(1)(iv):**

Other than the Rules amended above, no other HedgeStreet Rules are affected by the proposed rule change.

#### **5. Brief description of any substantive opposing views expressed with respect to the proposed rule changes that were not incorporated into the proposed rule changes prior to its submission to the Commission, as required by Regulation 40.5(a)(1)(v):**



No substantive opposing views have been expressed to HedgeStreet with respect to the proposed rule changes.

**6. Commission Regulation that may need to be amended or Section of the Act or Commission Regulations that the Commission may need to interpret, in order to approve the proposed rule change, and if such an amendment or interpretation is necessary, analysis supporting the amendment or interpretation, as required by Regulation 40.5(a)(1)(vi):**

HedgeStreet is not aware of any Commission Regulation that may need to be amended, or Sections of the Act or Commission Regulations that the Commission may need to interpret, in order to approve the proposed rule changes. However, Commission's February 18, 2004 Order of Designation ("Original Order") designating HedgeStreet as a contract market will need to be amended in order to authorize HedgeStreet to permit intermediation on its *iMarket*. The paragraph numbered (5) of the order states that "in the place of filing clearing member reports under Rule 16.00 and until further order of the Commission, HedgeStreet shall file large trader reports and forms under Part 17 on behalf of its clearing members...." In the February 18<sup>th</sup> covering letter to HedgeStreet's order of designation, the Commission stated that "since all trading on HedgeStreet will be non-intermediated, the reports filed under Rule 17.00 would capture the essential information regarding traders and their positions that would also be provided by reports under Rule 16.00. In these circumstances, and until otherwise warranted, the Commission does not believe that it is necessary for HedgeStreet to file clearing member reports under Rule 16.00 so long as HedgeStreet files large trader reports on behalf of its clearing members under Part 17." Since the proposed *iMarket* is anticipating there will be intermediation by Clearing Members, HedgeStreet understands that the Commission may request that HedgeStreet commence filing clearing member reports as defined under Rule 16.00 for the *iMarket* while requiring Clearing Member to file Part 17 reports with the Commission in accordance with Rule 17.00. HedgeStreet will continue to file Rule 17.00 reports for the Non-Intermediated Market unless otherwise instructed by the Commission.

In addition to paragraph 5 of the Original Order, the Commission will need to revise paragraph 2 and 6 of the Original Order which required HedgeStreet to make certain commitments<sup>8</sup> in its capacity as a non-intermediated DCM. The paragraph numbered (2) states that "the Commission FINDS that HedgeStreet has committed to certain conditions and undertakings as set forth in Section VII of the Staff Memorandum. The paragraph numbered (6) of the Original Order states that "the Commission has accepted the February 9<sup>th</sup> commitments from HedgeStreet in light of the fact that HedgeStreet's structure and intended manner of operation is qualitatively different from more traditional exchanges. HedgeStreet will not have any intermediaries, rather it will have members who interact directly with the trading facility. Most traditional markets have been intermediated markets in which the intermediaries conduct most customer solicitation. Since HedgeStreet is nonintermediated, any solicitation that occurs will be by HedgeStreet. In these

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<sup>8</sup> On February 9, 2004 in a letter sent to the Commission, HedgeStreet agreed to comply with the following commitments; HedgeStreet and any official, agent or other person acting on behalf of HedgeStreet within the scope of his or her employment or office shall not, in or in connection with the offer or sale of HedgeStreet products; (a) Cheat or defraud or attempt to cheat or defraud any person; (b) Willfully make or cause to be made to any person any fake report or statement or cause to be entered for any person any false record; or (c) Willfully deceive or attempt to deceive any person by any means whatsoever.





circumstances, these commitments are appropriate to ensure that HedgeStreet customers receive a similar level of protection against fraudulent conduct, including fraudulent solicitation, as customers of more traditional exchanges.” HedgeStreet will continue to abide by all of the commitments in the February 9<sup>th</sup> letter to the Commission since HedgeStreet will continue to operate the Non-Intermediated Market. However, in light of the fact that the iMarket will have Clearing Members that may be intermediaries soliciting Customer orders, such Customers will be afforded the protections against fraudulent conduct, fraudulent solicitation as provided under the Act and Commission Regulations adopted thereunder. Therefore, HedgeStreet requests that the Commission amend the Original Order authorizing HedgeStreet to permit intermediation on its market in accordance with the conditions provided herein.

**7. Information in this submission that is subject to a request for confidential treatment and justification for such treatment, as required by Regulation 40.5(a)(1)(vii):**

HedgeStreet has submitted simultaneously with this request for Commission approval the following documents pursuant to Regulation 145.9 on the grounds that the disclosure of such documents would reveal HedgeStreet’s trade secrets or confidential commercial or financial information.

Documents Submitted Pursuant to Commission Regulation 145.9

- Appendix 1 – Responses to staff questions sent by HedgeStreet on July 8, 2005
- Appendix 2 – Responses to staff questions sent by HedgeStreet on June 28, 2005
- Appendix 3 – Responses to staff questions sent by HedgeStreet on May 30, 2005
- Appendix 4 – Responses to staff questions sent by HedgeStreet on May 9, 2005
- Appendix 5a – 5g – Regulatory Services Agreement – NFA
- Appendix 6 – Clearing Services Agreement with The Clearing Corporation
- Appendix 7 – Institutional Trading Flow Diagram
- Appendix 8 – Notice of Financial Reporting

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Please do not hesitate to contact me at (650) 638-3511 if you or anyone else at the Commission have questions regarding these proposed rule changes.

Sincerely,

Stephanie Ford  
Vice President, Legal & Compliance



Cc: Ms. Jane Croessmann - CFTC  
Ms. Riva Adriance - CFTC  
Mr. Tom Bloom - CFTC