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A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations; Rules Relating to Intermediaries of Commodity Interest Transactions; A New Regulatory Framework for Clearing Organizations; Exemption for Bilateral Transactions; Final Rules

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 5, 15, 36, 37, 38, 100, 170 and 180

RIN 3038–AB55

A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is promulgating a new regulatory framework to apply to multilateral transaction execution facilities, to market intermediaries and to clearing organizations. This new framework constitutes a broad exemption under the authority of section 4(c) of the Commodity Exchange Act (Act or CEA) from many of the current rules applicable to designated contract markets. In addition, the new framework relies more heavily on disclosure rather than merit regulation. It establishes three new market categories, including the category of exempt multilateral transaction execution facility and two categories of Commission-recognized and regulated multilateral transaction execution facilities. In companion releases published in this edition of the **Federal Register**, the Commission also is adopting new rules for intermediaries and entities that clear derivative transactions. These final rules make fundamental and far-reaching changes to Federal regulation of commodity futures and option markets. However, nothing in these rules alters or diminishes the Commission's responsibility for overseeing and enforcing compliance by self-regulatory organizations, Commission registrants and market participants with the provisions of the Act.

The Commission in a companion release published in this edition of the **Federal Register** also is expanding and clarifying the operation of the current swaps exemption. Nothing in these releases, however, would affect the continued vitality of the Commission's exemption for swaps transactions under part 35 of its rules, or any of its other existing exemptions, policy statements or interpretations. Moreover, nothing in the final rules would affect the application of any statutory exclusion, including in particular, the applicability of the exclusion under section 2(a)(1)(A)(ii), known as ''the Treasury Amendment.''

EFFECTIVE DATE: February 12, 2001.

FOR FURTHER INFORMATION CONTACT: Paul M. Architzel, Chief Counsel, Division of Economic Analysis, or Alan L. Seifert, Deputy Director or Riva Spear Adriance, Special Counsel, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581. Telephone: (202) 418–5260. E-mail: (PArchitzel@cftc.gov), (ASeifert@cftc.gov) or (RAdriance@cftc.gov).

SUPPLEMENTARY INFORMATION:

I. Background

A. Overview

The Commission, on June 22, 2000, proposed a new regulatory framework to apply to multilateral transaction execution facilities that trade contracts of sale of a commodity for future delivery or commodity options. 65 FR 38986. The Commission proposed this new framework to ''promote innovation, maintain U.S. competitiveness, and at the same time reduce systemic risk and protect customers.'' *Id.* The framework provides U.S. futures exchanges greater flexibility with which to respond to the competitive challenges brought about by new technologies.

Specifically, the framework proposed to replace the current ''one-size-fits-all'' regulation for futures markets with broad, flexible ''core principles,'' and to establish three regulatory tiers for markets: recognized futures exchanges (RFEs), derivatives transaction facilities (DTFs) and exempt multilateral transaction execution facilities (exempt MTEFs). The proposed core principles were tailored to match the degree and manner of regulation to the varying nature of the products and the participants permitted to trade on a facility.

In general, the framework proposed a lower level of regulatory oversight where access to an exchange or facility is restricted to eligible participants or commercial participants or where the nature of the underlying commodity poses a relatively low susceptibility to manipulation. This reflects the reduced need to monitor closely such markets. The Commission also proposed, however, that markets serving a price discovery function, irrespective of the product traded or market participants, provide a degree of price transparency. The proposed framework therefore balanced the public interests of market and price integrity, protection against manipulation and customer protection with the need to permit exchanges and other trading facilities to operate more flexibly in today's competitive environment. As noted in the Notice of Proposed Rulemaking, the President's Working Group on Financial Markets and the chairmen of the Commission's Congressional oversight committees encouraged the Commission to consider proposing such major revisions to the regulatory framework.[1] 65 FR at 38987.

B. The Proposed Rules

Under the proposed framework, current U.S. futures exchanges would be included automatically in the RFE category.[2] These exchanges would be permitted greater business flexibility through compliance with core principles rather than the prescriptive regulations now in place. In addition to achieving greater flexibility in their current operations, the exchanges, as a business choice, also could operate as a DTF or as an exempt MTEF, as appropriate.

The proposed DTF market would be subject to an intermediate level of regulation. DTFs, like RFEs, would be Commission-recognized markets. As proposed, DTFs would be geared either to mainly institutional traders or to only commercial traders. Specific requirements proposed for DTFs differ somewhat depending upon whether a DTF is an institutional or a commercial market.

The Commission proposed that institutional-participant DTFs may provide a trading platform for transactions involving those commodities listed in the rules that are eligible for such an intermediate level of regulation.[3] Additional commodities,

[1] Recognizing the importance of the OTC derivatives markets, the Chairmen of the Senate and House Agriculture Committees asked the President's Working Group on Financial Markets (PWG) to conduct a study of OTC derivatives markets. After studying the existing regulatory framework for OTC derivatives, recent innovations, and the potential for future developments, the PWG on November 9, 1999, reported to Congress its recommendations. *See*, Over-the-Counter Derivatives Markets and the Commodity Exchange Act, Report of the President's Working Group. The PWG report focused on promoting innovation, competition, efficiency, and transparency in OTC derivatives markets and in reducing systemic risk. Although specific recommendations about the regulatory structure applicable to exchange-traded futures were beyond the scope of its report, the PWG suggested that the Commission review existing regulatory structures (particularly those applicable to markets for financial futures) to determine whether they were appropriately tailored to serve valid regulatory goals.

[2] Products subject to the special procedural provisions of section 2(a)(1)(B)(ii) of the Act, however, must continue to be designated and regulated by the Commission as contract markets.

[3] The eligible commodities are those that are listed as eligible for trading on an exempt MTEF.

including agricultural commodities, would be eligible to trade on an institutional-participant DTF on a case-by-case determination. The Commission would make that determination based upon the depth and liquidity of the cash market and on the surveillance history of the commodity based on its actual trading history.

Although institutional-participant DTFs would be intended primarily for institutional traders, the proposed rules provide individual DTFs with the flexibility to decide whether or not to permit access by non-institutional traders. The Commission proposed, therefore, to permit access to a DTF by non-institutional traders only through a registered futures commission merchant (FCM) that is a member of a recognized clearing organization and that has $20 million of adjusted net capital. Those FCMs would be required to provide their non-institutional customers trading on a DTF with additional disclosures and other protections.

In addition, the rules proposed an intermediate level of oversight for commercial-participant DTFs. Only commercial participants trading for their own accounts would have access to these facilities. Commercial-participant DTFs may trade any commodity other than the agricultural commodities enumerated in section 1a(3) of the Act, government securities and commodities subject to the provisions of section 2(a)(1)(B)(ii) of the Act. Such commercial traders generally would have both the financial ability and the physical means to deliver tangible commodities or otherwise be involved in trading that commodity in connection with their line of commerce. Accordingly, certain requirements that were proposed to apply to institutional-participant DTFs would not be applicable to commercial-participant DTFs.

The Commission also proposed a market tier exempt from all Commission regulation, subject only to the Act's anti-fraud and anti-manipulation provisions and a requirement that, if performing a price discovery function, the market provide pricing information to the public. This exemption was proposed for facilities on which transactions would be entered into among institutional traders in contracts based upon a specified list of commodities.[4] The Commission proposed to exempt counterparties to such transactions from a claim in a private right of action that a violation of the terms of the exemption renders the transactions void. These exempt markets could not hold themselves out as being regulated by the Commission. As noted above, existing futures markets, where appropriate, would have the opportunity to operate under the terms of this exemption, if they so choose.

C. Overview of Comments

The Commission received a total of 71 comments from a wide range of commenters on the proposed new regulatory framework for multilateral transaction execution facilities.[5] The commenters included 24 trade associations, six commodity exchanges, two government agencies, four financial institutions, three attorneys, two institutional study organizations, one agri-business firm, a self-regulatory organization, and several energy and communication firms or markets.

In addition to comment letters, the Commission received oral and written statements during a public meeting held at the Commission's headquarters on June 27 and 28, 2000. At that meeting, members of the public had an opportunity to address the Commission and to respond to questions.[6] During the meeting, several panels of industry experts, representing the U.S. futures exchanges, the over-the-counter derivatives markets, emerging information and technology providers, market intermediaries and clearing organizations discussed the proposals in the context of current market structures and future trends. The proposed rules were also discussed and public comments received at a July 19, 2000, meeting of the Commission's Agricultural Advisory Committee (AAC).[7]

The overwhelming majority of the comments expressed general support for the Commission's proposed framework, and provided specific suggestions for its improvement. Many commenters described the Commission's initiative as a bold or important departure from the status quo which recognizes the beginnings of a new financial market landscape. In general, the commenters supported the framework's innovative concepts of providing greater regulatory flexibility by substituting core principles for prescriptive, one-size-fits-all regulations, and of tiered regulations tailored to the particular nature of the market. They also generally supported the Commission's initiative as providing greater legal certainty to various types of instruments.

Four commenters, however, strongly disagreed with the Commission's approach, albeit for opposing reasons. One institutional study organization argued that the proposal would take regulatory reform too far. In contrast, a second institutional study organization, an investment banking firm and an attorney expressed serious reservations, contending that the framework provided neither significant regulatory relief nor greater legal certainty. The substance of individual comments is discussed in greater detail below.

II. Final Rules

A. Exempt Multilateral Transaction Execution Facilities (Exempt MTEFs)

As discussed above, the Commission, in revised part 36, proposed a new, self-effectuating exemption for those multilateral transaction facilities (MTEFs) to which only eligible participants have access, either trading for their own account or through another eligible participant, and only for contracts based upon: (1) A debt obligation; (2) a foreign currency; (3) an interest rate; (4) an exempt security or index thereof, as provided in section 2(a)(1)(B)(v) of the Act; (5) a measure of credit risk or quality, including instruments known as ''total return swaps,'' ''credit swaps'' or ''spread swaps''; (6) an occurrence or contingency beyond the control of the counterparties to the transaction; or (7) cash-settled, based upon an economic or commercial index or measure beyond the control of the counterparties to the transaction and not based upon prices derived from trading in a directly

The rules relating to exempt MTEFs are discussed below. A market that otherwise might be eligible to be exempt from regulation as an exempt MTEF may voluntarily become a DTF in order to be become a ''recognized'' market.

[4] The proposed list of commodities included: a debt obligation, a foreign currency, an interest rate, an exempt security, a measure of credit risk or quality, or cash-settled based upon an economic or commercial index or based upon an occurrence or contingency.

[5] A significant number of letters commenting on aspects of the regulatory framework raised in companion notices were also submitted to the Commission. In this and three companion Notices of Final Rulemaking which are being published in this edition of the **Federal Register**, comment letters (CL) are referenced by file number, letter number and page. Comments filed in response to the notice of proposed rulemaking on MTEFs, parts 36–38, are contained in file No. 21, on the notice of proposed rulemaking on intermediaries in file No. 22, on the notice of proposed rulemaking on clearing in file No. 23 and on the notice of proposed rulemaking on the part 35 exemption in file No. 24. These letters are available through the Commission internet web site, www.cftc.gov.

[6] A transcript of the proceedings was included in the Commission's comment file and is available through the Commission's internet web site.

[7] A transcript of the AAC meeting is also included in the Commission's comment file and is available on the Commission's website.

corresponding underlying cash market.[8] The Commission proposal was based upon the ''view that these commodities, when traded between or among eligible participants need not be subject to the regulatory scheme of the Act. Accord PWG Report at 17.'' 65 FR at 38988.

Many commenters strongly supported this new exemption. For example, the International Swaps and Derivatives Association, Inc. (ISDA) observed that the ''clarifications contained in the Exempt MTEF proposal are of critical importance to ISDA and its members.'' CL 21–37 at 4. Reuters Group PLC (Reuters), a provider and developer of ''electronic business-to-business transaction communities,'' stated that in its view, ''[t]his new category of Exempt MTEF provides significant legal certainty to new electronic marketplaces in the enumerated derivatives.'' CL 21–62 at 3. A group of commercial and investment banks (Coalition) [9] commented that it ''strongly supports the Commission's proposal, and believes that the proposal represents a very important initiative both to promote legal certainty and to facilitate the development by U.S. market participants of electronic trading systems and technologies and the expanded use of clearing facilities. In addition, proposed part 36 would * * * limit[] the ability of an eligible participant to repudiate unprofitable contracts based on the CEA. The Coalition strongly supports these provisions. * * *'' CL 21–65 at 9. An attorney with the firm of Covington & Burling commented that:

> Derivative transactions satisfying these three conditions would be exempt from virtually all CEA regulation * * * and *either* (1) *were* traded on a multilateral transaction execution facility (MTEF), under newly-proposed part 36 of the Commission's regulations; *or* (2) *were not* traded on an MTEF, under newly-revised part 35 of the Commission's regulations. Thus, participants * * * would obtain legal certainty about the limited scope of CEA regulation regardless of whether the means for executing transactions did or did not satisfy the technical definition of an MTEF.
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> It is our understanding that several comments have been filed with the Commission that seek changes to the proposed regulations in ways that conceivably could affect the legal certainty described above, including the Commission's statement supporting such legal certainty. We urge the Commission not to make any changes that would affect the interrelationship between the MTEF exemption and the bilateral transactions exemption in a manner that would diminish the legal certainty provided to eligible participants trading exempt commodities.

CL 21–63 at 2–3.

A number of the comments that generally supported proposed part 36 also suggested specific modifications, relating mainly to the commodities which were proposed to be eligible for the part 36 exemption and the proposed definition of MTEF. These issues, along with three comments opposing the proposed part 36 exemption on mainly jurisdictional grounds, are discussed below.

1. Jurisdictional Issues

Three commenters objected to the part 36 exemption on jurisdictional grounds. *See,* CLs 21–28, 55 and 57. One of the three, JP Morgan Securities, Inc. (JP Morgan), objected generally to proposed part 36, and particularly to the inclusion of instruments eligible for the exemption that are ''a measure of credit risk or quality, including instruments known as 'total return swaps,' 'credit swaps,' or 'credit spread swaps,''' reasoning that:

> An Exempt MTEF is to be subject to the anti-fraud and anti-manipulation provisions of the Act, as well as to whatever future rule the Commission may enact governing information dissemination. Therefore, a proposed ''exemption'' from the CEA has the effect of extending the Commission's authority to facilities that may trade products, such as swaps, which are not the Commission's to regulate under the terms of the Act itself. A self-effectuating ''exemption'' in this instance unintentionally becomes the reverse, an assertion of CFTC jurisdiction over non-futures products.

CL 21–55 at 4.

However, JP Morgan's conclusion is erroneous. As explained in its Notice of Proposed Rulemaking (65 FR at 38989), and reiterated herein, the Commission, by providing an exemption under part 36, is not thereby making an initial determination that any particular instrument which may be trading in reliance on the exemption is or is not within the Commission's jurisdiction. The use of the Commission's section 4(c) exemptive authority in this context to provide legal certainty to novel instruments without a preliminary determination by the Commission of complex jurisdictional issues is precisely as intended by the Congress. When Congress adopted section 4(c) in 1992, the Conferees stated:

> The conferees do not intend that the exercise of exemptive authority by the Commission [under Section 4(c)] would require any determination beforehand that the agreement, instrument, or transaction for which an exemption is sought is subject to the Act. Rather, this provision provides flexibility for the Commission to provide legal certainty to novel instruments where the determination as to jurisdiction is not straightforward.[10]

Moreover, the assertion that the Commission through this exemption would extend provisions of the Act to instruments or persons not subject to the Act misconstrues the nature and the scope of the exemption. As proposed, rule 36.3(a) provides that the anti-fraud and anti-manipulation sections of the Act ''continue to apply to transactions and persons otherwise subject to those provisions.'' [11] 65 FR at 38999. Thus, it is clear that the proposed rules do not attempt to extend application of the Act to any transactions not already subject to the Act.[12]

Proposed rule 36.2(g) requires that an exempt MTEF disseminate trading volume, price ranges and other trading data, but only pursuant to a Commission determination, after notice and an opportunity for a hearing, that the facility serves as a significant source for the discovery of prices. That procedure provides the facility with an opportunity to challenge the validity of the Commission's authority to issue and enforce such an order on the grounds that the instruments being traded are not subject to the Act.[13] Nevertheless, the Regulatory Studies Program of the Mercatus Center (Mercatus) opined that, even though ''a party could contest the CFTC's assertion of jurisdiction * * * it is the mere assertion of regulatory jurisdiction by the CFTC that in the past has created the legal uncertainties that these Proposals attempt to address.'' CL 21–57 at 4.

However, proposed rule 36.3(b), the contract non-repudiation provision,

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[8] It should be noted that the instruments eligible for exemption are limited by operation of section 2(a)(1)(B) of the Act, which is reserved in proposed § 36.3(a). As the Commission observed, ''[t]he reservation, and application, of this provision is consistent with the language of section 4(c) of the act which limits the Commission's authority to exempt transactions from the application of section 2(a)(1)(B) of the Act.'' 65 FR at 38988.

[9] They are: Chase Manhattan Bank; Citigroup, Inc.; Credit Suisse First Boston, Inc.; Goldman Sachs & Co.; Merrill Lynch & Co., Inc.; and Morgan Stanley Dean Witter & Co.

[10] H.R. Rep. No. 978, 102d Cong., 2d Sess. 82–83 (1992).

[11] *See also,* CL 21–57 at 4, which makes the same fundamental error.

[12] In this regard, it must be noted that sections 6(c) and 9(a)(2) of the Act prohibit manipulation of ''the market price of any commodity, in interstate commerce,'' and is not limited in application to ''contracts of sale of a commodity for future delivery.''

[13] For example, were the Chicago Mercantile Exchange (CME) to offer trading of its Eurodollar contract through an exempt MTEF, the rule provides for public notice and an opportunity for public comment in determining that the market ''serves as a significant source for the discovery of prices for an underlying commodity'' and to require that, as a consequence, it disseminate certain information to the public. *See,* PWG Report at 19.

further removes any such potential negative, collateral effects on other markets. To the extent that part 36 applies to transactions traded on a facility, the contract non-repudiation provision also applies, reinforcing the legal certainty and validity of the transactions. On the other hand, to the extent that transactions and a market are outside of the Commission's jurisdiction, the Act and Commission rules (including the part 36 exemption) are inapplicable, and hence there can be no legal uncertainty about the validity of the contracts arising from the Act or Commission rules thereunder. As the Commission explained in the Notice of Proposed Rulemaking,

> the Commission is not making a determination that any market that is eligible to be an exempt MTEF under the proposed exemption is or is not subject to the Commission's jurisdiction under the CEA. Moreover, the fact that one market may operate as an exempt MTEF in reliance upon the proposed exemption * * * does not imply that the Commission has made a determination that any firm or entity that operates in a similar manner is subject to the Commission's jurisdiction under the CEA.

65 FR at 38989 (footnote omitted). Thus, the existence and application to any particular market of the part 36 exemption carries no negative legal inference or uncertainty for any other market.

Nevertheless, Mercatus further argues that the proposed exemption ''raises a whole new area for legal uncertainty in that the broad definition of MTEF in Proposed Rule 36.1(b) would appear to cover auction markets such as eBay and all other forms of B2B trading facilities, whether electronic or not.'' CL 21–57 at 5. Similarly, an attorney with the firm of Vinson & Elkins argues that, ''multilateral transaction execution facilities—regardless of the nature of their participants or the nature of the economic activity being undertaken on those facilities—must agree to become regulated by the CFTC.'' CL 21–28 at 1. This misconstrues the operation and structure of the part 36 exemption. As noted above, the exemption in part 36 is from application of the Act. To the extent that the Act does not apply to a facility's transactions, the regulatory framework is simply inapplicable. Thus, so long as a facility auctions instruments outside of the Commission's regulatory jurisdiction under the Act, these exemptions therefrom and this framework would have no application to its business.

2. Eligible Commodities

Some commenters have suggested that the commodities eligible for this exemption should differ somewhat from those proposed by the Commission. Specifically, the United States Department of the Treasury (Treasury) recommended that government securities should be ineligible for trading on exempt MTEFs. Treasury noted that contracts eligible to trade on an exempt MTEF would have included both single government securities and baskets of government securities. It further noted that ''[s]ince the introduction of futures contracts on government securities in the late 1970s, the trading of these instruments on futures exchanges has always been subject to Commission regulation, and all dealers and brokers in the cash market for government securities have been subject to regulation since the enactment of the Government Securities Act.'' CL 21–50 at 2.

As the Commission explained in its Notice of Proposed Rulemaking, 65 FR at 38988, its determination of which commodities to include as eligible for exempt MTEF status was informed by the recommendations of the PWG, including its recommendation to exclude from the Act transactions by eligible participants on electronic trading systems in commodities other than non-financial commodities with finite supplies. Treasury, however, has concluded that, for futures and options on government securities, a higher level of regulation than trading as an exempt MTEF is necessary and appropriate in order not to ''undermine the integrity of the government securities markets.'' *Id.* As Treasury noted in its comment letter,

> [p]rior to 1986, * * * problems with these entities [government securities brokers and dealers] led to the passage of the Government Securities Act of 1986, which was amended in 1993 to address issues related to auction irregularities, short squeezes, and unfair sales practices * * *. Allowing government securities futures to trade on exempt MTEFs, where they would not be subject to the Government Securities Act or any other regulatory framework designed to address potential problems, could undermine the integrity of the government securities markets.
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> [T]here have been a number of attempts to manipulate individual securities within the broader market. Additionally, fraud and mistreatment of customers has in the past also been a concern in the government securities market.

Id.

In deference to Treasury's expressed concern that a higher level of regulation is necessary than provided at the exempt MTEF level, the final rules adopted by the Commission do not include government securities as eligible for trading on exempt MTEFs. Specifically, the Commission has removed the reference to exempt securities and indexes thereof previously included in proposed rule 36.2(b)(4) and has amended final rule 36.2(b)(1) to make clear that eligible debt instruments do not include such exempt securities.

In contrast to Treasury's recommendation to delete government securities from the list of eligible commodities, several commenters with energy-related businesses suggested that energy-related products be added to the list of commodities eligible to trade on exempt MTEFs. *See* CLs 21–34, 37, 38, 43. Merrill Lynch Co., Inc. (Merrill Lynch), for example, opined that ''over-the-counter bilateral trading in energy products between commercial entities has been exempted * * * since 1993 * * * and that no pattern of abuses or irregularities has been identified.'' CL 21–38 at 9. It further reasoned that, ''electricity trading remains subject to oversight by the FERC and the states, including licensing standards for market participants, reporting requirements, and enforcement authority to remedy any problems that may arise.'' *Id.* at 12. Merrill Lynch also noted that action has been taken by the FERC,

> to promote open access to transmission grids for natural gas. * * * Similarly, many state legislatures and public utility commissions * * * have adopt[ed] rules to facilitate or require the unbundling of gas distribution from production and supply. [A] standardized form of contract is in widespread use in the natural gas market. Given this statutory background, it would be inconsistent with the intent of Congress and actions taken by the FERC for the Commission to impose additional regulation on natural gas trading.

Id. at 13.

However, the Commission does not require that cash markets, such as those described above, come within the regulatory framework.[14] Centralized markets to trade spot and forward agricultural commodities have long existed outside of the regulatory scheme that applies to futures and option markets. The Act, and the regulatory framework thereunder, apply to markets that trade futures or option contracts on such underlying commodities. Accordingly, there is no inconsistency between the Commission's regulation of futures markets and regulation of the underlying cash markets by other regulators, such as the FERC or the states. To the contrary, the Commission in its oversight of the futures and option

[14] *See*, CFTC Staff Letter No. 99–67, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,970 (Dec. 16, 1999), relating to a market established by the legislature of California for the trading of electricity.

markets coordinates and cooperates with the regulators of related underlying cash markets.

Moreover, although some commenters expressed the view that energy products under the regulatory framework should be eligible to trade on exempt MTEFs based on the sophistication of traders in the market,[15] eligibility for exempt MTEF treatment must also be premised upon a finding that the likelihood of manipulation is sufficiently low that regulation is not required. That case has not yet been made. Existing derivative contracts involving energy commodities typically are based on physical delivery within a relatively narrow geographic area. Delivery under these contracts can be subject to physical constraints, *e.g.*, pipeline congestion, transmission congestion in the case of electricity, weather or natural disaster related events, concentration of ownership of transmission, pipeline or storage and production capacity. Although the total supplies of a broadly defined energy commodity may be large if viewed on a global basis, only a small subset of that total supply typically would be available for delivery on a derivatives contract. As the New York Mercantile Exchange (NYMEX) pointed out in its comment,

> [t]he President's Working Group drew a distinction in its report that limited exclusion from CFTC regulatory authority to financial derivatives. The Working Group's reasoning, in part, was that financial derivatives had ''virtually inexhaustible supplies'' and that dealers in the swaps markets, * * * were subject to other forms of regulatory oversight. That is not the case with many participants in the OTC energy derivative marketplace. Because the President's Working Group focused primarily upon financial derivatives in its report, one may reasonably conclude at this time that the case has yet to be made that such wholesale exemption from CFTC regulation for energy derivatives would serve the public interest.

CL 21–47 at 3. In agreement, Williams Energy Marketing and Trading Company, a company engaged in energy marketing and trading and risk management activities, noted that it ''supports the Commission's proposal to exempt from regulation those * * * MTEFs meeting the conditions specified in the proposed rule,'' and it urged the ''Commission to stay the course of establishing the basic parameters for its new regulatory framework.'' CL 21–25 at 3, 4.

As proposed, the final rules do not make energy-related commodities eligible for trading on exempt MTEF markets at this time.[16] The Commission is making this determination based upon its surveillance experience of designated contract markets on energy-related products and upon careful consideration of the comments. In making this determination, the Commission is not foreclosing generally any subsequent reconsideration of the issue. Moreover, the Commission proposed to permit individual markets, including those offering energy-related products, to petition the Commission for exemption under the provisions of part 36. As proposed, rule 36.2(h) specifically provides that ''any person or entity may apply to the Commission for exemption for other arrangements or facilities, on such terms and conditions as the Commission deems appropriate, including but not limited to, the applicability of other regulatory regimes.'' 65 FR at 38999. The New York Independent System Operator (NYISO) in its comment supported inclusion of this provision, stating that,

> [i]rrespective of whether the automatic exemption criteria are modified, NYISO supports the inclusion of a provision permitting the Commission authority to grant individual petitions for Exempt MTEF status * * *. This type of flexibility is, we believe, necessary to accommodate markets with which the Commission may not as yet be familiar as well as changing markets.

CL 21–61 at 7.

The Commission agrees that flexibility to address new and changing markets is both necessary and appropriate and is adopting proposed rule 36.2(h) as final.[17] As with other such general exemptive provisions, the rule does not limit the grounds on which such an exemption may be granted. *Compare*, 17 CFR 32.4(b) and 35.2(d). However, those petitioning for exemption should be guided by the overall principles underlying the framework, that

> the level of oversight applied to exchanges or trading facilities * * * be based on the nature of participants allowed to trade on the facility and certain characteristics of the commodities being traded. In general, where access to an exchange or facility is restricted to more sophisticated traders or commercial participants, or where the nature of the commodity being traded poses a relatively low susceptibility to manipulation, regulatory oversight would be set at a lower level, reflecting the reduced need to monitor closely such markets.

65 FR at 38988. The commodities that are eligible for exempt MTEF status enjoy nearly inexhaustible deliverable supplies or are otherwise not subject to limitation. Petitions for inclusion of additional commodities should be for commodities of a similar nature. In addition, petitioners should consider addressing the sufficiency and applicability of other regulatory schemes.

Proposed rule 36.2(b)(5) would make eligible for exemption contracts, agreements or transactions which are ''a measure of credit risk or quality, including instruments known as 'total return swaps,' 'credit swaps,' or 'spread swaps.' '' JP Morgan objected to their proposed eligibility on the grounds that:

> [t]he named swaps are commonly based upon the price of corporate equities or, in the case of credit swaps, corporate debt, which is represented by a non-exempt security. The Commission is given authority under 4(c) to exempt futures contracts. But if these particular swaps are futures, they cannot be exempted because they would run afoul of the Shad-Johnson Accord, which bans futures on non-exempt securities prices (except for indexes which have cleared a lengthy regulatory approval process). The part 36 exemption will be of no use because it specifically does not exempt such transactions from the Shad-Johnson Accord. So if the Commission has authority to exempt these transactions (which would only be the case if they are futures), it cannot do so (because the Shad-Johnson Accord prohibits such futures).

CL 21–55 at 4.

However, ''total return swaps,'' include a greater variety of instruments than just swaps on corporate equities or debt, which as JP Morgan correctly recognizes, are not exempt under part 36. Proposed rule 36.2(b) also includes instruments that are not the subject of the prohibitions of the Shad-Johnson Accord.[18] Specifically, for example,

[15] *See*, comment letter from the California Power Exchange, an exchange offering physical delivery cash forward markets for the purchase and sale of electricity between commercial parties. CL 21–34 at 3.

[16] Of course, the framework does not preclude the trading of such contracts altogether. Under the framework, contracts for these commodities may trade on an institutional-participant DTF based on a case-by-case determination by the Commission, on a commercial-participant DTF or on an RFE.

[17] ISDA suggests including a ''category of eligible commodities * * * that over time become traded in sufficient volume so as to be highly unlikely to be susceptible to manipulation.'' CL 21–37 at 4. The Commission is of the view that the petition procedure provided in part 36 would in fact provide it with the type of flexibility to respond to market developments that ISDA advocates. The Coalition recommended that this authority be delegated by the Commission to the Director of the Division of Economic Analysis. CL 21–65 at 10. The Commission is of the view that these determinations should not be delegated at this time.

[18] Moreover, the specific named types of instruments such as ''total return swaps'' in the clause beginning with the word ''including'' modify the more general description ''a measure of credit risk or quality.'' Thus ''total return swaps,'' a term which may include many different types of instruments, are included under this prong of the exemption only insofar as they are also ''a measure of credit risk or quality.'' Of course, as noted in the Notice of proposed Rulemaking and reiterated above, nothing in these rules would affect the

''total return swap'' also describes an agreement whereby one party agrees to pay the total return on a loan portfolio to its counterparty in exchange for semi-annual payments based on a floating interest rate. It is this type of contract, transaction or agreement, traded among eligible participants, that is exempt under rule 36.2(b)(5), which the Commission is adopting as proposed.[19]

Proposed rule 36.2(b)(7) provides that cash-settled contracts on any economic or commercial index or measure beyond the control of the counterparties and not based upon prices derived from trading in a directly corresponding underlying cash market are eligible to trade on an exempt MTEF. The Board of Trade of the City of Chicago (CBT) suggested that proposed rule 36.2(b)(7) be modified so that it is not limited to economic or commercial indexes not based upon prices derived from trading in a directly corresponding cash market. It argued that the requirement that the index or measure be beyond the control of the counterparties is alone sufficient to protect against manipulation. CL 21–36 at 3. However, the Commission believes that both requirements must be met to qualify for the exemption. Basing the cash settlement price of a futures contract on prices derived from trading on an underlying cash market necessarily raises issues regarding the potential ability and incentives of traders in one market to affect pricing in the other market.[20] The Commission, by adopting the rule as proposed, intends to make eligible for this broad exemption only those MTEFs on which the contract's settlement price is objectively determined based upon prices that are ''an objective measurement of an economic or commercial index.'' 65 FR at 38989. As the Commission made clear, the exemption,

> is not intended to include contracts based upon a cash-settlement price determined through cash-market trading of any physical commodity or financial instrument. * * * Finally, included in this category are contracts based on an objectively determined index value or measure of an economic or commercial index reflecting broad characteristics of the economy as a whole, or portions thereof, or material segments of commercial activity.

Id. The Notice of Proposed Rulemaking noted that the consumer price index or the gross domestic product, insurance data, bankruptcy rates, real estate rental indexes, measures of physical production or sales amounts such as housing starts or auto sales or crop yields are examples of contracts falling within this category.[21]

3. Definition of MTEF

Several comments raised issues relating to the proposed definition of MTEF. The Commission proposed in rule 36.1(b) to define ''MTEF'' as ''an electronic or non-electronic market or similar facility through which persons, for their own accounts or for the accounts of others, enter into, agree to enter into or execute binding transactions by accepting bids or offers made by one person that are open to multiple persons conducting business through such market or similar facility.'' 65 FR at 38999. As explained in the Notice of Proposed Rulemaking,

> [t]he definition as proposed does not, and is not intended to, ''preclude participants from engaging in privately negotiated bilateral transactions, even where these participants use computer or other electronic facilities, such as ''broker screens,'' to communicate simultaneously with other participants so long as they do not use such systems to enter orders to execute transactions.'' Accordingly, the definition makes clear that it does not include facilities merely used as a means of communicating bids or offers nor does it include markets in which a single market maker offers to enter into bilateral transactions with multiple counterparties who may not transact with each other.

Id. at 38989 (citation omitted).

Several commenters recommended that the definition of MTEF exclude trading systems that include a credit screen. CL 21–21 at 6; CL 21–37 at 4. One commenter, DNI Holdings, reasoned that ''this credit emphasis has always been a characteristic of swaps transactions, but has never been a characteristic of the futures exchanges.'' CL 21–21 at 5–6. However, in a companion notice of final rulemaking published in this edition of the **Federal Register**, the Commission, consistent with the amendment of part 35 to permit bilateral contracts, transactions or agreements to be cleared, is deleting individualized creditworthiness determinations as a condition for meeting its part 35 exemption for bilateral transactions.

Moreover, as technology increases the availability of electronic credit screens or filters, their use has become common in both multilateral and bilateral environments. As NYMEX notes in commenting on a different provision, which applies to multilateral trading facilities,

> this provision would appear to be premised upon the notion that the credit checking and position limit functionality would reside only within the FCM's internal systems * * *. However, * * * certain trading systems, such as NYMEX's NYMEX ACCESS'' electronic trading system maintains the credit checking functionality as a component of the host computer. Clearing Members may enter inputs into the system to set specific limits per customer.

CL 21–47 at 8.

Finally, the exemptions in part 35 and part 36, when taken together, exempt derivative instruments from regulation under the Act whether or not they are traded on an MTEF if: (1) They are traded among or between eligible counterparties; (2) they are based on the underlying commodities, instruments or measures listed in part 36; and (3) they are, if cleared, cleared by an authorized clearing organization. As correctly observed in a comment referenced above, ''participants in transactions that satisfy these three conditions would obtain legal certainty about the limited scope of CEA regulation regardless of whether the means for executing transactions did or did not satisfy the technical definition of an MTEF.'' CL 21–63 at 2. In light of the availability of the same degree of exemptive relief under either part 35 or part 36 for the specified commodities, the deletion of creditworthiness as a condition for exemption under part 35, and the use of credit screens and filters in both bilateral and multilateral environments, the final rule does not include such an exclusion.

The CBT suggested that the exclusion from the proposed MTEF definition in rule 36.1(b)(3) for ''any facility on which only a single firm may participate as market maker and participants other than the market maker may not accept

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continued applicability of any existing Commission exemptions, policy statements or interpretations to such ''total return swaps,'' or to any other instrument. Moreover, the non-repudiation provision of rule 35.3(c) that the Commission is adopting in a companion release would also apply to such instruments.

[19] The rule, as proposed, referenced ''spread swaps'' rather than ''credit spread swaps,'' which were referenced correctly in the preamble at page 38988. The final rule corrects this typographic error.

[20] This is in contrast to proposed 36.2(b)(6) which applies to ''an occurrence, extent of an occurrence or contingency beyond the control of the counterparties to the transaction.'' As the Commission explained, this category is intended to include contracts:

> based upon the outcome of a contingency, such as a recurring or nonrecurring event, a specific incident, a natural phenomenon or the unambiguous results of some other condition that gives rise to a hedgeable risk.

65 FR at 38989. The Commission does not anticipate that the settlement price of such contracts could be derived from trading in a directly related cash market and has therefore not included that as a criterion.

[21] The Commission provided specific examples for each category of commodities eligible to trade on an exempt MTEF under proposed rule 36.2(b). 65 FR at 38988–89. Except for exempt securities, which are being deleted from eligibility in the final rules, each of those examples is incorporated herein by reference.

bids or offers of other non-market maker participants'' should be deleted. It reasons that ''the Commission's approach could be read to allow a futures exchange * * * to decide to use a single market-maker or specialist system, like many securities exchanges, and avoid being considered to be an MTEF.'' CL 21–36 at 4. However, under the proposed exclusion there can be but one counterparty to all market participants. That is quite different from using one or more specialists in a multilateral trading setting. In that structure, the bids and offers of non-specialists are permitted to interact with each other. The Commission believes that this is a valid and logical distinction between bilateral and multilateral trading structures and is adopting the proposed language as final.

The CBT also questioned whether the definition of MTEF in proposed rule 36.1(b) would affect the Commission's view of the scope of the Treasury Amendment exclusion in section 2(a)(1)(A)(ii) of the Act. CL 21–36–4. As the Commission stated in the Notice of Proposed Rulemaking,

> the definition of MTEF in proposed § 36.1(b) applies only to those rules in which it is cited. It is not intended to modify, alter, amend or interpret any other provision of the Act or the Commission's rules. For example, the proposed § 36.1(b) definition of MTEF does not affect the meaning or application of the statutory term, ''board of trade.'' 7 U.S.C. 1a(1). Thus, the scope and application of the statutory exclusion in section 2(a)(1)(A)(ii) of the Act, popularly known as the ''Treasury Amendment,'' which depends in part on the meaning of ''board of trade,'' is in no way affected by the Commission's proposed adoption of a definition of MTEF under § 36.1(b) for purposes of the exemptions in part 35 and part 36 of its rules.

65 FR at 38989.[22]

Finally, commenters suggested a number of technical modifications to the rules. The CBT suggested that the Commission modify the final rules to clarify that it is the participant to whom notice is provided under proposed rule 36.2(f)(1) and that the separate trading location (or pit) required for trading on exempt MTEFs under proposed rule 36.2(f)(2) may nevertheless adjoin the location wherein Commission-recognized markets are traded. CL 21–36 at 5. The Commission agrees with these suggestions and is modifying the final rules accordingly. In addition, the Minneapolis Grain Exchange (MGE), CL 21–24 at 4, suggested that the Commission modify proposed rule 36.2(e)'s requirement that an exempt MTEF be legally separate from Commission-recognized markets. Upon further consideration of the issue, and based upon the fact that many of the exchanges historically overseen by the Commission have housed both designated contract markets and markets for trading spot or forward contracts without adverse consequence, the Commission is deleting that requirement from the final rules.

B. Derivatives Transaction Facilities.

The Commission also proposed a new exemptive category, ''Derivatives Transaction Facilities,'' which provides for an intermediate level of regulation. This intermediate level of regulation was proposed to be available for two separate types of markets. Although many of the proposed rules are common to both types of markets, some of the proposed rules were tailored to apply to one or the other market.

The first type of DTF proposed by the Commission was for (primarily) ''eligible-participants.''[23] Under the provisions of proposed part 37, these markets or similar facilities, including the current boards of trades, would be eligible to become a DTF regardless of the method of transmitting bids and offers or matching system used, either on a case-by-case determination or if the contracts traded were on the list of commodities eligible to trade as an exempt MTEF.[24] The Commission proposed that such ''eligible participant DTFs'' would have the choice of whether or not to permit access to the market by non-eligible traders. If they did permit access to non-eligible traders, a number of additional requirements were proposed to apply, including enhanced disclosure and higher net capital requirements for the carrying FCM.[25]

The Commission proposed a second type of DTF under proposed part 37 for facilities that restricted participation to ''eligible commercial participants.'' This type of ''commercial-participant DTF'' would be eligible to trade contracts on all commodities other than those domestic agricultural commodities enumerated in section 1a(3) of the Act,[26] any securities or indices thereof subject to section 2(a)(1)(B)(ii) of the Act or any exempt securities or indices thereof included in section 2(a)(1)(B)(v) of the Act. This type of eligible commercials-only market structure lessens many of the regulatory concerns regarding manipulation ordinarily present with contracts for tangible commodities and the regulations that are applicable to them have been tailored to this specific type of market.[27]

Although a few commenters objected to the DTF rules on jurisdictional grounds, many more commenters supported the concept of providing for an intermediate level of regulation. These commenters included both those interested in the eligible-participant DTF as well as those interested in the commercial-participant DTF. For example, Cargill stated that the ''three-tier system seems to provide adequate regulation for a wide range of financial products and market participants depending on the relative sophistication of the participants.'' CL 21–49 at 2. The Coalition stated that it supports the Commission's efforts to create an intermediate category of regulated trading facility subject to less regulation than an RFE and more regulation than an exempt MTEF. The Coalition went on to say that the tiered approach recognizes that there is a wide range of

[22] The CBT raises the concern whether the Act's Treasury Amendment exclusion would continue to apply to an exempt MTEF without an explicit reservation in the rules of that provision of the statute. CL 21–36 at 4. As the Commission explained in the Notice of Proposed Rulemaking and reiterated herein, ''the scope and application of the statutory exclusion in section 2(a)(1)(A)(ii) of the Act * * * is in no way affected'' by this regulatory exemption. Thus, the determination of whether or not a person or facility is a ''board of trade'' for purposes of the Act, generally, and the Treasury Amendment, specifically, should be made without reference to the definition of ''multilateral transaction execution facility'' under rule 36.1(b), which operates in the context of exemptions for markets to which access is limited to eligible participants.

[23] In a companion notice of final rulemaking published in this edition of the **Federal Register** entitled ''Rules Relating to Intermediaries of Commodity Interest Transactions,'' the term ''institutional customer'' is used rather than ''eligible participant.'' These terms can be used interchangeably.

[24] The Commission also expects, however, on a case-by-case basis, that the surveillance history and the self-regulatory undertakings of a particular exchange or facility could make it possible to include a specific contract traded on that facility within the DTF category even if the underlying commodity does not meet the general eligibility criteria. An exchange or facility seeking a case-by-case determination would be recognized as a DTF for that contract or contracts only upon CFTC approval.

[25] Amendments to the Commission's rules governing intermediaries are published today in a separate release in this edition of the **Federal Register**. Although those amendments apply to all categories of intermediaries irrespective of where they choose to transact business, certain proposals differentiate between intermediation on various types of markets and for different types of customers.

[26] They are wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, potatoes, wool, wool tops, fats and oils, cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice.

[27] Many of these trading facilities are expected to replicate electronically various aspects of today's commercial markets, including trading exclusively between principals, and direct negotiation and documentation of trades. In addition, these facilities often do not provide clearing arrangements for contracts.

types of markets, trading systems and market participants, and that it will facilitate market innovation. CL 21–65 at 16. The Association for Investment Management and Research (AIMR) opined that the tiered approach to regulation recognizes different operational profiles and risks inherent to individual participants. CL 21–64 at 3.

Commenters also suggested that the Commission reconsider various specific aspects of the rules as proposed. These suggestions clustered around how various commodities, including in particular, domestic agricultural commodities, should fit within the framework, how eligible participants should be defined, under what conditions non-eligible participants should have access, how the core principles should be enforced and what further tailoring might be appropriate for regulating commercial-participant DTFs. Each of these issues is discussed in greater detail below.

1. Jurisdictional Issues.

Although contracts, agreements or transactions traded on a DTF would be exempt from many of the Act's provisions and Commission regulations,[28] the exemption is contingent upon compliance with the conditions set forth in part 37. A market that applies to the Commission for recognition, and is so recognized by the Commission, is bound to comply with applicable provisions of the Act and Commission rules as a condition of this exemption.

Notwithstanding the requirement that a market or facility must apply to the Commission for recognition in order for the part 37 exemption to pertain, Mercatus questioned how commercial markets for physical commodities would be treated in this regime, and suggested that the Commission provide further guidance on the reach of the proposed part 37 in this area. CL 21–57 at 6. As the Commission noted in proposing part 37 (65 FR at 38989), and reiterates here, in exercising its section 4(c) exemptive authority to date, the Commission has not made a determination that the transactions being exempted were, or were not, subject to the Commission's jurisdiction under the CEA.[29] Rather, the Commission has exercised its section 4(c) authority to provide legal certainty for instruments that *may* be within its jurisdiction. However, the Commission will not entertain applications for recognition from markets or facilities offering transactions that clearly are outside of its jurisdiction.

The Coalition directly addressed this issue and supports the Commission's view. It reasoned that

> the Commission would not be authorized to exercise jurisdiction over activities that are clearly outside its jurisdiction under the CEA. Examples of this would include trading in equity options and spot transactions.
>
> At the same time, the conferees to the Futures Trading Practices Act of 1992 (the ''FTPA'') expressly authorized the Commission to exercise its exemptive authority under Section 4(c)(1) of the CEA without determining whether the exempted transactions are subject to the CEA. And they authorized the Commission to do so on such terms and conditions as the Commission deems appropriate. The conferees specifically so provided to enable the Commission to act without making consequential jurisdictional determinations that might create legal uncertainty for, or imply the illegality of, other transactions.
>
> For precisely the reasons motivating the FTPA conferees, the Coalition believes that the Commission is authorized to and should accept requests by trading facilities who wish to be registered as DTFs and who request that the Commission not make any determination that the underlying transactions are futures contracts or commodity options. The Coalition agrees with the Commission's implicit judgment that this approach will minimize the adverse jurisdictional implications, and therefore the legal uncertainty, that might otherwise arise if one trading facility elects to pursue DTF registration in circumstances where other, possibly analogous trading facilities do not. However, as suggested by the immediately preceding discussion, the Commission should only so proceed in cases where a bona fide issue as to its jurisdiction exists and should not so proceed in any case where it is clear that the Commission lacks jurisdiction.

CL 21–65 at 17–18.

As the Commission noted above with regard to the application of the part 36 exemption, this framework has no applicability to markets or facilities that clearly are outside of the scope of the Act and the Commission's jurisdiction. Thus, the availability of part 37 recognition to those markets that apply in no way carries a negative legal inference or uncertainty for any other market. Accordingly, the Commission is of the view that providing legal certainty through this part 37 exemptive relief to markets or facilities that may be subject to the Act is consistent with Congress' mandate to the Commission and is in the public interest.

2. Commodities

A number of commenters recommended that the framework be modified with regard to its application to the agricultural commodities enumerated in section 1a(3) of the Act. The Commission proposed that contracts on those commodities not be permitted to trade on a commercial-participant DTF, and that they be permitted to trade on an eligible-participant DTF only on a case-by-case determination by the Commission.

The response of commenters representing various agricultural interests was divided. National Grain and Feed Association (NGFA) argued that agricultural markets should be regulated in precisely the same manner as markets for financial commodities. The American Cotton Shippers (Cotton Shippers) argued that any differences in regulation of agricultural commodities penalizes these markets by denying them the benefit of potential marketing innovations. CL 21–12 at 3–5. MGE and the National Grain Trade Council (NGTC) also argued that there should be no distinction in the regulatory framework for the enumerated agricultural commodities. CL 21–24 at 1–2; CL 21–46. An FCM, F.C. Stone, contended that agribusiness firms have substantial risk management experience and can themselves weigh the risks of using a particular trading facility. CL 21–59 at 3.

A significant number of commenters favored permitting enumerated agricultural commodities to trade on an eligible-participant DTF on a case-by-case determination, as provided in the proposed rules. In a joint comment letter, eight agricultural producer groups[30] supported a case-by-case

[28] Certain sections of the Act, including the fraud and manipulation provisions of the Act and the Commission's regulations are reserved in rule 37.8 and would continue to apply.

[29] As noted above, the legislative history states that the Commission in exercising its section 4(c) exemptive authority is not required to make an initial determination that the agreement, instrument, or transaction for which an exemption is sought is subject to the Act. Accordingly, in carrying out this mandate, when the Commission exempted certain swap agreements in 1993, pursuant to section 4(c) of the Act, it stated:

> The issuance of this rule (Rule 35.2) should not be construed as reflecting any determination that the swap agreements covered by the terms hereof are subject to the Act, as the Commission has not made and is not obligated to make any such determination.

58 FR 5587, 5588 (Jan. 22, 1993). See also Order Granting the London Clearing House's Petition for an Exemption Pursuant to Section 4(c) of the Commodity Exchange Act, 64 FR 53346 (Oct. 1, 1999); Exemption for Certain Contracts Involving Energy Products, 58 FR 21286, 21288 (Apr. 20, 1993); Regulation of Hybrid Instruments, 58 FR 5580, 55821 n. 2 (Jan. 22, 1993). The Commission is following this same mandate with respect to this exemption for DTFs.

[30] The eight groups are: the American Farm Bureau Federation, American Soybean Association, National Association of Wheat Growers, National Cattlemen's Beef Association, National Corn Growers Association, National Farmers Union,

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Commission determination of eligibility for DTF trading of individual agricultural commodities. They emphasized, however, that the Commission should provide notice and accept public comment as part of its deliberative process. They further cautioned that such a determination should include appropriate conditions in addition to the seven DTF core principles. CL 21–60 at 1. The NGTC concurred, suggesting that DTFs be permitted to trade agricultural commodities conditioned upon enhanced surveillance (RFE Core Principle 3), position limits (RFE Core Principle 4), and such other requirements that the Commission concludes are essential to market integrity. Cargill, while recognizing that certain agricultural commodities may be subject to manipulation, nevertheless recommended that the CFTC should retain flexibility to address this issue by spelling out criteria that would have to be met for such a commodity to achieve DTF status. CL 21–49 at 2–3.

The final rules, as proposed, provide that the Commission may determine on a case-by-case basis to permit any commodity, including the enumerated agricultural commodities, to trade on an eligible-participant DTF. The Commission remains convinced, as do many commenters, that this strikes the appropriate balance between caution and flexibility to respond to future developments. Moreover, the commenters' suggestions that any case-by-case determination include particular, tailored conditions to the general core principles are well-taken. In this regard, the Commission is of the view that, at a minimum, any DTF trading a commodity on a case-by-case basis will be required to retain the large trader reporting system that pertains to RFEs. The Commission will determine additional requirements, if any, during each individualized determination. In this regard, the procedures to be used by the Commission in such case-by-case determinations will indeed include public notice and an opportunity for public comment.[31]

Commission rule 37.2(a)(2)(i) provides that commodities eligible through a case-by-case determination to trade on a DTF ''have a sufficiently liquid and deep cash market and a surveillance history based on actual trading experience to provide assurance that the contract is highly unlikely to be manipulated.'' The Global TeleExchange (GTX) commented that the Commission should articulate the standards that it will use to judge whether there is a ''sufficiently liquid and deep cash market'' to warrant approving a contract for DTF trading. CL 21–40 at 4. The Commission is not establishing quantitative thresholds or criteria for DTF inclusion *a priori,* because the appropriate standards necessarily would differ across markets and time, and the adoption of specific, detailed standards would deny the Commission and applicants needed flexibility.[32]

In making a determination whether a contract is highly unlikely to be manipulated and thus eligible for DTF trading through an individualized determination, the Commission will consider both the liquidity and depth of the underlying cash market *and* the actual trading experience of the contract, including, where relevant, the facility's surveillance history in monitoring the market and in addressing market problems. Sufficient liquidity and depth of the underlying commodity can be demonstrated by looking at a number of specific factors. These include: (1) A high level of liquidity; (2) bid-ask spreads that are narrow relative to traded values; (3) relatively frequent transactions involving participants that represent major segments of the industry; (4) the absence of material impediments to participation by commercial entities; (5) transfer of ownership that is easily and readily accomplished at minimal cost; and (6) a pattern of pricing that exhibits continuity and the absence of frequent, sharp price changes such that a person cannot readily move materially the price of the product in normal cash market channels. Facilities seeking recognition as a DTF should provide to the Commission information on these factors. Actual trading experience acceptable for DTF eligibility can be based upon a history that the contract terms and conditions provide for a deliverable supply that is adequate to minimize the threat of market abuses such as price manipulation and distortions, congestion, and defaults,[33] and by having in place appropriate procedures effectively to oversee the market, including a large trader system, as well as a history of active surveillance to prevent or mitigate market problems.[34]

3. Access by Non-Eligible Participants

Only eligible participants (*i.e.,* institutional traders) would have unrestricted access to an eligible-participant DTF. Non-eligible participants may access the market, but only through a registered FCM with $20 million in net capital that is a clearing member of a contract market or RFE. *See,* rule 37.2(a)(2)(ii). A number of commenters opposed this requirement. The CBT contended that this requirement is overly burdensome and does not further the Commission's stated goal that DTF transactions ''be transacted through FCMs that are more capable of properly maintaining such accounts and handling the associated risk.'' CL 21–36 at 7. It further reasoned that net capital is a poor proxy for an FCM's trading capabilities or level of regulatory compliance and that the rule favored large FCMs at the expense of smaller FCMs. *Accord,* CL 21–24. The CME disagreed with the premise of the rule that transactions on a DTF entail a higher degree of financial risk than do transactions on an RFE, especially in the context of futures based on liquid financial instruments carrying little risk of manipulation. CL 21–51 at 8. NGTC also questioned the relationship between an FCM's capitalization and its fitness to handle retail accounts on a DTF and argued that the $20 million threshold requirement was inconsistent with other CFTC capital requirements. CL 21–46 at 4–6.

Although adjusted net capital may be an imprecise measure of an FCM's capability to service accounts, the Commission nevertheless believes that the capital requirement proposed to be required of FCMs who trade on DTFs for non-institutional customers is appropriate at this time. Because of the absence of restrictions on the type of

National Grain Sorghum Producers and National Pork Producers Council, and will be referred to hereafter as ''agricultural producer groups.''

[31] Treasury similarly commented with respect to whether government securities should be permitted to trade on a DTF. It recommended that continued application of the segregation of customer funds requirements, certain adjustments to capital requirements for FCMs executing trades for retail customers and large trader reporting be conditions of permitting government securities to trade on a DTF. The Commission will certainly consider these views if any such request to trade government securities on a DTF is received. Moreover, consistent with current practice under the Act, the Commission will continue to keep Treasury apprised of new contracts involving government securities to be listed on both DTFs and RFEs.

[32] GTX also added that, in its view, telecommunication minutes and other telecommunication products should qualify as such a market. The Commission is not making such a determination in this rulemaking. That decision is better made as an individualized determination where a factual record can be developed and public comment specifically sought on the issue.

[33] In this regard, deliverable supply represents the amount of the commodity meeting the contract's specifications at the delivery locations that is available for delivery at its economic value in normal cash marketing channels.

[34] This requirement is not intended to preclude a market experienced in the trading of only cash or other instruments from making the necessary demonstrations. Such facilities may rely on that market experience in making the necessary demonstration.

trading mechanisms that could be used by a DTF, and the possibility of a greater number of such competing markets trading similar products, filling non-institutional customer orders at the best price would likely require the FCM to have a more extensive and sophisticated infrastructure and greater trading resources than an FCM operating in a traditional setting. Accordingly, the Commission, at this time, is adopting the capital-related access restriction as proposed. The Commission will consider further appropriate measures to permit additional FCMs to handle non-institutional customers' access to DTFs as experience is gained under the rules.

The Managed Funds Association (MFA) argued that customers trading through registered CTAs should have trading access to DTFs without regard to their individual financial qualifications. In particular, MFA suggested that a CTA with at least $25 million under management should be permitted to engage in transactions on behalf of their clients on all eligible-participant DTFs. CL 21–31 at 5. Although the Commission is not prepared at this time to treat a CTA's customers as eligible participants without limitation on the basis of the CTA's management of the account, the Commission does recognize that CTAs provide expertise and professional management to their customers. In recognition of this role, the Commission is revising proposed rule 37.2(a)(2)(ii) to permit CTAs, with at least $25 million under management and having non-institutional clients, to access DTFs that permit non-institutional participants on behalf of both their institutional and non-institutional customers through accounts carried by *any* registered FCM. The Commission will reconsider this issue when it looks more broadly at revising current rules applicable to CTAs and commodity pool operators.

NYMEX expressed concern that the proposed requirement that non-eligible traders access a DTF through an FCM may not address adequately electronic systems with direct customer order entry on which FCM credit filters are resident. The Commission agrees, and is modifying 37.2(a)(2)(ii) to make it clear that while the accounts of non-eligible traders must be carried by registered FCMs, they may have direct trading access to the DTF if a credit filter is required to be used by the FCM, regardless of where the filter is resident.

4. Commercial-Participant DTF

The Commission proposed that an intermediate level of regulation also apply to commercial-participant DTFs. The proposed rules applicable to commercial-participant DTFs, although having common elements with eligible-participant DTFs, also have a number of special features. For example, the proposed core principles for DTFs may include two alternatives, with the proviso that they apply to the market ''as applicable.'' *See, e.g.,* Core Principle 2, rule 37.4(b). Only one of the alternatives may be appropriate for a particular facility, and should be understood to apply in that manner.

One commenter, a company beginning an electronic platform for trading ''physical commodities and derivative products * * * among commercial participants,'' opined that ''the overall approach * * * will result in the imposition of excessive and unwarranted burdens on Commercial DTFs.'' Intercontinental Exchange, LLC (Intercontinental) CL 21–22 at 2. A second letter from a group of oil and gas producers, refiners, processors, and marketers and electric utilities and marketers (Energy Group) raised many of the same issues as did Intercontinental. CL 21–23. Specifically, these letters suggested that the Commission provide for a streamlined review procedure for recognition of a DTF within a fixed time period. The letters further stated that the DTF may not have ''exchange-style memberships or rules. Any substantive review of commercial DTFs, their owners or operators, therefore, or any review of rules or principles applicable to trading on or through such facilities would be inappropriate and unwarranted and will render the DTF framework completely unworkable.'' CL 21–22 at 3. They also noted that electronic platforms may have ''trading protocols, product descriptions, fee schedules, user guides and similar trading or transaction related documents or information'' rather than trading rules. *Id.*

The proposed rules, however, recognized this distinction and provided that the facility have rules *or terms and conditions* governing trading procedures. *See, e.g.,* proposed rule 37.3(a)(2). The reference to ''terms and conditions'' was intended to apply to trading platforms that did not have exchange-style rules and instead incorporated their trading procedures as terms of their operating agreements. However, ''terms and conditions'' is already a defined term under Commission rule 1.41(a)(2). To provide greater clarity of the Commission's intent, the final rules refer to ''rules, which may be trading protocols.'' Trading protocols include the methods and conditions for trading that may be included in a user's guide or operator's manual, customer agreements, screen trading prompts or other similar documents or writings.[35]

Intercontinental also opined that the reservation of various sections of the Act in proposed rule 37.5(a) potentially would subject a DTF to a number of additional obligations beyond those included in the rules themselves. CL 21–22 at 4. The Commission's intent, however, in reserving various sections of the Act in part 37 was not to import additional regulatory obligations into the part 37 rules. Rather, its reservation of various sections of the Act is to establish legal authority for promulgating these regulatory requirements. By reserving these sections of the Act, the Commission does not intend to incorporate regulatory requirements for DTFs beyond those specified in part 37. Moreover, the Commission intends that the reserved sections of the Act be interpreted as applying to DTFs as the difference in the contexts require. Some of the Act's provisions, such as section 4c(a) of the Act are reserved ''as applicable,'' depending upon the particular characteristics of a trading facility. The Commission will confirm whether that section of the Act applies to a particular facility in its Order granting recognition to the facility.

In contrast to the reservation of provisions of the Act effectuating the regulatory conditions of the exemption, the Commission has deleted from the final rules in parts 37, 38, and 39 specific reservation of various enforcement provisions that it had proposed specifically to retain. The Commission has determined that such specific reservations are unnecessary. Rather, such specific reservations do not affect the Commission's existing authority to investigate violations and to bring enforcement actions. *See,* section 4(d) of the Act.

In order to conform the regulatory requirements of the commercial-participant DTF more closely to cash market practices, the Commission is deleting the proposed requirement that participants respond to special calls for information about their trading activities. The Commission will rely instead on its investigative authority, which also applies to a person's cash market activities. Moreover, the Commission is not requiring that a non-U.S. participant appoint an agent for receipt of service of process within the United States or that the DTF act in that

[35] In addition, the Commission is amending the definition of ''rules'' under Commission rule 1.41(a)(1) specifically to include the term ''trading protocols.''

capacity. Instead, the Commission is requiring that the commercial-participant DTF provide notice to its non-U.S. participants of communications from the Commission. In the event that a non-U.S. participant fails to comply with such a Commission communication, the Commission may direct recognized DTFs to deny the participant further trading access. *Compare,* 17 CFR 21.03. By modifying the final rules in this way, the Commission is bringing the rules for commercial-participant DTFs into closer alignment with the operation of related cash markets, and the requirements on participants on commercial-participant DTFs, by and large, will be no greater or no different than is applicable to cash market trading.

Finally, both comment letters suggested that the rules applicable to DTFs be located entirely within part 37 without cross-referencing other rules. The Commission has modified the final rules to reduce the number of cross-references within part 37. Accordingly, the final rules have been reorganized to include a new rule 37.5 relating to information requirements (formerly in proposed part 20) and has divided the requirements for recognition into two sections. These modifications to the final rules change the substance of the rules only as discussed above. A number of voluntary provisions remain as cross-references to other rules.

Several commenters raised issues regarding the proposed definition of ''eligible commercial participant.'' Both NYMEX and the Commodity Floor Brokers and Traders Association expressed concern that exchange locals were not included within the category of eligible commercial participants. They reasoned that locals provide the same market making function as do dealers, a category included within the definition of eligible commercial participant. NYMEX noted that professional floor traders provide approximately 43–49% of the trading volume in NYMEX energy contracts. CL 21–47 at 4. NYMEX further noted that unless floor traders were included, the commercial-participant DTF model would ''be used to exclude * * * another business model [exchanges] that is generally comparable but for the sharing of market making responsibilities among a group of professional market makers rather than concentration of this function in a single dealer.'' *Id.* at 10. The CBT concurred, stating that ''[c]ertainly floor brokers and floor traders that trade regularly on exchange markets should be considered to be as sophisticated as any market participants. For that reason, in the Commission's current part 36 rules, floor brokers and traders are defined to be eligible participants without regard to any total or net asset test.'' CL 21–36 at 6. The Commission agrees that Commission registrants, particularly floor brokers and floor traders should be included as eligible to trade in a DTF with a guarantee of their obligations by a futures commission merchant, as suggested by NYMEX.[36]

These rules establish an intermediate level of regulation for DTFs appropriate to the commodities traded and the participants trading thereon. DTFs have great flexibility in determining the trading systems and mechanisms that they will use. Accordingly, and in light of their institutional nature, participants trading on DTFs are expected to exercise the appropriate degree of understanding in making use of these facilities. Notwithstanding part 37's greater degree of regulatory flexibility, the Commission retains its enforcement responsibility to ensure compliance with the fundamental regulatory goals of the Act, as included within these rules. The Commission believes that it has retained the tools necessary to accomplish this mandate and by adopting a more flexible regulatory approach is not thereby indicating any diminishment in its resolve effectively to enforce compliance.

5. Procedures for Recognition

A board of trade, facility, or entity seeking recognition as a derivatives transaction facility would be deemed to be recognized thirty days after the Commission received the application if the application met the conditions for recognition pursuant to §§ 37.3 and 37.4 and the applicant and/or its rules or procedures do not violate the Act or the Commission's regulations.[37] An entity seeking recognition as a DTF may request that the Commission approve its initial set of rules, which may be trading protocols, and any subsequent rules or rule amendments under section 5a(a)(12)(A) of the Act and Commission regulations thereunder. However, the DTF is only required to notify the Commission of rules and rule amendments, which include trading protocols, in the same manner that it notifies market participants, but no later than close of business on the day preceding implementation.

Several commenters raised issues regarding the procedures for recognition. Kiodex, a risk management services firm, suggested that the applicant have an opportunity to correct a deficiency before the ''Commission convert the review into a full-scale designation proceeding.'' CL 21–29 at 4. However, proposed rule 37.4(c) merely provided that upon termination of review under the thirty-day period, the application would be subject to the ''procedures specified in section 6 of the Act.'' That provision merely incorporates the time periods and other procedures from section 6; it is not intended to convert the application or its review into one for contract market designation.

On a related point, the CBT suggested a technical modification to clarify that a board of trade or other entity that files for recognition as a DTF by certification is not required to demonstrate that it satisfies conditions for recognition under part 37. CL 21–36 at 10. As both the proposed and final rules provide, however, the filing by a facility which is already a designated contract market need only include the DTF's rules and its certification that it meets the conditions for recognition as a DTF under the part 37 rules.

Intercontinental suggested that the Commission specifically retain the flexibility to grant recognition to new facilities at various stages of readiness. CL 21–22 at 1–3. The Commission agrees, and has modified rule 37.4 as proposed to provide that the Commission may determine to recognize a DTF upon conditions. These might relate either to additional regulatory undertakings by a particular facility, or to recognition of a facility pending its subsequent fulfillment of a regulatory requirement. This flexibility will enable new entrants to apply for recognition before development of their trading system is complete and to be recognized contingent upon their

[36] This determination is based on the important role that floor brokers and floor traders, which are Commission registrants, may fulfill in trading on a Commission-recognized market under the part 37 exemption. For this reason, the Commission does not agree, as NYMEX suggests, that floor trades or floor brokers should be eligible participants for purposes of parts 35 and 36 under conditions other than currently provided.

[37] The Commission has made clear in the rule 37.1(a) scope provision that the part 37 rules apply to a ''a board of trade operating as a derivatives transaction facility.'' Moreover, DTFs, as a condition of the part 37 rules, generally would be considered under proposed rule 37.1(a) to be subject to the Act's provisions as though the DTF were a ''designated contract market'' under the Act. As a board of trade within the meaning of that term under the Act (and as a contract market by operation of part 37), a DTF on which futures transactions are traded would be covered by the provisions of Subchapter IV of Chapter 7, Title 11 of the Bankruptcy Code. Similarly, DTFs should be considered ''contract markets'' for the purpose of, for example, Sections 556 and 761 of the Bankruptcy Code, and 12 U.S.C. 4402. The Commission has modified final rule 38.1(b) to make a similar clarification relating to RFEs.

meeting all of the recognition requirements.[38]

6. Enforcement of Core Principles

Several letters raised concerns regarding the interpretation, enforcement and oversight of core principles. NYMEX suggested that the guidance with respect to Core Principle 6 which provides that rule 1.31 is the acceptable practice should be amended to read ''an acceptable but non-exclusive means regarding the form and manner for keeping records.'' CL 21–47 at 11. The Commission appreciates that the current wording does not appear to offer a high degree of flexibility in meeting this core principle. However, rule 1.31 was recently amended (64 FR 28910) and in its amended form provides a degree of flexibility in compliance. Moreover, rule 1.31's provisions are consistent with the record-keeping requirements of the Securities and Exchange Commission (SEC). In light of the importance of recordkeeping to the Commission's ability to fulfill its oversight function and the high number of Commission registrants that must also comply with similar SEC requirements, the Commission is adopting the guidance as proposed and will provide further guidance on acceptable record-keeping practices after additional study of the issue.

The CBT opined that ''safeguards should be provided to ensure that flexible standards do not become a license for the CFTC to dictate to exchanges.'' CL 21–1 at 2–3. In contrast, Mercatus objected to the use of core principles as too vague. *See* CL 21–57 at 7, 10. *See also* CL 21–45 at 3. The Commission finds both of these arguments unpersuasive. First, the core principles are specifically designed to afford flexibility to trading facilities to design innovative trading mechanisms in an expeditious manner. Second, this flexibility should not be confused with vagueness. While not like typical prescriptive regulations, the core principles nevertheless do set forth specific standards to be satisfied by those seeking to gain and maintain recognition. Finally, any interpretative advice, assistance or direction provided by the Commission would constitute guidance only. It does not preclude any facility from complying with the core principle in some other manner.

Accordingly, the framework does not place the burden of proof upon those covered by the framework to demonstrate why a particular practice that differs from the specific guidance offered in a statement of acceptable practices complies with a particular core principle. See, CL 21–57 at 7. If, as a practical matter, a disagreement on the interpretation of any core principle could not be addressed through informal mechanisms, the burden of proof to establish a violation of a core principle would not differ from the Commission's current burden, and would rest with the Commission in any formal regulatory or enforcement proceeding.

Nevertheless, the CBT and CME called for a ''mechanism'' for resolving disagreements over interpretation of core principles short of the CFTC taking punitive action. CL 21–51 at 5. CBT suggested, for example, that all adjectives, such as ''appropriate,'' ''periodically,'' ''proper,'' and ''timely'' be removed from the core principles and that the Commission ''structure an alternative dispute resolution mechanism to resolve disagreements about the application of core principles.'' CL 21–36 at 10. The Commission appreciates the concerns of these commenters. By moving from prescriptive rules to more general core principles, self-regulatory organizations will have not only greater flexibility in how they meet the regulatory requirements, but more responsibility, as well. Purging the core principles of adjectives will not address the issue of whether the self-regulatory organizations act in a manner consistent with these internationally accepted norms for the conduct of trading facilities. The Commission fully expects that as self-regulators, the entities covered by the framework will strive to act at the highest ethical and professional standards for the protection of customers and the integrity of the market.

Finally, trading facilities must recognize that the requirements contained in the core principles may involve many interested parties, not just a facility's members or owners. Accordingly, as FIA suggested, when issuing interpretative guidance having industry-wide application, the Commission will follow the notice and public comments procedures of the Administrative Procedure Act, as appropriate. CL 21–45 at 5.[39]

C. Recognized Futures Exchanges

The Commission further proposed to recognize all currently designated contract markets, except for those designated as contract markets in section 2(a)(1)(B) commodities, as ''Recognized Futures Exchanges'' under proposed part 38. To provide recognized futures exchanges with greater operational flexibility, part 38, as proposed, would replace many prescriptive rules with performance-based rules, or core principles. Moreover, Commission review would not be required for new contracts or for rules and rule amendments prior to listing or implementation, except for the terms and conditions of agricultural commodities enumerated in section 1a(3) of the Act. Furthermore, the exchanges would not be required to be responsible for auditing intermediaries' sales practices. Instead, enforcement could be the responsibility of a registered futures association.[40]

The preamble to proposed part 38 noted that RFE markets can list for trading contracts on any commodity, including those having potentially a greater risk of price manipulation. In addition, because they could permit unconditioned access to both institutional and non-institutional traders, they raise greater concerns regarding customer protection than do DTFs. 65 FR at 38991. Therefore, as the preamble noted, the proposed rules in part 38 preserve a higher level of market surveillance, position reporting obligations, customer protections and financial safeguards than do the proposed rules for DTFs. *Id.* A number of commenters questioned these requirements as incorporated in the core principles that are applicable to RFEs.

1. RFEs as a Means of Regulatory Reform

As was the case with commenters on the proposed DTF category, many commenters supported the general concept of changing from prescriptive regulations to broad, flexible core principles for RFEs.[41] Some

[38] The Commission has modified the final application guidances to make clear that DTFs and RFEs must disclosure limitations of liability, if any. Such limitations of liability, consistent with longstanding Commission policy, may not limit liability for violations of the Act or Commission rules, fraud, or wanton or willful misconduct.

[39] The National Futures Association (NFA) advocated that its member rules be the primary means of developing best practice or other interpretative guidance for core principles applying the framework. The Commission appreciates the NFA's willingness to assist in interpreting Commission rules and in certain instances, where the parts of the framework involve NFA's member rules, the Commission may ask for NFA's interpretative assistance. However, it would be inappropriate for NFA to assume that role for areas of the framework that do not involve its membership, particularly for example, where a trading facility does not permit intermediation.

[40] As pointed out in the Federal Register release proposing part 38, the NFA currently is the only such registered organization. *See* 65 FR at 38991.

[41] Specifically, for example, Cargill supported the basic structure of the regulatory relief for organized

Continued

commenters expressed concern, however, that the RFE proposal would permit greater deregulation than appropriate for these commodities and market participants. For example, the Silver Users Association (SUA) maintained that any change in the regulatory structure for silver trading must provide clear assignment of responsibility for trading facility operators, and procedures for market participants to obtain redress for improper actions.[42] The agricultural producer groups urged that new agricultural contracts and amendments to such contracts continue to be subject to Commission review prior to their trading. CL 21–60 at 1. Two commenters, Mercatus and CBT, questioned whether the proposed framework for RFEs was sufficiently deregulatory in nature. CL 21–36 at 12.

The Commission remains convinced, and most commenters agreed, that the use of core principles supplemented by statements of acceptable practices strikes the right balance between the need for appropriate regulation and for flexibility. The proposed rules for RFEs are not intended to remove internationally accepted standards for market or financial integrity or for the protection of customers trading on futures exchanges. Rather, they are intended to offer U.S. exchanges greater flexibility in meeting those requirements. As the Commission noted:

> [t]hese proposed rules * * * [are] intended to provide greater flexibility in meeting technological and competitive challenges. At the same time, the Commission will retain its oversight authority to ensure the integrity of markets and prices, to deter manipulation, to protect the markets' financial integrity, and to protect customers.

65 FR at 38987. This approach, although providing exchanges a high degree of flexibility to meet these challenges, is not intended to relieve U.S. exchanges from their obligations to comply with the policies and requirements of the Act, nor to operate in a manner that fails to meet ''internationally-accepted guidance regarding appropriate regulatory measures for exchange-traded derivatives markets.''[43] 65 FR at 38987.

2. Comments Concerning the Core Principles

A number of commenters offered suggested changes to the core principles. The Commission has considered these comments within the overall goal that the core principles establish broad, flexible requirements, that at the same time are specific enough to provide notice of the required performance by the recognized entity. In this regard, the final version of Appendix A to part 38 herein, clarifies that the guidance offered on the means of complying with the core principles is for illustrative purposes only and is not intended to be a mandatory checklist for compliance.

Specifically, AIMR suggested that Core Principle 3 (Position Monitoring and Reporting) should simply require exchanges to have the process and rules necessary to deter market manipulation. CL 21–64 at 4. That formulation, however, fails to capture the breadth of an RFE's responsibility under the Act. Both prevention of price manipulation and assurance of market and price integrity are fundamental public policy interests of the Act. Accordingly, the Commission believes that it is vital that RFEs have more than just rules and a process to deter manipulation, as suggested by AIMR. The Commission therefore is retaining the language of Core Principle 3, which requires an RFE to monitor ''on a routine and non-routine basis as necessary to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process.''[44]

NYBOT and CBT expressed concerns about Core Principle 7, which relates to transparency. NYBOT raised the concern that the required level of transparency under Core Principle 7 should be appropriate to the method of order execution, explaining that some aspects of transparency are affected by whether trading is electronic or open-outcry (*e.g.*, bids and offers are not automatically captured in open-outcry trading). CL 21–7 at 3, CL 21–27 at 2. However, technology is rapidly transforming futures markets and the core principles are intended to be understood broadly and applied flexibly in each particular market context. Accordingly, the Commission believes that the transparency requirement, as proposed, provides the necessary guidance for both open-outcry and electronic markets. The CBT suggested that the Commission revise the DTF Transparency Core Principle to mirror the proposed RFE Transparency Core Principle, commenting that DTFs appear to have the more onerous transparency burden. CL 21–36 at 10. The material difference between the two core principles is that the DTF Transparency Core Principle requires disclosure of information to both market participants and the public. That requirement is particularly necessary at the DTF level in light of the framework's greater reliance on disclosure rather than merit-type regulation.

Upon further consideration, however, the Commission believes that the Transparency Core Principle proposed to apply to DTFs should be applied at the RFE level, as well. The RFE Transparency Core Principle as proposed could result in permitting an inappropriate reduction in the information currently available to market participants. Therefore, under the final Transparency Core Principle, both RFEs and DTFs must provide information to market participants, on a fair, equitable and timely basis, regarding prices, bids and offers, as well as other pertinent information as appropriate to the market. This additional language is not intended to interfere with the current practice of futures exchanges of selling price and other market information through various information vendors.

FIA suggested in its comment that the guidance regarding price and reporting time as it relates to block trading should be eliminated from Appendix A, Core Principle 8.[45] CL 21–45 at 6–7. The

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futures exchanges. CL 21–49 at 2. NYMEX strongly supported the overall design of the proposal. CL 21–47 at 1. CME strongly supported the Commission's approach in moving from prescriptive regulations to core principles. CL 21–51 at 5. NYBOT stated that the proposed framework struck a measured balance between self-regulation and federal oversight in many respects. CL 21–27 at 1.

[42] The SUA expressed the additional concern that if liquidity in silver trading at RFEs using open-outcry diminishes due to interest in electronic platforms, procedures should be in place for making pricing data from electronic trading platforms available to the public on a timely basis. CL 21–39 at 3.

[43] Under Rule 38.3(f), as modified in the final rules, RFEs are required to carry out international financial and surveillance information sharing arrangements. The Commission points out that, at this time, the International Information Sharing Agreement and Memorandum of Understanding developed by the FIA Global Task Force on Financial Integrity is one such arrangement.

[44] AIMR also suggested that Core Principle 4 (Position Limits) be modified only to require RFEs to hold members accountable for their positions. However, position limits are a necessary tool for preventing market manipulation or distortion in many markets and the Commission therefore declines to modify the core principle as proposed. However, the Commission in its proposed statement of acceptable practices specifically determined that exchange position accountability rules are an acceptable means of meeting the core principle for various types of markets. 65 FR at 39005.

[45] Core Principle 8 requires an RFE to ''provide a competitive, open and efficient market.'' A primary goal of the Commission's framework is to ensure that prices discovered in futures and derivatives markets are accurate and reflective of current supply and demand conditions in the markets. Core Principle 8 specifically includes the concept of ''efficient'' markets in order to make clear that trading systems that discover prices reflective of the forces of supply and demand and accurately reflect publicly held information may include certain practices, such as block trades, that permit large traders to enter the market with a single trade as opposed to having to execute

Commission understands the difficulties in implementing both the ''fair and reasonable price'' and ''transparency'' guidance. Nevertheless, current block trading provisions meet both such criteria, and the Commission believes it appropriate to retain them at this time. In this regard, the Commission notes that the reporting time provision is not the ''specific timing requirement'' referred to by FIA, but a provision for transparency of the block trade, directing that the trade be reported ''within a reasonable period of time.''(emphasis added). 65 FR at 39006. Without such transparency, the market's price discovery role would be harmed. The Commission may reconsider this guidance in the future if, in practice, these criteria prove to be unworkable.[46]

NYBOT suggested that requiring all RFEs on which intermediaries trade to have relevant rules under Core Principle 10 (Financial Standards) would impose a new, onerous burden, and might result in conflicting rules being implemented at different RFEs. NYBOT states that segregation of customer and proprietary funds and custody and investment of customer funds are currently governed by Commission rules implemented under the auspices of a designated self-regulatory organization. CL 21–7 at 2. The adoption of Core Principle 10 is not intended to impose a ''new, onerous burden'' on exchanges, to change current systems in place for the oversight of intermediaries nor to discourage the voluntary harmonization of rules by the exchanges through the operation of organizations such as the Joint Audit Committee.

The Commission has modified Core Principle 15 in response to concerns that it inadvertently could impose a duty different in form or degree from the antitrust statutes and court decisions construing them. *See, e.g.,* comment of the Board of Trade Clearing Corporation, CL 21–20 at 13. Final Core Principle 15 requires that RFEs operate in a manner consistent with the public interest to be protected by the antitrust laws. The Commission itself remains subject to the requirements of section 15 of the Act, and will continue to take into consideration the public interest to be protected by the antitrust laws and to endeavor to take the least anticompetitive means of achieving the objectives of the Act in requiring or approving any bylaw, rule or regulation of any facility recognized under this framework.[47]

3. New Products and Rules and Amendments Thereof

The Commission proposed that alteration by RFEs of the terms and conditions of futures contracts on the enumerated agricultural contracts be subject to prior review and approval by the Commission. The NYBOT, MGE, CBT, and CME opposed this provision, arguing that RFEs should be permitted to alter the terms or conditions of agricultural contract terms and conditions by self-certification, the same process permitted for contracts on all other commodities.[48] In contrast to the exchange commenters, a number of commenters representing agricultural interests specifically supported retention of the proposed 45-day prior approval requirement for changes to the terms and conditions of existing agricultural contracts.[49] Concern was also raised by the National Cotton Council and the agricultural producers groups regarding the certification process for new contracts. CL 21–54 at 1. They suggested that Commission prior approval under a 45-day review period be required for new agricultural contracts, as well as for alterations of existing contracts.[50] CL 21–60 at 2.

The Commission concurs with the agricultural producers groups that, as ''agricultural futures markets serve as the price discovery mechanism for agricultural commodities, any changes to these markets can have a significant impact on farmers and ranchers.'' CL 21–60 at 2. In light of their reliance on the existing futures markets for price discovery, the Commission concurs that agricultural producers, processors and merchants have an interest in commenting on significant alterations to the terms of contracts prior to their implementation. Accordingly, the Commission is adopting the prior approval provision for amendments to contract terms and conditions, as proposed. However, the Commission does not agree that the same opportunity for comment is necessary for new contracts, upon which producers have not previously relied. The success of a new contract will rest on its attractiveness to market participants and the marketplace will determine whether the terms and conditions of a new contract offer a reliable price discovery mechanism. Accordingly, the Commission has decided to permit an RFE to list new agricultural contracts by self-certification, as proposed.

Several commenters opposed Commission authority to stay the effectiveness of rules implemented by exchange certification during a Commission action to disapprove those rules. *See,* rule 1.41(c)(4) as amended.[51] They argued that such stays could disrupt the marketplace.[52] However, under the rule, the Commission would only be able to stay a proposed rule incident to disapproval proceedings and the stay determination would not be delegable to Commission staff. The Commission anticipates that it will stay implementation of an RFE rule only in limited and egregious situations, where, for example, one or more core principles

numerous small trades. By including ''efficiency'' in addition to open and competitive markets, the Commission is promoting a flexible standard that protects the price discovery process of the markets while permitting a variety of trading practices.

[46] AIMR recommended that the Commission reword Core Principle 8 as an RFE should not only provide for, but should also facilitate the appearance of, a competitive, open and efficient market (trading system). CL 21–64 at 4. The final version of Core Principle 8 does not include the additional language proposed by AIMR. The Commission believes that provision of an open and competitive market would also promote the appearance of such a market, without the need explicitly to so require.

[47] Section 15 of the Act is also reserved under rule 38.6(a). Section 15 of the Act requires the Commission to take into consideration the public interest to be protected by the antitrust laws and to endeavor to take the least anticompetitive means of achieving the objectives of the Act in issuing any order, adopting any regulation, or approving any rule.

[48] *See* CL 21–7 at 2, 4; CL 21–24 at 3–4; CL 21–36 at 11; CL 21–51 at 5.

[49] *See* CL 21–52 at 1–2 (National Cattlemen's Beef Association); CL 21–54 at 1 (The National Cotton Council of America, ''National Cotton Council''); CL 21–60 at 1–2 (agricultural producers groups).

[50] The comment letter stated that the agricultural organizations were concerned that exchanges could use the ability to offer a new contract with one day's notice to avoid prior review and approval for amendments and changes to agricultural contracts. It could also cause market fragmentation, since new trading facilities might test new contracts on the market without a thorough prior business analysis.

[51] Amendments to Commission rule 1.41 were proposed as part of the new regulatory framework. These amendments, appearing in the final version in this **Federal Register** release, allow an RFE to make modifications to its rules (other than terms or conditions of contracts on the commodities enumerated in section 1a(3) of the Act) by certification to the Commission that the new or amended rule does not violate the Act or the Commission's regulations. Upon the adoption of the attached amendments to Commission rule 1.41, the Commission's earlier certification proposal, published as a proposed rule on November 26, 1999 (64 FR 55428), will be unnecessary. Therefore, the Commission is withdrawing proposed rule 1.41(z) at this time.

[52] *See, e.g.,* CL 21–24 at 4 (assertions by MGE that rules should not be stayed absent sufficient evidence that market participants will suffer material harm). *See also* CL 21–27 at 3 (conclusions by NYBOT that staying a rule pending a proceeding to disapprove or amend it could take months, and the uncertainty thus created would deter traders); CL 21–36 at 11–12 (statement by CBT that it could be detrimental for the Commission to retain authority to impose a stay during a proceeding to disapprove, alter, or amend an RFE rule as stays could disrupt the marketplace); CL 21–51 at 5 (observation by CME that the Commission should not retain authority to stay operation of an exchange rule as, in an emergency situation, the Commission could act under section 8a(9) of the Act, without advance notice or a hearing).

were being violated, but that the Commission's emergency authority would not apply.[53] In such serious situations, the Commission believes that the unavailability of a stay could cause significantly more disruptive effects than imposition of a stay in appropriate situations. In those rare instances, the absence of a stay could cause significantly greater harm to the market than its use. The Commission has determined that this authority is central to its ability to oversee the operation of RFEs consistent with its responsibilities under the Act.

4. Bankruptcy Status

Several commenters requested that the Commission clarify that transactions on both DTFs and RFEs continue to enjoy the same Bankruptcy Code status as transactions on a designated contract market.[54] As noted above, recognized RFEs and DTFs are both ''boards of trade'' within the meaning of the Act, and pursuant to these regulations, are deemed to be subject to all provisions of the Act and Commission rules applicable to a ''designated contract market.'' *See, e.g.,* rule 38.1(b). Moreover, final part 38 explicitly reserves the applicability of part 190 to part 38 transactions. Accordingly, as explained in footnote 37 above, as a board of trade within the meaning of that term under the Act (and as a contract market by operation of part 38), transactions on RFEs (and DTFs) would be covered by the provisions of Subchapter IV of Chapter 7, Title 11 of the Bankruptcy Code, which apply to futures contracts (or options) traded on or subject to the rules of a board of trade or contract market.[55]

III. Section 4(c) Findings

These rule amendments are being promulgated under section 4(c) of the Act, which grants the Commission broad exemptive authority. Section 4(c) of the Act provides that, in order to promote responsible economic or financial innovation and fair competition, the Commission may by rule, regulation or order exempt any class of agreements, contracts or transactions, either unconditionally or on stated terms or conditions from any of the requirements of any provision of the Act. For any exemption granted pursuant to 4(c), the Commission must find that the exemption would be consistent with the public interest. For any exemption granted pursuant to 4(c) from the requirements of section 4(a), the Commission must further find that the section 4(a) requirement(s) should not be applied to the agreement, contract or transaction to be exempted, that the exemption would be consistent with the public interest and the purposes of the Act, that the agreement, contract, or transaction to be exempted would be entered into solely between appropriate persons and that the exemption will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act.[56]

The Commission specifically requested the public to comment on these issues. The Commission finds and the commenters overwhelmingly concurred that the proposed regulatory framework would be in the public interest. As explained above, these proposed rules establish a new regulatory framework. The proposed framework is intended to promote innovation and competition in futures trading and to permit the markets the flexibility to respond to technological and structural changes. Consequently, the Commission finds that section 4(a) requirements should not be applied to agreements, contracts or transactions executed pursuant to parts 36, 37 or 38 except as provided for in each part, respectively. Moreover, the proposed framework establishes three regulatory tiers with regulations tailored to the nature of the commodities traded and the nature of the market participant. As the Commission explained above, access to each of the tiers is dependent upon the appropriateness of the participant.

Accordingly, and for the reasons detailed above, the Commission finds that each class of participant eligible to participate in a specific tier is appropriate for that exemptive relief. Finally, the exemptions for parts 37 and 38 are upon stated terms. As detailed above, these terms include application of regulatory and self-regulatory requirements tailored to the nature of the market. In light of these conditions, this exemptive relief would have no adverse effect on any of the regulatory or self-regulatory responsibilities imposed by the Act and the exemptions are consistent with the purposes of the Act.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601, *et seq.* (1994 & Supp. II 1996), requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. The rules adopted herein would affect contract markets, FCMs, CTAs, Floor Brokers and Floor Traders. The Commission has previously established certain definitions of ''small entities'' to be used by the Commission in evaluating the impact of its rules on small entities in accordance with the RFA.[57] In its previous determinations, the Commission has concluded that contract markets and registered FCMs are not small entities for the purpose of the RFA.[58] With respect to CTAs, Floor Brokers and Floor Traders, the Commission has stated that it is appropriate to evaluate within the context of a particular rule proposal whether some or all of the affected entities should be considered small entities and, if so, to analyze the economic impact on them of any rule. In this regard, the rules being adopted herein would allow qualifying CTAs, floor brokers and floor traders to access trading in less regulated futures markets than is currently the case; consequently, these rules should not have any, or result in only a de minimus, increase in the regulatory requirements that apply to CTAs, Floor Brokers and Floor Traders. Accordingly, the Commission does not expect the rules, as adopted herein, to have a significant economic impact on a substantial number of small entities. Furthermore, no comments were received from the public on the RFA and its relation to the proposed rules. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the action taken herein will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act of 1995

These parts 15, 37, 38 contain information collection requirements. As required by the Paperwork Reduction Act of 1995 (Pub. L. 104–13 (May 13,

[53] For example, a rule that altered a trade matching algorithm to give one class of participants a significant and improper ongoing advantage over another or that had a continuing significant adverse affect on customers could be the subject of a stay. In contrast, such a rule might not be a proper basis for a market emergency, as it might not result in a situation where action was necessary to ensure that the market accurately reflected the forces of supply and demand. The term ''emergency'' as defined in the Act means, in addition to threatened or actual market manipulations and corners, any act of the United States or a foreign government affecting a commodity or any other major market disturbance which prevents the market from accurately reflecting the forces of supply and demand for such commodity. *See* section 8a(9) of the Act.

[54] *See, e.g.,* CL 21–65 at 22.

[55] Similarly, the Commission believes that transactions on recognized DTFs and RFEs should be subject to the same tax treatment as transactions on formally designated contract markets.

[56] *See* 7 U.S.C. 6(c).

[57] 47 FR 18618–21 (Apr. 30, 1982).

[58] 47 FR 18618, 18619 (discussing contract markets); 47 FR 18619–20 (discussing FCMs and CPOs).

1996)), the Commission has submitted a copy of these proposed parts to the Office of Management and Budget (OMB) for its review (44 U.S.C. 3504(h)). No comments were received in response to the Commission's invitation in the NPRM to comment on any potential paperwork burden associated with these regulations.

List of Subjects

17 CFR Part 1

Commodity futures, Consumer protection, Contract markets, Designation application, Reporting and recordkeeping requirements.

17 CFR Part 5

Authority delegations (Government agencies), Commodity futures, Contract markets, Designation application, Reporting and recordkeeping requirements.

17 CFR Part 15

Commodity futures, Contract markets, Reporting and recordkeeping requirements.

17 CFR Part 36

Commodity futures, Commodity Futures Trading Commission.

17 CFR Part 37

Authority delegations (Government agencies), Commodity futures, Commodity Futures Trading Commission.

17 CFR Part 38

Commodity futures, Commodity Futures Trading Commission.

17 CFR Part 100

Commodity futures, Commodity Futures Trading Commission.

17 CFR Part 170

Authority delegations (Government agencies), Commodity futures, Reporting and recordkeeping requirements.

17 CFR Part 180

Claims, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

In consideration of the foregoing, and pursuant to the authority contained in the Act and, in particular, sections 4, 4c, 4i, 5, 5a, 6 and 8a thereof, 7 U.S.C. 6, 6c, 6i, 7, 7a, 8, and 12a, the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

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

2. Section 1.37 is amended by adding paragraphs (c) and (d) to read as follows:

§ 1.37 Customer's or option customer's name, address, and occupation recorded; record of guarantor or controller of account.

* * * * *

(c) Each recognized futures exchange shall keep a record in permanent form which shall show the true name; address; and principal occupation or business of any foreign trader executing transactions on the facility or exchange, as well as the name of any person guaranteeing such transactions or exercising any control over the trading of such foreign trader.

(d) Paragraph (c) of this section shall not apply to a recognized futures exchange on which transactions in futures or option contracts of foreign traders are executed through and the resulting transactions are maintained in accounts carried by a registered futures commission merchant or introducing broker subject to the provisions of paragraph (a) of this section.

* * * * *

3. Section 1.41 is amended as follows:

a. By revising paragraph (a)(1),

b. By removing and reserving paragraph (b), and removing paragarphs (i) through (t),

c. By redesignating paragraph (e) as paragraph (i) and revising it,

d. By revising paragraphs (c) and (d) and adding (e), and

e. By amending paragraphs (f) and (g) by adding the words ''or recognized futures exchange'' after the words ''contract market'' each time they appear, to read as follows:

§ 1.41 Contract market rules; submission of rules to the Commission; exemption of certain rules.

(a) * * *

(1) The term rule of a contract market means any constitutional provision, article of incorporation, bylaw, rule, regulation, resolution, interpretation, stated policy, term and condition, trading protocol, agreement or instrument corresponding thereto, in whatever form adopted, and any amendment or addition thereto or repeal thereof, made or issued by a contract market, or by the governing board thereof or any committee thereof.

* * * * *

(b) [Reserved]

(c) *Exemption from the rule review procedure requirements of section 5a(a)(12)(A) of the Act and related regulations.* Notwithstanding the rule approval and filing requirements of section 5a(a)(12) of the Act, designated contract markets, recognized futures exchanges and recognized clearing organizations may place a rule into effect without prior Commission review or approval if:

(1) The rule is not a term or condition of a contract for future delivery of an agricultural commodity listed in section 1a(3) of the Act;

(2) The entity has filed a submission for the rule, and the Commission has received the submission at its Washington, D.C. headquarters and at the regional office having jurisdiction over the entity by close of business on the business day preceding implementation of the rule; and

(3) The rule submission includes:

(i) The label, ''Submission of rule by self-certification;'

(ii) The text of the rule (in the case of a rule amendment, brackets must indicate words deleted and underscoring must indicate words added);

(iii) A brief explanation of the rule including any substantive opposing views not incorporated into the rule; and

(iv) A certification by the eligible entity that the rule does not violate any provision of the Act and regulations thereunder.

(4) The Commission retains the authority to stay the effectiveness of a rule implemented pursuant to paragraph (c)(1) of this section during the pendency of Commission proceedings to disapprove, alter or amend the rule. The decision to stay the effectiveness of a rule in such circumstances may not be delegable to any employee of the Commission.

(d)(1) *Voluntary submission of rules for fast-track approval.* A designated contract market, recognized futures exchange, derivatives transaction facility or recognized clearing organization may submit any rule or proposed rule (which may be terms or conditions of trading or trading protocols), except those submitted to the Commission under paragraph (f) of this section, for approval by the Commission pursuant to section 5a(a)(12)(A) of the Act, whether or not so required by section 5a(a)(12) of the Act under the following procedures:

(i) One copy of each rule submitted under this section shall be furnished in hard copy or electronically in a format specified by the Secretary of the Commission to the Commission at its Washington, DC headquarters. If a hard copy is furnished for submissions under appendix A to part 5 of this chapter, two additional hard copies shall be furnished to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581. Each submission under this paragraph (d)(1) shall be in the following order:

(A) Label the submission as ''Submission for Commission rule approval'';

(B) Set forth the text of the rule or proposed rule (in the case of a rule amendment, brackets must indicate words deleted and underscoring must indicate words added);

(C) Describe the proposed effective date of a proposed rule and any action taken or anticipated to be taken to adopt the proposed rule by the contract market, recognized futures exchange, derivatives transaction facility or recognized clearing organization or by its governing board or by any committee thereof, and cite the rules of the entity that authorize the adoption of the proposed rule;

(D) Explain the operation, purpose, and effect of the proposed rule, including, as applicable, a description of the anticipated benefits to market participants or others, any potential anticompetitive effects on market participants or others, how the rule fits into the contract market, recognized futures exchange, derivatives transaction facility or recognized clearing organization's framework of self-regulation, and any other information which may be beneficial to the Commission in analyzing the proposed rule. If a proposed rule affects, directly or indirectly, the application of any other rule of the submitting entity, set forth the pertinent text of any such rule and describe the anticipated effect;

(E) Note and briefly describe any substantive opposing views expressed with respect to the proposed rule which were not incorporated into the proposed rule prior to its submission to the Commission; and

(F) Identify any Commission regulation that the Commission may need to amend, or sections of the Act or Commission regulations that the Commission may need to interpret in order to approve or allow into effect the proposed rule. To the extent that such an amendment or interpretation is necessary to accommodate a proposed rule, the submission should include a reasoned analysis supporting the change.

(ii) All rules submitted for Commission approval under paragraph (d)(1)(i) of this section shall be deemed approved by the Commission under section 5a(a)(12)(A) of the Act, forty-five days after receipt by the Commission, unless notified otherwise within that period, if:

(A) The submission complies with the requirements of paragraphs (d)(1)(i) (A) through (F) of this section or, for dormant contracts, the requirements of § 5.3 of this chapter;

(B) The submitting entity does not amend the proposed rule or supplement the submission, except as requested by the Commission, during the pendency of the review period; and

(C) The submitting entity has not instructed the Commission in writing during the review period to review the proposed rule under the 180 day review period under section 5a(a)(12)(A) of the Act.

(iii) The Commission, within forty-five days after receipt of a submission filed pursuant to paragraph (d)(1)(i) of this section, may notify the entity making the submission that the review period has been extended for a period of thirty days where the proposed rule raises novel or complex issues which require additional time for review or is of major economic significance. This notification shall briefly describe the nature of the specific issues for which additional time for review is required. Upon such notification, the period for review shall be extended for a period of thirty days, and, unless the entity is notified otherwise during that period, the rule shall be deemed approved at the end of the enlarged review time.

(iv) During the forty-five day period for fast-track review, or the thirty-day extension when the period has been enlarged under paragraph (d)(1)(iii) of this section, the Commission shall notify the submitting entity that the Commission is terminating fast-track review procedures and will review the proposed rule under the 180 day review period of section 5a(a)(12)(A) of the Act, if it appears that the proposed rule may violate a specific provision of the Act, regulations, or form or content requirements of this section. This termination notification will briefly specify the nature of the issues raised and the specific provision of the Act, regulations, or form or content requirements of this section that the proposed rule appears to violate. Within fifteen days of receipt of this termination notification, the designated contract market, recognized futures exchange, derivatives transaction facility or recognized clearing organization may:

(A) Withdraw the rule;

(B) Request the Commission to review the rule pursuant to the one hundred and eighty day review procedures set forth in section 5a(a)(12)(A) of the Act; or

(C) Request the Commission to render a decision whether to approve the proposed rule or to institute a proceeding to disapprove the proposed rule under the procedures specified in section 5a(a)(12)(A) of the Act by notifying the Commission that the submitting entity views its submission as complete and final as submitted.

(2) *Voluntary submission of rules for expedited approval.* Notwithstanding the provisions of paragraph (d)(1) of this section, changes to terms and conditions of a contract that are consistent with the Act and Commission regulations and with standards approved or established by the Commission in a written notification to the market or clearing organization of the applicability of this paragraph (d)(2) shall be deemed approved by the Commission at such time and under such conditions as the Commission shall specify, provided, however, that the Commission may at any time alter or revoke the applicability of such a notice to any particular contract.

(e)(1) *Notification of rule amendments.* Notwithstanding the rule approval and filing requirements of section 5a(a)(12) of the Act and of paragraphs (c) and (d) of this section, designated contract markets, recognized futures exchanges and recognized clearing organizations may place the following rules into effect without prior notice to the Commission if the following conditions are met:

(i) The designated contract market, recognized futures exchange, or recognized clearing organization provides to the Commission at least weekly a summary notice of all rule changes made effective pursuant to this paragraph during the preceding week. Such notice must be labeled ''Weekly Notification of Rule Changes'' and need not be filed for weeks during which no such actions have been taken. One copy of each such submission shall be furnished in hard copy or electronically in a format specified by the Secretary of the Commission to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581; and

(ii) The rule change governs:

(A) *Nonmaterial revisions.* Corrections of typographical errors, renumbering, periodic routine updates to identifying information about

approved entities and other such nonsubstantive revisions of contract terms and conditions that have no effect on the economic characteristics of the contract;

(B) *Delivery standards set by third parties.* Changes to grades or standards of commodities deliverable on futures contracts that are established by an independent third party and that are incorporated by reference as terms of the contract, provided that the grade or standard is not established, selected or calculated solely for use in connection with futures or option trading;

(C) *Index contracts.* Routine changes in the composition, computation, or method of selection of component entities of an index other than a stock index referenced and defined in the contract's terms, made by an independent third party whose business relates to the collection or dissemination of price information and that was not formed solely for the purpose of compiling an index for use in connection with a futures or option contract;

(D) *Transfer of membership or ownership.* Procedures and forms for the purchase, sale or transfer of membership or ownership, but not including qualifications for membership or ownership, any right or obligation of membership or ownership or dues or assessments; or

(E) *Administrative procedures.* The organization and administrative procedures of a contract market's governing bodies such as a Board of Directors, Officers and Committees, but not voting requirements and procedures or requirements or procedures relating to conflicts of interest.

(2) *Notification of rule amendments not required.* Notwithstanding the rule approval and filing requirements of section 5a(a)(12) of the Act and of paragraphs (c) and (d) of this section, designated contract markets, recognized futures exchanges and recognized clearing organizations may place into effect without notice to the Commission, rules governing:

(i) *Administration.* The routine, daily administration, direction and control of employees, requirements relating to gratuity and similar funds, but not guaranty, reserves, or similar funds; declaration of holidays, and changes to facilities housing the market, trading floor or trading area; or

(ii) *Standards of decorum.* Standards of decorum or attire or similar provisions relating to admission to the floor, badges, visitors, but not the establishment of penalties for violations of such rules.

* * * * *

(i) *Membership lists.* Upon request of the Commission each designated contract market, recognized futures exchange or recognized clearing organization shall promptly furnish to the Commission a current list of the facility's or entity's members or owners subject to fitness requirements.

§§ 1.43, 1.45 and 1.50 [Removed]

4. In part 1, §§ 1.43, 1.45, and 1.50 are proposed to be removed and reserved.

5. Part 5 is amended as follows:

PART 5—PROCEDURES FOR LISTING NEW PRODUCTS

a. The authority citation for part 5 continues to read as follows:

Authority: 7 U.S.C. 6(c), 6c, 7, 7a, 8 and 12a.

b. The heading of part 5 is revised as set forth above and §§ 5.1 through 5.3 are revised to read as follows:

§ 5.1 Listing contracts for trading by exchange certification.

(a) Notwithstanding the provisions of section 4(a)(1) of the Act or § 33.2 of this chapter, a board of trade that has been recognized by the Commission as a recognized futures exchange under part 38 of this chapter may list for trading contracts of sale of a commodity for future delivery or commodity option contracts, if the recognized futures exchange:

(1) Lists for trading at least one contract which is not dormant within the meaning of § 5.3;

(2) In connection with the trading of the contract complies with all requirements of the Act and Commission regulations thereunder applicable to the recognized futures exchange under part 38 of this chapter;

(3) Files with the Commission at its Washington, D.C., headquarters either in electronic or hard-copy form a copy of the contract's initial terms and conditions and a certification by the recognized futures exchange that the contract's initial terms and conditions do not violate any requirement of part 38 of this chapter, any applicable provision of the Act or of the rules thereunder, and the filing is received no later than the close of business of the business day preceding the contract's initial listing; and

(4) Identifies the contract in its rules as listed for trading pursuant to exchange certification.

(b) The provisions of this section shall not apply to:

(1) A contract subject to the provisions of section 2(a)(1)(B) of the Act;

(2) A contract to be listed initially for trading that is the same or substantially the same as one for which an application for Commission review and approval pursuant to § 5.2 was filed by another board of trade while the application is pending before the Commission; or

(3) A contract to be listed initially for trading that is the same or substantially the same as one which is the subject of a pending Commission disapproval proceeding under section 6 of the Act, to disapprove a term or condition under section 5a(a)(12) of the Act, to alter or supplement a term or condition under section 8a(7) of the Act, to amend terms or conditions under section 5a(a)(10) of the Act, to declare an emergency under section 8a(9) of the Act, or to any other proceeding the effect of which is to disapprove, alter, supplement, or require a contract market or a recognized futures exchange to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

§ 5.2 Voluntary submission of new products for Commission review and approval.

(a) *Cash-settled contracts.* A new contract to be listed for trading by a recognized futures exchange under part 38 of this chapter or a recognized derivatives transaction facility under part 37 of this chapter shall be deemed approved by the Commission ten business days after receipt by the Commission of the application for contract approval, unless notified otherwise within that period, if:

(1) The submitting entity labels the submission as being submitted pursuant to Commission rule 5.2—Fast Track Ten-Day Review;

(2)(i) The application for approval is for a futures contract providing for cash settlement or for delivery of a foreign currency for which there is no legal impediment to delivery and for which there exists a liquid cash market; or

(ii) For an option contract that is itself cash-settled, is for delivery of a foreign currency that meets the requirements of paragraph (a)(2)(i) of this section or is to be exercised into a futures contract which has already been designated as a contract market or approved under this section;

(3) The application for approval is for a commodity other than those enumerated in section 1a(3) of the Act or one that is subject to the procedures of section 2(a)(1)(B) of the Act;

(4) The submitting entity trades at least one contract which is not dormant within the meaning of this part;

(5) The submission complies with the requirements of Appendix A of this part—Guideline No. 1;

(6) The submitting entity does not amend the terms or conditions of the proposed contract or supplement the application for designation, except as requested by the Commission or for correction of typographical errors, renumbering or other such nonsubstantive revisions, during that period; and

(7) The submitting entity has not instructed the Commission in writing during the review period to review the application for designation under the usual procedures under section 6 of the Act.

(b) *Contracts for physical delivery.* A new contract to be listed for trading by a recognized futures exchange under part 38 of this chapter or by a derivatives transaction facility under part 37 of this chapter shall be deemed approved by the Commission forty-five days after receipt by the Commission of the application for contract approval, unless notified otherwise within that period, if:

(1) The submitting entity labels the submission as being submitted pursuant to Commission rule 5.2—Fast Track Forty-Five Day Review;

(2) The application for contract approval is for a commodity other than those subject to the procedures of section 2(a)(1)(B) of the Act;

(3) The submitting entity lists for trading at least one contract which is not dormant within the meaning of this part;

(4) The submission complies with the requirements of Appendix A to this part—Guideline No. 1;

(5) The submitting entity does not amend the terms or conditions of the proposed contract or supplement the application for designation, except as requested by the Commission or for correction of typographical errors, renumbering or other such nonsubstantive revisions, during that period; and

(6) The submitting entity has not instructed the Commission in writing during the forty-five day review period to review the application for designation under the usual procedures under section 6 of the Act.

(c) *Notification of extension of time.* The Commission, within ten days after receipt of a submission filed under paragraph (a) of this section, or forty-five days after receipt of a submission filed under paragraph (b) of this section, may notify the submitting entity that the review period has been extended for a period of thirty days where the application for approval raises novel or complex issues which require additional time for review. This notification will briefly specify the nature of the specific issues for which additional time for review is required. Upon such notification, the period for fast-track review of paragraphs (a) and (b) of this section shall be extended for a period of thirty days.

(d) *Notification of termination of fast-track procedures.* During the fast-track review period provided under paragraphs (a) or (b) of this section, or of the thirty-day extension when the period has been enlarged under paragraph (c) of this section, the Commission shall notify the submitting entity that the Commission is terminating fast-track review procedures and will review the proposed contract under the usual procedures of section 6 of the Act, if it appears that the proposed contract may violate a specific provision of the Act, regulations, or form or content requirements of Appendix A to this part. This termination notification will briefly specify the nature of the issues raised and the specific provision of the Act, regulation, or form or content requirement of Appendix A to this part that the proposed contract appears to violate. Within ten days of receipt of this termination notification, the submitting entity may request that the Commission render a decision whether to approve the designation or to institute a proceeding to disapprove the proposed application for designation under the procedures specified in section 6 of the Act by notifying the Commission that the exchange views its application as complete and final as submitted.

(e) *Delegation of authority.* (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Economic Analysis or to the Director's delegatee, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to request under paragraphs (a)(6) and (b)(5) of this section that the recognized futures exchange or derivatives transaction facility amend the proposed contract or supplement the application, to notify a submitting entity under paragraph (c) of this section that the time for review of a proposed contract term submitted for review under paragraphs (a) or (b) of this section has been extended, and to notify the submitting entity under paragraph (d) of this section that the fast-track procedures of this section are being terminated.

(2) The Director of the Division of Economic Analysis may submit to the Commission for its consideration any matter which has been delegated in paragraph (e)(1) of this section.

(3) Nothing in the paragraph prohibits the Commission, at its election, from exercising the authority delegated in paragraph (e)(1) of this section.

§ 5.3 Dormant contracts.

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

(1) The term *dormant contract* means any commodity futures or option contract:

(i) In which no trading has occurred in any future or option expiration for a period of six complete calendar months; or

(ii) Which has been certified by a recognized futures exchange or a recognized derivatives transaction facility to the Commission to be a dormant contract market.

(2) [Reserved]

(b) *Listing of additional futures trading months or option expiration by certification.* A contract that has been listed for trading initially under the procedures of either §§ 5.1 or 5.2 that has become dormant may be relisted for trading additional months pursuant to the procedures of § 1.41(c) of this chapter by filing the bylaw, rule, regulation or resolution to list additional trading months or expirations with the Commission as specified in that section. Upon relisting, the contract must be identified by the recognized futures exchange as listed for trading by exchange certification.

(c) *Approval for listing of additional futures trading months or option expirations.* A contract that has been initially approved by the Commission under § 5.2 and that has become dormant may be relisted for trading additional months pursuant to the procedures of § 1.41(d) of this chapter by filing the bylaw, rule, regulation or resolution to list additional trading months or expirations with the Commission as specified in that section.

(1) Each such submission shall clearly designate the submission as filed pursuant to Commission Rule 5.3; and

(2) Include the information required to be submitted pursuant to § 5.3 or an economic justification for the listing of additional months or expirations in the dormant contract market, which shall include an explanation of those economic conditions which have changed subsequent to the time the contract became dormant and an explanation of how any new terms and conditions which are now being proposed, or which have been proposed for an option market's underlying futures contract market, would make it reasonable to expect that the futures or

option contract will be used on more than an occasional basis for hedging or price basing.

(d) *Exemptions.* No contract shall be considered dormant until the end of sixty (60) complete calendar months:

(1) Following initial listing; or

(2) Following Commission approval of the contract market bylaw, rule, regulation, or resolution to relist trading months submitted pursuant to paragraph (c) of this section.

Appendices C and D [Removed and Reserved]

c. Appendices C and D are removed and reserved.

PART 15—REPORTS—GENERAL PROVISIONS

6. The authority citation for Part 15 is revised to read as follows:

Authority: 7 U.S.C. 2, 4, 5, 6(c), 6a, 6c(a)–(d), 6f, 6g, 6i, 6k, 6m, 6n, 7, 9, 12a, 19 and 21.

7. Section 15.05 is amended by revising the heading and by adding paragraphs (e) through (h) to read as follows:

§ 15.05 Designation of agent for foreign brokers, customers of a foreign broker and foreign traders.

* * * * *

(e) Any derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange that permits a foreign broker to intermediate transactions in futures or option contracts on the facility or exchange, or permits a foreign trader to effect transactions in futures or option contracts on the facility or exchange shall be deemed to be the agent of the foreign broker and any of its customers for whom the transactions were executed, or the foreign trader for purposes of accepting delivery and service of any communication issued by or on behalf of the Commission to the foreign broker, any of its customers or the foreign trader with respect to any futures or option contracts executed by the foreign broker or the foreign trader on the derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange. Service or delivery of any communication issued by or on behalf of the Commission to a derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange pursuant to such agency shall constitute valid and effective service upon the foreign broker, any of its customers, or the foreign trader. A derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange which has been served with, or to which there has been delivered, a communication issued by or on behalf of the Commission to a foreign broker, any of its customers, or a foreign trader shall transmit the communication promptly and in a manner which is reasonable under the circumstances, or in a manner specified by the Commission in the communication, to the foreign broker, any of its customers or the foreign trader.

(f) It shall be unlawful for any derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange to permit a foreign broker, any of its customers or a foreign trader to effect transactions in futures or option contracts unless the derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange prior thereto informs the foreign broker, any of its customers or the foreign trader in any reasonable manner the derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange deems to be appropriate, of the requirements of this section.

(g) The requirements of paragraphs (e) and (f) of this section shall not apply to any transactions in futures or option contracts if the foreign broker, any of its customers or the foreign trader has duly executed and maintains in effect a written agency agreement in compliance with this paragraph with a person domiciled in the United States and has provided a copy of the agreement to the derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange prior to effecting any transactions in futures or option contracts on the derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange. This agreement must authorize the person domiciled in the United States to serve as the agent of the foreign broker, any of its customers or the foreign trader for purposes of accepting delivery and service of all communications issued by or on behalf of the Commission to the foreign broker, any of its customers or the foreign trader and must provide an address in the United States where the agent will accept delivery and service of communications from the Commission. This agreement must be filed with the Commission by the derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange prior to permitting the foreign broker, any of its customers or the foreign trader to effect any transactions in futures or option contracts. Unless otherwise specified by the Commission, the agreements required to be filed with the Commission shall be filed with the Secretary of the Commission at Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581. A foreign broker, any of its customers or a foreign trader shall notify the Commission immediately if the written agency agreement is terminated, revoked, or is otherwise no longer in effect. If the derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange knows or should know that the agreement has expired, been terminated, or is no longer in effect, the derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange shall notify the Secretary of the Commission immediately. If the written agency agreement expires, terminates, or is not in effect, the derivatives transaction facility eligible under § 37.2(a)(2) of this chapter or recognized futures exchange and the foreign broker, any of its customers or the foreign trader are subject to the provisions of paragraphs (e) and (f) of this section.

(h) The provisions of paragraphs (e), (f) and (g) of this section shall not apply to a derivatives transaction facility or recognized futures exchange on which all transactions in futures or option contracts of foreign brokers, their customers or foreign traders are executed through and the resulting transactions are maintained in accounts carried by a registered futures commission merchant or introducing broker subject to the provisions of Rules 15.05(a), (b), (c) and (d).

* * * * *

8. Part 36 is revised to read as follows:

PART 36—EXEMPTION OF TRANSACTIONS ON MULTILATERAL TRANSACTION EXECUTION FACILITIES

Sec.

Authority: 7 U.S.C. 2, 6, 6c, and 12a.

§ 36.1 Definitions.

As used in this part:

(a) *Eligible participant* means and shall be limited to the parties or entities listed in § 35.1(b)(1) through (11) of this chapter; and

(b) *Multilateral transaction execution facility* means an electronic or non-electronic market or similar facility through which persons, for their own accounts or for the accounts of others,

enter into, agree to enter into or execute binding contracts, agreements or transactions by accepting bids or offers made by one person that are open to multiple persons who conduct business through such market or similar facility, but does not include:

(1) A facility whose participants individually negotiate (or have individually negotiated) with counterparties the material terms applicable to contracts, agreements, or transactions between them, including contracts, agreements, or transactions conducted on the facility, and which are subject to subsequent acceptance by the counterparties;

(2) Any electronic communications system on which the execution of a contract, agreement or transaction results from the content of bilateral communications exchanged between the parties and not by the interaction of multiple orders within a predetermined, non-discretionary automated trade matching algorithm; or

(3) Any facility on which only a single firm may participate as market maker and participants other than the market maker may not accept bids or offers of other non-market maker participants.

§ 36.2 Exemption.

A contract, agreement or transaction traded on a multilateral transaction execution facility as defined in § 36.1(b) is exempt from all provisions of the Act and any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to such contract, agreement or transaction is exempt for such activity from all provisions of the Act (except in each case the provisions enumerated in § 36.3(a)) provided the following terms and conditions are met:

(a) Only eligible participants, either trading for their own account or through another eligible participant, have trading access to the multilateral transaction execution facility;

(b) The contract, agreement or transaction listed on or traded through the multilateral transaction execution facility is based upon:

(1) A debt obligation other than an exempt security under section 3 of the Securities Act of 1933 or section 3a(12) of the Securities Exchange Act of 1934;

(2) A foreign currency;

(3) An interest rate;

(4) A measure of credit risk or quality, including instruments known as ''total return swaps,'' ''credit swaps'' or ''credit spread swaps'';

(5) An occurrence, extent of an occurrence or contingency beyond the control of the counterparties to the transaction; or

(6) An economic or commercial index or measure which is beyond the control of the counterparties to the transaction, and is not based upon prices derived from trading in a directly corresponding underlying cash market and for which the related contract, agreement or transaction is cash settled;

(c) If cleared, the submission of such contracts, agreements or transactions for clearance and/or settlement must be to a clearing organization that is authorized under § 39.2 of this chapter: *Provided, however,* that nothing in this paragraph precludes:

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

(2) Arrangements or facilities among parties to such contracts, agreements or transactions, that provide for netting of payments or deliveries resulting from such contracts, agreements or transactions;

(d) The multilateral transaction execution facility on or through which such contracts, agreements or transactions are traded and the parties to, participants in, or intermediaries in such a facility that is exempt under this section are prohibited from claiming that the facility is regulated, recognized or approved by the Commission; and

(e) The facility:

(1) If an electronic system that also lists for trading products pursuant to parts 37 or 38 of this chapter, must provide notice to participants of the agreements, contracts or transactions traded on the facility pursuant to this part 36 and that such transactions are not subject to regulation under the Act; or

(2) If providing a physical trading environment, must provide that products trading pursuant to parts 37 or 38 of this chapter be traded in a location separate from, but which may adjoin, the location for products traded pursuant to this part 36.

(f) If the Commission determines by order, after notice and an opportunity for a hearing through submission of written data, views and arguments, that the facility serves as a significant source for the discovery of prices for an underlying commodity, the facility must on a daily basis disseminate publicly trading volume and price ranges and other trading data appropriate to that market as specified in the order.

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

§ 36.3 Enforceability.

(a) Notwithstanding the exemption in § 36.2, sections 2(a)(1)(B), 4b, and 4o of the Act and § 32.9 of this chapter as adopted under section 4c(b) of the Act, and sections 6(c) and 9(a)(2) of the Act to the extent they prohibit manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, continue to apply to transactions and persons otherwise subject to those provisions.

(b) A party to a contract, agreement or transaction that is with a counterparty that is an eligible participant (or counterparty reasonably believed by such party at the time the contract, agreement or transaction was entered into to be an eligible participant) shall be exempt from any claim, counterclaim or affirmative defense by such counterparty under section 22(a)(1) of the Act or any other provision of the Act:

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

(2) To rescind, or recover any payment made in respect of, such contract, agreement or transaction, based solely on the failure of such party or such contract, agreement or transaction to comply with the terms or conditions of the exemption under this part.

9. Chapter I of 17 CFR is amended by adding new Part 37 as follows:

PART 37—EXEMPTION OF TRANSACTIONS ON A DERIVATIVES TRANSACTION FACILITY

Sec.

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

§ 37.1 Scope and definitions.

(a) *Scope.* (1) A board of trade operating as a recognized derivatives transaction facility and the products listed for trading thereon under this exemption shall be deemed to be subject to all of the provisions of the Act and Commission regulations thereunder which are applicable to a ''board of trade,'' ''board of trade licensed by the Commission,'' ''exchange,'' ''contract market,'' ''designated contract market,'' or ''contract market designated by the Commission'' as though those provisions were set forth in this section and included specific reference to contracts listed for trading by recognized derivatives transaction facilities pursuant to this section.

(2) The provisions of this section shall not apply to a commodity or a contract subject to the provisions of section 2(a)(1)(B) of the Act.

(b) *Definitions.* As used in this part:

(1) *Eligible participant* means, and shall be limited to, the parties or entities listed in § 35.1(b)(1) through (11) of this chapter, *Provided, however,* that notwithstanding the proviso of § 35.1(b)(10), a floor broker or floor trader that is a natural person or proprietorship shall be considered to be an eligible participant for transactions on a derivatives transaction facility recognized under § 37.7 if the floor broker or floor trader is registered in such a capacity under the Act and its trading obligations on the derivatives trading facility are guaranteed by a futures commission merchant.

(2) ''Eligible commercial participant'' means, and shall be limited to, a party or entity listed in §§ 35.1(b)(1), (b)(2), (b)(3), (b)(6) and (b)(8) of this chapter that in connection with its business, makes and takes delivery of the underlying commodity and regularly incurs risks in addition to price risk related to such commodity, is a dealer that regularly provides hedging, risk management or market-making services to the foregoing entities, or is a registered floor trader or floor broker trading for its own account, whose trading obligations are guaranteed by a futures commission merchant.

§ 37.2 Exemption.

Notwithstanding § 37.1(a)(1), a contract, agreement or transaction traded on a multilateral transaction execution facility as defined in § 36.1(b) of this chapter, the facility and the facility's operator are exempt from all provisions of the Act and from all Commission regulations thereunder for such activity, except for those provisions of the Act and Commission regulations which, as a condition of this exemption, are reserved in § 37.8(a), provided the following terms and conditions are met:

(a)(1) *Commercial-participant derivatives transaction facility.* Only eligible commercial participants trading for their own account have trading access to the derivatives transaction facility for contracts, agreements or transactions in any commodity except for those listed in section 1a(3) of the Act or an exempted security under section 3 of the Securities Act of 1933 or section 3(a)(12) of the Securities Exchange Act of 1934; or

(2)(i) *Eligible-participant derivatives transaction facility.* The contract, agreement or transaction listed on or traded through the multilateral transaction execution facility meets the requirements set forth in § 36.2(b) of this chapter or has been found by the Commission on a case-by-case determination to have a sufficiently liquid and deep cash market and a surveillance history based on actual trading experience to provide assurance that the contract is highly unlikely to be manipulated; and

(ii) *Non-eligible participants.* Participants that are not eligible participants as defined in § 37.1(b)(1) may have trading access only through:

(A) A registered futures commission merchant that operates in accordance with the provisions of § 1.17(a)(1)(ii) of this chapter and that carries such participant's account, including access directly through any credit filter on which the futures commission merchant affirmatively imposes credit standards; or

(B) A commodity trading advisor that operates in accordance with § 4.32 of this chapter, where the participant's account is carried by any registered futures commission merchant;

(b) The multilateral transaction execution facility through which the contract, agreement or transaction is entered into has been recognized by the Commission as a derivatives transaction facility pursuant to § 37.7;

(c) A multilateral transaction execution facility that applies to be, and is, a recognized derivatives transaction facility must comply with all of the conditions of this part 37 exemption and must disclose to participants transacting on or through its facility that transactions conducted on or through the facility are subject to the provisions of this part 37;

(d)(1) If intermediated, the transactions of eligible participants must be carried in accounts at a registered futures commission merchant;

(2) If cleared, the submission of such contracts, agreements or transactions for clearance and/or settlement must be to a clearinghouse that is recognized by the Commission under § 39.4 of this chapter. *Provided, however,* that nothing in this paragraph (d)(2) precludes:

(i) Arrangements or facilities between parties to such contracts, agreements or transactions that provide for netting of payment or delivery obligations resulting from such contracts, agreements, or transactions; or

(ii) Arrangements or facilities among parties to such contracts, agreements or transactions, that provide for netting of payments or deliveries resulting from such contracts, agreements or transactions; and

(e) The products if traded on an electronic system must be clearly identified as traded on a recognized derivatives transaction facility or if traded in a physical trading environment must be traded in a location separate from, but which may adjoin the location for, the trading of products pursuant to contract market designation, or to parts 36 and 38 of this chapter.

§ 37.3 General conditions for recognition as a derivatives transaction facility.

To be recognized as a derivatives transaction facility, the facility initially must have:

(a) Rules, which may be trading protocols, relating to trading on its facility, including, depending on the nature of the trading mechanism:

(1) Rules, which may be trading protocols, to deter trading abuses, and adequate power and capacity to detect, investigate and take action against violation of its trade rules or trading protocols including arrangements to obtain necessary information to perform the functions in this paragraph (a)(1), or

(2) Use of technology that provides participants with impartial access to transactions and captures information that is available for use in determining whether violations of its rules or trading protocols have occurred;

(b) Rules, which may be trading protocols, defining, or specifications detailing, the operation of the trading mechanism or electronic matching platform; and

(c) Rules, which may be trading protocols, detailing the financial framework applying to the transactions or ensuring the financial integrity of transactions entered into by, or through, its facilities.

§ 37.4 Conditions for recognition as a derivatives transaction facility, compliance with core principles.

To be recognized as a derivatives transaction facility, the facility, initially and on a continuing basis, must meet and adhere to the following core principles:

(a) *Enforcement.* Effectively monitor and enforce its rules, which may be trading protocols, including, if applicable, limitations on access.

(b) *Market oversight.* As appropriate to the market and the contracts traded:

(1) Monitor markets on a routine and nonroutine basis as necessary to ensure fair and orderly trading, and have, and where appropriate exercise, authority to maintain a fair and orderly market; or

(2) Provide information to the Commission as requested by the Commission to satisfy its obligations under the Act.

(c) *Operational information.* Disclose to regulators and to market participants, as appropriate, information concerning trading terms, trading protocols, contract terms and conditions, trading mechanisms, financial integrity arrangements or mechanisms, as well as other relevant information.

(d) *Transparency.* Provide to market participants on a fair, equitable and timely basis information regarding prices, bids and offers, and other information appropriate to the market and, as appropriate to the market, make available to the public with respect to actively traded products, to the extent applicable, information regarding daily opening and closing prices, price range, trading volume and other related market information.

(e) *Fitness.* Have appropriate fitness standards for members, operators or owners with greater than 10 percent interest or an affiliate of such an owner, members of the governing board, and those who make disciplinary determinations.

(f) *Recordkeeping.* Keep full books and records of all activities related to its business as a recognized derivatives transaction facility, including full information relating to data entry and trade details sufficient to reconstruct trading, in a form and manner acceptable to the Commission for a period of five years, during the first two of which the books and records are readily available, and which shall be open to inspection by any representative of the Commission or the U.S. Department of Justice.

(g) *Competition.* Operate in a manner consistent with the public interest to be protected by the antitrust laws.

§ 37.5 Additional conditions for recognition as a derivative transaction facility.

To be recognized as a derivatives transaction facility, initially and on a continuing basis, the facility must:

(a) *Products.* Notwithstanding the provisions of section 4(a)(1) of the Act or § 33.2 of this chapter, notify the Commission of the listing of new contracts for trading, posting of new product descriptions, terms and conditions or trading protocols or providing for a new system product functionality, by filing with the Commission at its Washington, D.C. headquarters, a submission labeled ''DTF Notice of Product Listing'' that includes the text of the contract's terms or conditions, product description, trading protocol or description of the system functionality or by electronic notification of the foregoing at the time traders or participants in the market are notified, but in no event later than the close of business on the business day preceding initial listing, posting or implementation of the trading protocol or system functionality;

(b) *Material modifications.* Notwithstanding the rule approval and filing requirements of section 5a(a)(12)(A) of the Act, notify the Commission prior to placing a material rule, term or condition or trading protocol into effect or amending a material rule, term or condition or trading protocol, by filing with the Commission at its Washington, D.C. headquarters a submission labeled, ''DTF Rule Notice'' which includes the text of the rule or rule amendment, term and condition or trading protocol (brackets must indicate words deleted and underscoring must indicate words added) or by electronic notification of the rule, term and condition or trading protocol to be placed into effect or to be changed, at the time and in the manner traders or participants in the market are notified, but in no event later than the close of business on the business day preceding implementation of the rule, term and condition or trading protocol. The derivatives transaction facility must maintain documentation regarding all changes to rules, terms and conditions or trading protocols;

(c) *Identify participants.* Keep a record in permanent form which shall show the true name; address; and principal occupation or business of any foreign trader executing transactions on the facility or exchange, as well as the name of any person guaranteeing such transactions or exercising any control over the trading of such foreign trader. *Provided, however,* this paragraph shall not apply to a derivatives transactions facility insofar as transactions in futures or option contracts of foreign traders are executed through and the resulting transactions are maintained in accounts carried by a registered futures commission merchant or introducing broker subject to § 1.37 of this chapter; and

(d) *Identify persons subject to fitness.* Upon request by the Commission, furnish to the Commission a current list of persons subject to the fitness requirements in accordance with § 37.4(e).

§ 37.6 Information relating to transactions on derivative transaction facilities.

(a) *Special calls for information from derivatives transaction facilities.* Upon special call by the Commission, a derivatives transaction facility shall provide to the Commission such information related to its business as a derivatives transaction facility, including information relating to data entry and trade details, in the form and manner and within the time as specified by the Commission in the special call.

(b) *Notification of communications.* (1) Upon receipt of any communications issued by or on behalf of the Commission to any person who resides or is domiciled outside of the United States, its territories, or possessions, relating to contracts, agreements, or transactions effected on or through a derivatives transaction facility, the derivatives transaction facility shall promptly notify such foreign person of, and transmit the communication to such foreign person, in a manner reasonable under the circumstances, or as specified by the Commission.

(2) If the Commission has reason to believe that a person has not complied with a communication issued by or on behalf of the Commission pursuant to paragraph (b)(1) of this section, the Commission in writing may direct the derivatives transaction facility on or through which the person is or has traded to deny that person further trading access either directly or, if applicable, through an intermediary or, as applicable, to permit that person access to trade for liquidation only.

(3) Any person that believes he or she is or may be adversely affected or aggrieved by action taken by the Commission under paragraph (b)(2) of this section, shall have the opportunity for a prompt hearing after the Commission acts pursuant to paragraph (b)(2) of this section under the procedures provided in § 21.03(g) of this chapter.

(c) *Special calls for information from futures commission merchants.* Upon special call by the Commission, each

person registered as a futures commission merchant that carries or has carried an account for a customer on a derivatives transaction facility shall provide information to the Commission concerning such accounts or related positions carried for the customer on that or other facilities or markets, in the form and manner and within the time specified by the Commission in the special call.

(d) *Special calls for information from participants.* Upon special call by the Commission, any person who enters into or has entered into a contract, agreement or transaction on a derivatives transaction facility eligible under § 37.2(a)(2) shall provide information to the Commission concerning such contracts, agreements, or transactions or related positions on other facilities or markets, in the form and manner and within the time specified by the Commission in the special call.

(e) *Delegation of authority.* The Commission hereby delegates, until the Commission orders otherwise, the authority set forth in paragraphs (a) through (d) of this section to the Directors of the Division of Economic Analysis and the Division of Trading and Markets to be exercised separately by each Director or by such other employee or employees as the Director may designate from time to time. The Director of the Divisions of Economic Analysis and Trading and Markets may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

§ 37.7 Procedures for recognition.

(a) *Recognition by certification.* A board of trade, facility or entity that is designated under sections 4c, 5, 5a(a) or 6 of the Act as a contract market in at least one commodity which is not dormant within the meaning of § 5.2 of this chapter will be recognized by the Commission as a derivatives transaction facility upon receipt by the Commission at its Washington, D.C. headquarters of a copy of the derivatives transaction facility's rules, which may be trading protocols, and a certification by the board of trade, facility or entity that it meets the conditions for recognition under this part.

(b) *Recognition by application.* A board of trade, facility or entity shall be recognized or, as determined by the Commission, recognized upon conditions as a derivatives transaction facility thirty days after receipt by the Commission of an application for recognition as a derivatives transaction facility unless notified otherwise during that period, if:

(1) The application demonstrates that the applicant satisfies the conditions for recognition under this part;

(2) The submission is labeled as being submitted pursuant to this part 37;

(3) The submission includes a copy of:

(i) The derivatives transaction facility's rules, which may be trading protocols;

(ii) Any agreements entered into or to be entered into between or among the facility, its operator or its participants, technical manuals and other guides or instructions for users of such facility, descriptions of any system test procedures, tests conducted or test results, and descriptions of the trading mechanism or algorithm used or to be used by such facility, to the extent such documentation was otherwise prepared; and

(iii) To the extent that compliance with the conditions of recognition is not self-evident, a brief explanation of how the rules or trading protocols satisfy each of the conditions for recognition under §§ 37.3 and 37.4;

(4) The applicant does not amend or supplement the application for recognition, except as requested by the Commission or for correction of typographical errors, renumbering or other nonsubstantive revisions, during that period; and

(5) The applicant has not instructed the Commission in writing during the review period to review the application pursuant to procedures under section 6 of the Act.

(6) Appendix A to this part provides guidance to applicants on how the conditions for recognition enumerated in §§ 37.3 and 37.4 could be satisfied.

(c) *Termination of part 37 review.* During the thirty-day period for review pursuant to paragraph (b) of this section, the Commission shall notify the applicant seeking recognition that the Commission is terminating review under this section and will review the proposal under the procedures of section 6 of the Act, if it appears that the application fails to meet the conditions for recognition under this part. This termination notification will state the nature of the issues raised and the specific condition of recognition that the application appears to violate, is contrary to or fails to meet. Within ten days of receipt of this termination notification, the applicant seeking recognition may request that the Commission render a decision whether to recognize the derivatives transaction facility or to institute a proceeding to disapprove the proposed submission under procedures specified in section 6 of the Act by notifying the Commission that the applicant seeking recognition views its submission as complete and final as submitted.

(d) *Delegation of authority.* (1) The Commission hereby delegates, until it orders otherwise, to the Directors of the Division of Trading and Markets and the Division of Economic Analysis or their delegatees, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to notify the entity seeking recognition under paragraph (b) of this section that review under those procedures is being terminated or to recognize the entity as a derivatives transaction facility upon conditions.

(2) The Directors of the Division of Trading and Markets or the Division of Economic Analysis may submit to the Commission for its consideration any matter which has been delegated in this paragraph.

(3) Nothing in the paragraph prohibits the Commission, at its election, from exercising the authority delegated in paragraph (d)(1) of this section.

(e) *Request for Commission approval of rules and products.* (1) An entity seeking recognition as a derivatives transaction facility may request that the Commission approve any or all of its rules and subsequent amendments thereto, including both operational rules and the terms or conditions of products listed for trading on the facility, at the time of recognition or thereafter, under section 5a(a)(12) of the Act and §§ 1.41(d) and 5.2 of this chapter, as applicable. A derivatives transaction facility may label a product in its rules as, ''Listed for trading pursuant to Commission approval,'' if the product's terms or conditions have been approved by the Commission.

(2) An entity seeking recognition as a derivatives transaction facility may request that the Commission consider under the provisions of section 15 of the Act any of the entity's rules or policies, including both operational rules and the terms or conditions of products listed for trading, at the time of recognition or thereafter.

(f) *Request for withdrawal of application for recognition or withdrawal of recognition.* A recognized derivatives transaction facility may withdraw an application to be a recognized derivatives transaction facility or, once recognized, may withdraw from Commission recognition by filing with the Commission at its Washington, D.C., headquarters such a request. Withdrawal from recognition

shall not affect any action taken or to be taken by the Commission based upon actions, activities or events occurring during the time that the facility was recognized by the Commission.

§ 37.8 Enforceability.

(a) Notwithstanding the exemption in § 37.2, the following provisions of the Act and Commission regulations thereunder are reserved, and shall continue to apply: sections 1a, 2(a)(1), 4, 4b, 4c(a) as applicable to the market, 4c(b), 4g, 4i, 4o, 5(6), 5(7), 5a(a)(1), 5a(a)(2), 5a(a)(8), 5a(a)(16), 5a(a)(17), 5a(b), 6(a), 6(c) to the extent it prohibits manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, 8a(9), 8c(a) as applicable to the market, 9(a)(2), 9(a)(3), 9(f), 14, 15, 20 and 22 of the Act and §§ 1.3, 1.31, 1.41, 5.2, 15.05 as applicable to the market, § 33.10, this part 37 and part 190 of this chapter; and for derivatives transaction facilities eligible under § 37.2(a)(2), in addition to the foregoing, the rule disapproval procedures of section 5a(a)(12) of the Act, section 9(a)(1) of the Act, and sections 8c(b), 8c(c) and 8c(d) of the Act and parts 15 through 21 of this chapter as applicable to the market.

(b) For purposes of section 22(a) of the Act, a party to a contract, agreement or transaction is exempt from a claim that the contract, agreement or transaction is void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable solely for failure of the parties to a contract, agreement or transaction, or the contract, agreement or transaction itself, to comply with the terms and conditions for the exemption under this part or as a result of:

(1) A violation by the recognized derivatives transaction facility of the provisions of this part 37; or

(2) Any Commission proceeding to disapprove a rule, term or condition under section 5a(a)(12) of the Act, to alter or supplement a rule, term or condition under section 8a(7) of the Act, to declare an emergency under section 8a(9) of the Act, or any other proceeding the effect of which is to disapprove, alter, supplement, or require a recognized derivatives transaction facility to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

§ 37.9 Fraud in connection with part 37 transactions.

It shall be unlawful for any person, directly or indirectly, in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of any transaction entered into pursuant to this part—

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

(2) Willfully to make or cause to be made to any person any false report or statement thereof or cause to be entered for any person any false record thereof; or

(3) Willfully to deceive or attempt to deceive any person by any means whatsoever.

Appendix A to Part 37—Application Guidance

This appendix provides guidance to applicants for recognition as derivatives transaction facilities under §§ 37.3 and 37.4. Addressing the issues and questions set forth in this appendix would help the Commission in its consideration of whether the application has met the conditions for recognition. To the extent that compliance with, or satisfaction of, a core principle is not self-explanatory from the face of the derivatives transaction facilities rules or terms, the application should include an explanation or other form of documentation demonstrating that the applicant meets the conditions for recognition.

Core Principle 1: Enforcement: Effectively monitor and enforce its rules, which may be trading protocols, including, if applicable, limitations on access.

(a) A derivatives transaction facility should have arrangements and resources and authority for effectively and affirmatively enforcing its rules, including the authority and ability to collect or capture information and documents on both a routine and non-routine basis and to investigate effectively possible rule violations.

(b) This should include the authority and ability to discipline, and limit or suspend a member's or participant's activities and/or the authority and ability to terminate a member's or participant's activities or access pursuant to clear and fair standards.

Core Principle 2: Market Oversight. As appropriate to the market and the contracts traded: (1) Monitor markets on a routine and nonroutine basis as necessary to ensure fair and orderly trading, and have, and where appropriate exercise, authority to maintain a fair and orderly market; or (2) Provide information to the Commission as requested by the Commission to satisfy its obligations under the Act.

(a) Arrangements and resources for effective market surveillance programs should facilitate, on both a routine and nonroutine basis, direct supervision of the market. Appropriate objective testing and review of any automated systems should occur initially and periodically to ensure proper system functioning, adequate capacity and security. The analysis of data collected should be suitable for the type of information collected and should occur in a timely fashion. A derivatives transaction facility should have the authority to collect the information and documents necessary to reconstruct trading for appropriate market analysis as it carries out its market surveillance programs. The derivatives transaction facility also should have the authority to intervene as necessary to maintain an open and competitive market. In carrying out this responsibility, the facility should address access to, and use of, material non-public information by members, owners or operators, participants or facility employees.

(b) Alternatively, and as appropriate to the market, a derivatives transaction facility may choose to satisfy Core Principle 2 by providing information to the Commission as requested by the Commission to satisfy its obligations under the Act. The derivatives transaction facility should have the authority to collect or capture and retrieve all necessary information.

(c) The Commission will collect reporting data from eligible participants trading in a derivatives transaction facility eligible under § 37.2(a)(2) only upon Special Call as provided in § 37.6(d).

Core Principle 3: Operational Information: Disclose to regulators and to market participants, as appropriate, information concerning trading terms, trading protocols, contract terms and conditions, trading mechanisms, financial integrity arrangements or mechanisms, as well as other relevant information.

A derivatives transaction facility should have arrangements and resources for the disclosure and explanation of trading terms, trading protocols, contract terms and conditions, trading mechanisms, system functioning, system capacity, system security, system testing and review, financial integrity arrangements or mechanisms. The facility must also disclose any limitations of liability (which may not include limitations of liability for violations of the Act or Commission rules, fraud, or wanton or willful misconduct. Such information may be made publicly available through the operation of a website by the derivatives transaction facility.

Core Principle 4: Transparency: Provide to market participants on a fair, equitable and timely basis information regarding prices, bids and offers, and other information appropriate to the market and, as appropriate to the market, make available to the public with respect to actively traded products, to the extent applicable, information regarding daily opening and closing prices, price range, trading volume and other related market information.

All market participants should have information regarding prices, bids and offers, or other information appropriate to the market readily available on a fair and equitable basis. The derivatives transaction facility should provide to the public information regarding daily opening and closing prices, price range, trading volume, open interest and other related market information for actively traded products. Provision of information could be through such means as provision of the information to a financial information service or by placement of the information on a facility's web site.

Core Principle 5: Fitness: Have appropriate fitness standards for members, operators or

owners with greater than 10 percent interest or an affiliate of such an owner, members of the governing board, and those who make disciplinary determinations.

A derivatives transaction facility should have appropriate eligibility criteria for the categories of persons set forth in the Core Principle which would include standards for fitness and for the collection and verification of information supporting compliance with such standards. Minimum standards of fitness are those bases for refusal to register a person under section 8a(2) of the Act. or a history of serious disciplinary offenses, such as those which would be disqualifying under § 1.63 of this chapter. A demonstration of the fitness of the applicant's members, operators or owners may include providing the Commission with registration information for such persons, certification to the fitness of such persons, an affidavit of such persons' fitness by the facility's Counsel or other information substantiating the fitness of such persons.

Core Principle 6: Recordkeeping: Keep full books and records of all activities related to its business as a recognized derivatives transaction facility, including full information relating to data entry and trade details sufficient to reconstruct trading, in a form and manner acceptable to the Commission for a period of five years, during the first two of which the books and records are readily available, and which shall be open to inspection by any representative of the Commission or the U.S. Department of Justice.

Commission rule 1.31 constitutes the acceptable practice regarding the form and manner for keeping records.

Core Principle 7: Competition: Operate in a manner consistent with the public interest to be protected by the antitrust laws.

An entity seeking recognition as a derivatives transaction facility may request that the Commission consider under the provisions of section 15 of the Act any of the entity's rules, which may be trading protocols or policies, and including both operational rules and the terms or conditions of products listed for trading, at the time of recognition or thereafter. The Commission intends to apply Section 15 of the Act to its consideration of issues under the Competition Core Principle in a manner consistent with that previously applied to contract markets.

10. Chapter I of 17 CFR is amended by adding new Part 38 as follows:

PART 38—EXEMPTION OF TRANSACTIONS ON A RECOGNIZED FUTURES EXCHANGE

Sec.

Authority: 7 U.S.C. 2, 6, 6c, and 12a.

§ 38.1 Scope.

(a) Except for commodities subject to paragraph (c) of this section, the provisions of the exemption in § 38.2 shall apply to every board of trade that has been designated as a contract market in a commodity under section 6 of the Act. *Provided, however*, nothing in this provision affects the eligibility of designated contract markets for exemption under parts 36 or 37 of this chapter.

(b) A board of trade operating as a recognized futures exchange and the products listed for trading thereon under this exemption shall be deemed to be subject to all of the provisions of the Act and Commission regulations thereunder which are applicable to a ''board of trade,'' ''board of trade licensed by the Commission,'' ''exchange,'' ''contract market,'' ''designated contract market,'' or ''contract market designated by the Commission'' as though those provisions were set forth in this section and included specific reference to contracts listed for trading by recognized futures exchanges pursuant to this section.

(c) The provisions of this section shall not apply to a commodity or a contract subject to the provisions of section 2(a)(1)(B) of the Act.

§ 38.2 Exemption.

Notwithstanding § 38.1(b), a contract, agreement or transaction traded on a multilateral transaction execution facility as defined in § 36.1(b) of this chapter, the facility and the facility's operator is exempt from all provisions of the Act and from all Commission regulations thereunder for such activity, except for those provisions of the Act and Commission regulations which, as a condition of this exemption, are reserved in § 38.6(a), provided the following terms and conditions are met:

(a) The multilateral transaction execution facility on which the contract, agreement or transaction is entered into has been recognized by the Commission as a recognized futures exchange pursuant to § 38.5;

(b) A multilateral transaction execution facility that applies to be, and is, a recognized futures exchange must comply with all of the conditions of this part 38 exemption and must disclose to participants transacting on or through its facilities that transactions conducted on or through the facility are subject to the provisions of part 38;

(c)(1) If intermediated, the transactions of participants must be carried in accounts at a registered futures commission merchant;

(2) If cleared, the submission of such contracts, agreements or transactions for clearance and/or settlement must be to a clearinghouse which is recognized by the Commission under part 39 of this chapter. *Provided, however*, that nothing in this paragraph precludes:

(i) Arrangements or facilities between parties to such contracts, agreements or transactions that provide for netting of payment or delivery obligations resulting from such agreements; or

(ii) Arrangements or facilities among parties to such contracts, agreements or transactions, that provide for netting of payments or deliveries resulting from such agreements; and

(d) The products if traded on an electronic system must be clearly identified as traded on a recognized futures exchange or if traded in a physical trading environment must be traded in a location separate from, but which may adjoin the location for, the trading of products pursuant to parts 36 and 37 of this chapter;

§ 38.3 General conditions for recognition as a recognized futures exchange.

To be recognized as a recognized futures exchange, the exchange must demonstrate initially that it has:

(a) A clear framework for conducting programs of market surveillance, compliance, and enforcement, including having procedures in place to make use of collected data for real-time monitoring and for post-event audit and compliance purposes to prevent market manipulation;

(b) Rules relating to trading on the exchange, including rules to deter trading abuses, and adequate power and capacity to detect, investigate and take action against violations of its trading rules, and a dedicated regulatory department or delegation of that function to an appropriate entity;

(c) Rules defining, or specifications detailing, the manner of operation of the trading mechanism or electronic matching platform and a trading mechanism or electronic matching platform that performs as articulated in the operational rules or specifications;

(d) A clear framework for ensuring the financial integrity of transactions entered into by or through the exchange;

(e) Established procedures for impartial disciplinary committee(s) or other similar mechanisms empowered to discipline, suspend, and expel members, or to deny access to participants or, if provided for, discipline participants; and

(f) Arrangements to obtain necessary information to perform the functions in this section, including the capacity and arrangements to share financial and surveillance information with other derivative exchanges, both domestic and international, and a mechanism to provide to the public ready access to its rules and regulations.

§ 38.4 Conditions for recognition as a recognized futures exchange, compliance with core principles.

To be recognized as a futures exchange, the exchange initially, and on a continuing basis, must meet and adhere to the following core principles:

(a) *Rule enforcement.* Effectively monitor and enforce its rules.

(b) *Products.* List contracts for trading that are not readily susceptible to manipulation.

(c) *Position monitoring and reporting.* Monitor markets on a routine and nonroutine basis as necessary to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process.

(d) *Position limits.* Adopt position limits on trading where necessary and appropriate to lessen the threat of market manipulation or congestion during delivery months.

(e) *Emergency authority.* Exercise authority to intervene to maintain fair and orderly trading, including, where applicable, authority to liquidate or transfer open positions, to require the suspension or curtailment of trading, and to require the posting of additional margin.

(f) *Public information.* Make information concerning the contract terms and conditions and the trading mechanism, as well as other relevant information, readily available to market authorities, users and the public.

(g) *Transparency.* Provide market participants on a fair, equitable and timely basis information regarding, as appropriate to the market, prices, bids and offers, and other appropriate information, and make available to the public information regarding daily opening and closing prices, price ranges, trading volume, open interest and other related market information.

(h) *Trading system.* Provide a competitive, open and efficient market.

(i) *Audit trail.* Have procedures to ensure the recording of full data entry and trade details sufficient to reconstruct trading, the quality of the data captured, and the safe storage of such information, and have systems to enable information to be used in assisting in detecting and deterring customer and market abuse.

(j) *Financial standards.* Have, monitor, and enforce rules regarding the financial integrity of the transactions that have been executed on the exchange and, where intermediaries are permitted, rules addressing the financial integrity of the intermediary and the protection of customer funds, as appropriate, and a program to enforce those requirements.

(k) *Customer protection.* Have, monitor and enforce rules for customer protection.

(l) *Dispute resolution.* Provide for alternative dispute resolution mechanisms appropriate to the nature of the market.

(m) *Governance.* Have fitness standards for members, owners or operators with greater than ten percent interest or an affiliate of such an owner, members of the governing board, and those who make disciplinary determinations. The recognized futures exchange must have a means to address conflicts of interest in making decisions and access to, and use of, material non-public information by the foregoing persons and by exchange employees. For mutually owned futures exchanges, the composition of the governing board must reflect market participants.

(n) *Recordkeeping.* Keep full books and records of all activities related to its business as a recognized futures exchange in a form and manner acceptable to the Commission for a period of five years, during the first two of which the books and records are readily available, and which shall be open to inspection by any representative of the Commission or the U.S. Department of Justice.

(o) *Competition.* Operate in a manner consistent with the public interest to be protected by the antitrust laws.

§ 38. 5 Procedures for recognition.

(a) *Recognition by prior designation.* A board of trade, facility or entity that is designated under sections 4c, 5, 5a(a) or 6 of the Act as a contract market on February 12, 2001 in at least one commodity which is not dormant within the meaning of § 5.3 of this chapter is recognized by the Commission as a recognized futures exchange and each of the contracts traded thereon that has been designated by the Commission as a designated contract market in a commodity may be labeled in the recognized futures exchange's rules as listed for trading pursuant to Commission approval.

(b) *Recognition by application.* A board of trade, facility or entity shall be recognized or, as determined by the Commission, recognized upon conditions as a recognized futures exchange sixty days after receipt by the Commission of an application for recognition unless notified otherwise during that period, if:

(1) The application demonstrates that the applicant satisfies the conditions for recognition under this part;

(2) The submission is labeled as being submitted pursuant to this part 38;

(3) The submission includes a copy of the applicant's rules and, to the extent that compliance with the conditions for recognition is not self-evident, a brief explanation of how the rules satisfy each of the conditions for registration under §§ 38.3 and 38.4;

(4) The applicant does not amend or supplement the application for recognition, except as requested by the Commission or for correction of typographical errors, renumbering or other nonsubstantive revisions, during that period; and

(5) The applicant has not instructed the Commission in writing during the review period to review the application pursuant to procedures under section 6 of the Act.

(6) Appendix A to this part provides guidance to applicants on how the conditions for recognition enumerated in §§ 38.3 and 38.4 could be satisfied.

(c) *Termination of part 38 review.* During the sixty-day period for review pursuant to paragraph (b) of this section, the Commission shall notify the applicant seeking recognition that the Commission is terminating review under this section and will review the proposal under the procedures of section 6 of the Act, if it appears that the application fails to meet the conditions for recognition under this part. This termination notification will state the nature of the issues raised and the specific condition of recognition that the application appears to violate, is contrary to or fails to meet. Within ten days of receipt of this termination notification, the applicant seeking recognition may request that the Commission render a decision whether to recognize the futures exchange or to institute a proceeding to disapprove the proposed submission under procedures specified in section 6 of the Act by notifying the Commission that the applicant seeking recognition views its submission as complete and final as submitted.

(d) *Delegation of authority.* (1) The Commission hereby delegates, until it orders otherwise, to the Directors of the Division of Trading and Markets and the Division of Economic Analysis or their delegatees, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to notify the entity seeking recognition under paragraph (b) of this section that review under those procedures is being

terminated or to recognize the entity as a recognized futures exchange upon conditions.

(2) The Directors of the Division of Trading and Markets or the Division of Economic Analysis may submit to the Commission for its consideration any matter which has been delegated in this paragraph.

(3) Nothing in the paragraph prohibits the Commission, at its election, from exercising the authority delegated in paragraph (d)(1) of this section.

(e) *Request for Commission approval of rules and products.* (1) An entity seeking recognition as a recognized futures exchange may request that the Commission approve any or all of its rules and subsequent amendments thereto, including both operational rules and the terms or conditions of products listed for trading on the exchange, at the time of recognition or thereafter, under section 5a(a)(12) of the Act and §§ 1.41 and 5.2 of this chapter, as applicable. A product the terms or conditions of which have been approved by the Commission may be labeled in its rules as listed for trading pursuant to Commission approval. In addition, rules of the recognized futures exchange not submitted pursuant to § 38.5(b)(3) shall be submitted to the Commission pursuant to § 1.41.

(2) An entity seeking recognition as a recognized futures exchange may request that the Commission consider under the provisions of section 15 of the Act any of the entity's rules or policies, including both operational rules and the terms or conditions of products listed for trading, at the time of recognition or thereafter.

(f) *Request for withdrawal of application for recognition or withdrawal of recognition.* An entity may withdraw an application to be a recognized futures exchange or once recognized, may withdraw from Commission recognition by filing with the Commission at its Washington, D.C. headquarters such a request. Withdrawal from recognition shall not affect any action taken or to be taken by the Commission based upon actions, activities or events occurring during the time that the exchange was recognized by the Commission.

§ 38.6 Enforceability.

(a) Notwithstanding the exemption in § 38.2, the following provisions of the Act and the Commission's regulations thereunder are reserved and shall continue to apply, as applicable: sections 1a, 2(a)(1), 4, 4a, 4b, 4c, 4g, 4i, 4o, 5(6), 5(7), 5a(a)(1), 5a(a)(2), 5a(a)(8), the rule disapproval procedures of 5a(a)(12), 5a(a)(16), 5a(a)(17), 5a(b), 6(a), 6(c) to the extent it prohibits manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market, 8a(7), 8a(9), 8c(a), 8c(b), 8c(c), 8c(d), 9(a), 9(f), 14, 15, 20 and 22 of the Act and §§ 1.3, 1.31, 1.38, 1.41, 33.10, part 5, part 9, parts 15 through 21, part 38 and part 190 of this chapter.

(b) For purposes of section 22(a) of the Act, a party to a contract, agreement or transaction is exempt from a claim that the contract, agreement or transaction is void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable as a result of:

(1) A violation by the recognized futures exchange of the provisions of this part 38; or

(2) Any Commission proceeding to disapprove a rule, term or condition under section 5a(a)(12) of the Act, to alter or supplement a rule, term or condition under section 8a(7) of the Act, to declare an emergency under section 8a(9) of the Act, or any other proceeding the effect of which is to disapprove, alter, supplement, or require a recognized futures exchange to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

§ 38.7 Fraud in connection with part 38 transactions.

It shall be unlawful for any person, directly or indirectly, in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of any transaction entered pursuant to this part:

(a) To cheat or defraud or attempt to cheat or defraud any person;

(b) Willfully to make or cause to be made to any person any false report or statement thereof or cause to be entered for any person any false record thereof; or

(c) Willfully to deceive or attempt to deceive any person by any means whatsoever.

Appendix A to Part 38—Guidance for Applicants and Acceptable Practices

1. This appendix provides guidance and acceptable practices for the core principles found in Part 38. Guidance to applicants for recognition as recognized futures exchanges under §§ 38.3 and 38.4 is offered under subsection (a) following a core principle. This appendix is only illustrative of the types of matters an applicant may address, as applicable, and is not intended to be a mandatory checklist. Addressing the issues and questions set forth in this appendix would help the Commission in its consideration of whether the application has met the conditions for recognition. To the extent that compliance with, or satisfaction of, a core principle is not self-explanatory from the face of the recognized futures exchange's rules or terms, the application should include an explanation or other form of documentation demonstrating that the applicant meets the conditions for recognition.

2. Acceptable practices meeting the requirements of the core principles are set forth in subsection (b). Recognized futures exchanges that follow specific practices outlined under subsection (b) for any core principle in this appendix will meet the applicable core principle. Except where otherwise provided, subsection (b) is for illustrative purposes only, and does not state the exclusive means for satisfying a core principle.

Core Principle 1: Rule Enforcement: Effectively monitor and enforce its rules.

(a) *Application Guidance.*

(1) A recognized futures exchange should have arrangements and resources for effective trade practice surveillance programs, with the authority to collect information and documents on both a routine and non-routine basis including the examination of books and records kept by members/participants of the exchange. The arrangements and resources should facilitate the direct supervision of the market and the analysis of data collected.

(2) A recognized futures exchange should have arrangements, resources and authority for effective rule enforcement. The Commission believes that this should include the authority and ability to discipline and limit or suspend a member's or participant's activities as well as the authority and ability to terminate a member's or participant's activities pursuant to clear and fair standards.

(b) *Acceptable Practices.* An effective trade practice surveillance program should include:

(1) Maintenance of data reflecting the details of each transaction executed on an RFE;

(2) Electronic analysis of this data routinely to detect potential trading violations;

(3) Appropriate and thorough investigative analysis of these and other potential trading violations brought to its attention; and

(4) Prompt and effective disciplinary action for any violation that is found to have been committed. The Commission believes that the latter element should include the authority and ability to discipline and limit or suspend a member's or participant's activities pursuant to clear and fair standards. *See, e.g.,* 17 CFR part 8.

Core Principle 2: Products: List contracts for trading that are not readily susceptible to manipulation.

(a) *Application Guidance.* Applicants should submit their initial product for listing for Commission approval under § 5.2 and Part 5, Appendix A, of this chapter. Subsequent products may be listed for trading by self-certification under § 5.1 of this chapter.

(b) *Acceptable Practices.*

Guideline No. 1, 17 CFR Part 5, Appendix A may be used as guidance in meeting this core principle.

Core Principle 3: Position monitoring and reporting: Monitor markets on a routine and nonroutine basis as necessary to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process.

(a) *Application Guidance.* [Reserved]

(b) *Acceptable Practices.*

(1) An acceptable program for monitoring markets will generally involve the collection of various market data, including information on traders' market activity. Those data should be evaluated on an ongoing basis in order to make an appropriate regulatory response to potential market disruptions or abusive practices.

(2) The recognized futures exchange should collect data in order to assess whether the market price is responding to the forces of supply and demand. Appropriate data usually include various fundamental data about the underlying commodity, its supply, its demand, and its movement through marketing channels. Especially important are data related to the size and ownership of deliverable supplies—the existing supply and the future or potential supply, and to the pricing of the deliverable commodity relative to the futures price and relative to similar, but nondeliverable, kinds of the commodity. For cash-settled markets, it is more appropriate to pay attention to the availability and pricing of the commodity making up the index to which the market will be settled, as well as monitoring the continued suitability of the methodology for deriving the index.

(3) To assess traders' activity and potential power in a market, at a minimum, every exchange should have routine access to the positions and trading done by the members of its clearing facility. Although clearing member data may be sufficient for some exchanges, an effective surveillance program for exchanges with substantial numbers of customers trading through intermediaries should employ a much more comprehensive large-trader reporting system (LTRS). The Commission operates an industry-wide LTRS. As an alternative to having its own LTRS or contracting out for such a system, exchanges may find it more efficient to use information available from the Commission's LTRS data for position monitoring.

Core Principle 4: Position Limits. Adopt position limits on trading where necessary and appropriate to lessen the threat of market manipulation or congestion during delivery months.

(a) *Application Guidance.* [Reserved]

(b) *Acceptable Practices.*

(1) In order to diminish potential problems arising from excessively large speculative positions, the Commission sets limits on traders' positions for certain commodities. These position limits specifically exempt bona fide hedging, permit other exemptions, and set limits differently by markets, by futures or delivery months, or by time periods. For purposes of evaluating an exchange speculative-limit program, the Commission considers the specified limit levels, aggregation policies, types of exemptions allowed, methods for monitoring compliance with the specified levels, and procedures for enforcement to deal with violations.

(2) In general, position limits are not necessary for markets where the threat of excessive speculation or manipulation is very low. Thus, exchanges do not need to set position-limit levels for futures markets in major foreign currencies and in certain financial futures having very liquid and deep underlying cash markets. Where speculative limits are appropriate, acceptable speculative-limit levels typically are set in terms of a trader's combined position in the futures contract plus its position in the option contract (on a delta-adjusted basis).

(3) Spot-month levels for physical-delivery markets should be based upon an analysis of deliverable supplies and the history of spot-month liquidations. Spot-month limits for physical-delivery markets are appropriately set at no more than 25 percent of the estimated deliverable supply. For cash-settled markets, spot-month position limits may be necessary if the underlying cash market is small or illiquid such that traders can disrupt the cash market or otherwise influence the cash-settlement price to profit on a futures position. In these cases, the limit should be set at a level that minimizes the potential for manipulation or distortion of the futures contract's or the underlying commodity's price. Markets may elect not to provide all-months-combined and non-spot month limits.

(4) An exchange may provide for position accountability provisions in lieu of position limits for contracts on financial instruments, intangible commodities, or certain tangible commodities. Markets appropriate for position accountability rules include those with large open-interest, high daily trading volumes and liquid cash markets.

(5) Exchanges must have aggregation rules that apply to those accounts under common control, those with common ownership, *i.e.,* where there is a 10 percent or greater financial interest, and those traded according to an expressed or implied agreement. Exchanges will be permitted to set more stringent aggregation policies. For example, one major exchange adopted a policy of automatically aggregating members of the same household, unless they were granted a specific waiver. Exchanges may grant exemptions to their position limits for bona fide hedging (as defined in Commission Rule 1.3(z)) and may grant exemptions for reduced risk positions, such as spreads, straddles and arbitrage positions.

(6) Exchanges must establish a program for effective monitoring and enforcement of these limits. One acceptable enforcement mechanism is a program whereby traders apply for these exemptions by the exchange and are granted a position level higher than the applicable speculative limit. The position levels granted under hedge exemptions are based upon the trader's commercial activity in related markets. Exchanges may allow a brief grace period where a qualifying trader may exceed speculative limits or an existing exemption level pending the submission and approval of appropriate justification. An exchange should consider whether it wants to restrict exemptions during the last several days of trading in a delivery month. Acceptable procedures for obtaining and granting exemptions include a requirement that the exchange approve a specific maximum higher level.

(7) Exchanges with many markets with large numbers of traders should have an automated means of detecting traders' violations of speculative limits or exemptions. Exchanges should monitor the continuing appropriateness of approved exemptions by periodically reviewing each trader's basis for exemption or requiring a reapplication.

(8) Finally, an acceptable speculative limit program must have specific policies for taking regulatory action once a violation of a position limit or exemption is detected. The exchange policy will need to consider appropriate actions where the violation is by a non-member and should address traders carrying accounts through more than one intermediary.

(9) A violation of exchange position limits that have been approved by the Commission is also a violation of section 4a(e) of the Act.

Core Principle 5: Emergency Authority: Exercise authority to intervene to maintain fair and orderly trading, including, where applicable, authority to liquidate or transfer open positions, to require the suspension or curtailment of trading, and to require the posting of additional margin.

(a) *Application Guidance.*

A recognized futures exchange should have clear procedures and guidelines for exchange decision-making regarding emergency intervention in the market, including procedures and guidelines to carry out such decision-making without a conflict of interests. An exchange should also have the authority to intervene as necessary to maintain markets with fair and orderly trading as well as procedures for carrying out the intervention. The Commission believes that a recognized futures exchange should also have procedures and guidelines for the notification of the Commission of the exercise of regulatory emergency authority, as well as procedures and guidelines to prevent conflicts of interest, for the documentation of the exchange's decision-making process and for the reasons for use of its emergency action authority.

(b) *Acceptable Practices.*

As is necessary to address perceived market threats, the exchange, among other things, should be able to impose position limits in particular in the delivery month, impose or modify price limits, modify circuit breakers, call for additional margin either from customers or clearing members, order the liquidation or transfer of open positions, order the fixing of a settlement price, order the reduction in positions, extend or shorten the expiration date or the trading hours, suspend or curtail trading on the market, order the transfer of customer contracts and the margin for such contracts from one member of the exchange to another or alter the delivery terms or conditions.

Core Principle 6: Public Information: Make information concerning the contract terms and conditions and the trading mechanism, as well as other relevant information, readily available to market authorities, users and the public.

(a) *Application Guidance.*

A recognized futures exchange should have arrangements and resources for the

disclosure of contract terms and conditions and trading mechanisms to the Commission, users and the public. Procedures should also include the provision of information on listing new products, rule amendments or other changes to previously disclosed information to the Commission, users and the public.

(b) *Acceptable Practices.* [Reserved]

Core Principle 7: Transparency: Provide market participants on a fair, equitable and timely basis information regarding, as appropriate to the market, prices, bids and offers, and other appropriate information, and make available to the public information regarding daily opening and closing prices, price ranges, trading volume, open interest and other related market information.

(a) *Application Guidance.* [Reserved].

(b) *Acceptable Practices.* [Reserved]

Core Principle 8: Trading System: Provide a competitive, open and efficient market.

(a) *Application Guidance.*

(1) Appropriate objective testing and review of any automated systems should occur initially and periodically to ensure proper system functioning, adequate capacity and security. A recognized futures exchange's analysis of its automated system should address appropriate principles for the oversight of automated systems, ensuring proper system function, adequate capacity and security. The Commission believes that the guidelines issued by the International Organization of Securities Commissions (IOSCO) in 1990 (which have been referred to as the ''Principles for Screen-Based Trading Systems''), subsequently adopted by the Commission on November 21, 1990 (55 FR 48670), are appropriate guidelines for a recognized futures exchange to apply to electronic trading systems. Any program of objective testing and review of the system should be performed by a qualified independent professional. The Commission believes that information gathered by analysis, oversight or any program of objective testing and review of any automated systems regarding system functioning, capacity and security should be made available to the Commission and the public.

(2) A recognized futures exchange that determines to allow block trading should have rules which:

(i) Define the block based upon the customary size of large positions in the cash and derivatives market,

(ii) Restrict access to block trading to eligible participants,

(iii) Provide a mechanism for ensuring that the block's price will be fair and reasonable, and

(iv) provide for transparency of the trade by requiring that it be reported for clearing within a reasonable period of time and that it be identified separately in the price reporting system.

(b) *Acceptable Practices.*

A professional that is a certified member of the Informational Systems Audit and Control Association experienced in the industry would be an example of an acceptable party to carry out such testing and review.

Core Principle 9: Audit Trail: Have procedures to ensure the recording of full data entry and trade details sufficient to reconstruct trading, the quality of the data captured, and the safe storage of such information, and have systems to enable information to be used in assisting in detecting and deterring customer and market abuse.

(a) *Application Guidance.*

A recognized futures exchange should have arrangements and resources for recording of full data entry and trade details sufficient to reconstruct trading and the safe storage of audit trail data systems enabling information to be used in combating customer and market abuse.

(b) *Acceptable Practices.*

(1) The goal of an audit trail is to detect and deter customer and market abuse. An effective exchange audit trail should capture and retain sufficient trade-related information to permit exchange staff to detect trading abuses and to reconstruct all transactions. An audit trail should include specialized electronic surveillance programs that would identify potentially abusive trades and trade patterns, including for instance, withholding or disclosing customer orders, trading ahead, and preferential allocation. An acceptable audit trail must be able to track a customer order from time of receipt through fill allocation. The exchange must create and maintain an electronic transaction history database that contains information with respect to transactions affected on the recognized futures exchange.

(2) An acceptable audit trail, therefore, should include the following: original source documents, transaction history, electronic analysis capability, and safe storage capability. A registered futures exchange whose audit trail satisfies the following acceptable practices would satisfy Core Principle 9.

(i) *Original Source Documents.* Original source documents include unalterable, sequentially identified records on which trade execution information is originally recorded, whether recorded manually or electronically. For each customer order, such records reflect the terms of the order, an account identifier that relates back to the account(s) owner(s), and the time of order entry. For floor-based exchanges, the time of report of execution of the order should also be captured.

(ii) *Transaction History.* A transaction history which consists of an electronic history of each transaction, including:

(A) All data that are input into the trade entry or matching system for the transaction to match and clear;

(B) Whether the trade was for a customer or proprietary account;

(C) Timing and sequencing data adequate to reconstruct trading; and

(D) The identification of each account to which fills are allocated.

(iii) *Electronic Analysis Capability.* An electronic analysis capability that permits sorting and presenting data included in the transaction history so as to reconstruct trading and to identify possible trading violations with respect to both customer and market abuse.

(iv) Safe Storage Capability. Safe storage capability provides for a method of storing the data included in the transaction history in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss. Data should be retained in accordance with the recordkeeping standards of Core Principle 14.

Core Principle 10: Financial Standards: Have, monitor, and enforce rules regarding the financial integrity of the transactions that have been executed on the exchange and, where intermediaries are permitted, rules addressing the financial integrity of the intermediary and the protection of customer funds, as appropriate, and a program to enforce those requirements.

(a) *Application Guidance.*

Clearing of transactions executed on a recognized futures exchange should be provided through a Commission-recognized clearing facility. In addition, a recognized futures exchange should maintain the financial integrity of its transactions by maintaining minimum financial standards for its members and having default rules and procedures. The minimum financial standards should be monitored for compliance purposes. The Commission believes that in order to monitor for minimum financial requirements, a recognized futures exchange should routinely receive and promptly review financial and related information. Rules concerning the protection of customer funds should address the segregation of customer and proprietary funds, the custody of customer funds, the investment standards for customer funds, and related recordkeeping.

(b) *Acceptable Practices.* [Reserved]

Core Principle 11: Customer Protection: Have, monitor and enforce rules for customer protection.

(a) *Application Guidance.*

A recognized futures exchange should have rules prohibiting conduct by intermediaries that is fraudulent, noncompetitive, unfair, or an abusive practice in connection with the execution of trades and a program to detect and discipline such behavior. Intermediated markets are not required to have, monitor or enforce rules requiring intermediaries to provide risk disclosure or to comply with other sales practices.

(b) *Acceptable Practices.* [Reserved]

Core Principle 12: Dispute Resolution: Provide for alternative dispute resolution mechanisms appropriate to the nature of the market.

(a) *Application Guidance.*

A recognized futures exchange should provide customer dispute resolution procedures that are fair and equitable and that are made available to the customer on a voluntary basis, either directly or through another self-regulatory organization.

(b) *Acceptable Practices.*

(1) Core Principle 12 requires a recognized futures exchange to provide for dispute resolution mechanisms that are appropriate to the nature of the market.

(2) In order to satisfy acceptable standards, a recognized futures exchange should provide a customer dispute resolution mechanism that is fundamentally fair and is equitable. The procedure should provide:

(i) The customer with an opportunity to have his or her claim decided by a decision-maker that is objective and impartial,

(ii) Each party with the right to be represented by counsel, at the party's own expense,

(iii) Each party with adequate notice of claims presented against him or her, an opportunity to be heard on all claims, defenses and permitted counterclaims, and an opportunity for a prompt hearing,

(iv) For prompt written final settlement awards that are not subject to appeal within the exchange, and

(v) Notice to the parties of the fees and costs which may be assessed.

(3) The procedure employed also must be voluntary and may permit counter claims, as provided in § 166.5 of this chapter.

(4) If the recognized futures exchange also provides a procedure for the resolution of disputes which do not involve customers (*i.e.*, member-to-member disputes), the procedure for the resolution of such disputes must be independent of and shall not interfere with or delay the resolution of customers' claims or grievances.

(5) A recognized futures exchange may delegate to another self-regulatory organization or to a registered futures association its responsibility to provide for customer dispute resolution mechanisms, *Provided, however,* that, if the recognized futures exchange does so delegate that responsibility, the exchange shall in all respects treat any decision issued by such other organization or association as if the decision were its own including providing for the appropriate enforcement of any award issued against a delinquent member.

Core Principle 13: Governance: Have fitness standards for members, owners or operators with greater than 10 percent interest or an affiliate of such an owner, members of the governing board, and those who make disciplinary determinations. The recognized futures exchange must have a means to address conflicts of interest in making decisions and access to, and use of, material non-public information by the foregoing persons and by exchange employees. For mutually owned futures exchanges, the composition of the governing board must reflect market participants.

(a) *Application Guidance.*

(1) A recognized futures exchange should have appropriate eligibility criteria for the categories of persons set forth in the Core Principle which should include standards for fitness and for the collection and verification of information supporting compliance with such standards. Minimum standards of fitness are those bases for refusal to register a person under section 8a(2) of the Act or a history of serious disciplinary offenses, such as those which would be disqualifying under § 1.63 of this chapter. The Commission believes that such standards should include the provision to the Commission of registration information for such persons, whether registration information, certification to the fitness of such persons, an affidavit of such persons' fitness by the facility's counsel or other information substantiating the fitness of such persons. If an exchange provided certification of the fitness of such a person, the Commission believes that such certification should be based on verified information that the person is fit to be in their position. The means to address conflicts of interest in decision-making should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict. In addressing the access to, and use of, material non-public information, the Commission believes that the recognized futures exchange should provide for limitations on exchange employee trading.

(2) A recognized futures exchange may not limit its liability or the liability of any of its officers, directors, employees, licensors, contractors and/or affiliates where such liability arises from such person's violation of the Act or Commission rules, fraud, or wanton or willful misconduct.

(b) *Acceptable Practices.* [Reserved]

Core Principle 14: Recordkeeping: Keep full books and records of all activities related to its business as a recognized futures exchange in a form and manner acceptable to the Commission for a period of five years, during the first two of which the books and records are readily available, and which shall be open to inspection by any representative of the Commission or the U.S. Department of Justice.

(a) *Application Guidance.* [Reserved]

(b) *Acceptable Practices.*

Commission rule 1.31 constitutes the acceptable practice regarding the form and manner for keeping records.

Core Principle 15: Competition: Operate in a manner consistent with the public interest to be protected by the antitrust laws.

(a) *Application Guidance.*

An entity seeking recognition as a recognized futures exchange may request that the Commission consider under the provisions of section 15 of the Act any of the entity's rules, including trading protocols or policies, and including both operational rules and the terms or conditions of products listed for trading, at the time of recognition or thereafter. The Commission intends to apply section 15 of the Act to its consideration of issues under the Competition Core Principle in a manner consistent with that previously applied to contract markets.

(b) *Acceptable Practices.* [Reserved]

PART 170—REGISTERED FUTURES ASSOCIATIONS

11. The authority citation for Part 170 continues to read as follows:

Authority: 7 U.S.C. 6p, 12a, and 21.

12. Section 170.8 is revised to read as follows:

§ 170.8 Settlement of customer disputes (section 17(b)(10) of the Act).

A futures association must be able to demonstrate its capacity to promulgate rules and to conduct proceedings which provide a fair, equitable and expeditious procedure, through arbitration or otherwise, for the voluntary settlement of a customer's claim or grievance brought against any member of the association or any employee of a member of the association. Such rules shall conform to and be consistent with section 17(b)(10) of the Act and be consistent with the guidelines and acceptable practices for dispute resolution found within Appendix A and Appendix B to part 38 of this chapter.

PART 180—ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES

13. Part 180 is removed.

Issued in Washington, DC, this 21st day of November, 2000, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[This statement will not appear in the Code of Federal Regulations]

Dissent of Commissioner Thomas J. Erickson Regarding Final Rules for a New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations

I dissent from the Commission's final rules regarding multilateral transaction execution facilities, or ''MTEFs.'' While I believe this is the most dynamic element of the proposed framework, I also fear that it will only expand the legal uncertainty that the industry has decried for so long in reference to the existing swaps exemption in Part 35. I am thus simultaneously interested in the potential this proposal represents and disappointed in the lost opportunity for clarification.

At its core, my concern is this: The framework will, for the first time, inject legal uncertainty into regulated exchange markets by conferring ''recognition'' upon derivatives transaction facilities, or DTFs, without any determination that the transactions are within the CFTC's jurisdiction. I believe that if an agency of the United States Government tells market participants, other branches of the government, and counterpart foreign regulators that a market is regulated, then it should be, in fact, regulated.

At the DTF level, it seems clear that some markets will not be subject to Commission oversight because the Commission's jurisdiction—over transactions for future delivery and commodity options—will not attach to markets for certain products traded on DTFs. The nature of the Commission's mixed jurisdiction was not lost on commenters to the proposed framework; while some saw this as a flaw in the

proposal,[1] others took comfort in it.[2] Despite this ''don't ask, don't tell'' approach, DTFs all will be ''recognized'' by the Commission as regulated markets.[3] In turn, these DTF markets will hold themselves out to the public as markets regulated by the CFTC.

The Commission and certain commenters within the industry find the possible mix of futures and non-futures products on DTFs acceptable. They rely on Congressional report language from the 1992 legislation that, in effect, allows the Commission to exempt transactions without first determining that they are in the agency's jurisdiction.[4]

In the context of bilateral, privately negotiated transactions—such as those swaps the Commission was directed by Congress to ''promptly exempt—such an exemption makes a certain amount of sense. The consequence of any performance failure or fraud is borne solely by the parties to the transaction.

However, today the Commission extends this rationale to entities that are, in fact, exchange markets. Global participants and international regulators rely on our representations that these markets are regulated. I will not be comfortable making such representations with regard to DTFs where the Commission's jurisdiction is so questionable.

As a secondary matter, I am concerned with the level of oversight that will be applied to all DTF markets. Under the new framework, DTFs generally will not be required to maintain or provide the Commission with reports of futures positions held by their customers that exceed certain thresholds. In what appears to be a nod to the need for these reports, known as ''large trader reports,'' the Commission contemplates collecting this information only in a select, few markets. But the vast majority of markets trading at the DTF level—generally those without retail participants—will have no obligation or duty to the Commission or the public with regard to this important information.

Large trader reports are an essential tool in the Commission's effort to detect and deter market manipulations. Deterrence is important because the effects of market manipulations reach far beyond the market's participants. Consumers ultimately pay for manipulations in commodity markets: Home buyers pay higher interest rates; commuters pay higher prices for gasoline; and we all pay higher prices for heating oil and food. For these reasons, I would require large trader reports in all DTF markets, regardless of the type of commodity product or participant involved.

The Department of the Treasury identified this issue in its comment letter, stating that ''large trader reporting requirements have worked well in the market for treasury futures, both for the information they reveal to regulators and their deterrent effect.'' [5] I could not agree more strongly with the Treasury Department on this point. While it appears that large trader reporting will attach to government securities markets, I do not understand why the Treasury's views have not provided just as compelling a rationale for other markets which are not nearly as deep or liquid.

I believe that DTF markets may prove to be very successful, commercially. They may well grow to be the commercial markets where pricing and price-basing of commodities occurs. The Commission would be wise to retain its ability to detect and deter manipulations at their incipience.

Dated: November 20, 2000.

Thomas J. Erickson,

Commissioner.

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[1] *See* Mercatus letter, Aug. 21, 2000, p. 4 (''While it may be appropriate for the CFTC to avoid such a determination in granting an exemption from regulation, it is not clear that the CFTC can exercise its antifraud authority in relation to a particular transaction without determining that the CFTC is authorized to exercise jurisdiction in the first instance.'') The drafters of the Mercatus letter further note that the ''broad definition of MTEF'' in the proposed rules could even be read ''to cover auction markets such as eBay and all other forms of B2B trading facilities, whether electronic or not.'' *Id.* at 5. The Commission attempts to deflect this criticism in the final rules, stating that ''so long as a facility auctions instruments outside of the Commission's regulatory jurisdiction under the Act, [the] exemptions therefrom and this framework would have no application to its business.'' *See* Final Rules for a New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations, pp. 13–14. The Commission's response misses the rudimentary point that it will be anyone's guess whether some instruments possibly traded on DTFs are within or outside the Commission's jurisdiction.

[2] *See* Lehman Brothers letter, Sept. 5, 2000, p. 2 (''[T]he Commission's jurisdiction extends solely to futures and commodity options, such that reserving anti-fraud and anti-manipulation authority over futures and commodity options merely restates the current state of law. Such a reservation of authority cannot, legally, extend to transactions other than futures and commodity options and repeating the nature of the agency's statutory jurisdiction carries no legal baggage.'')

[3] The only apparent penalty for refusing to comply with Commission rules is the market's loss of recognition as a DTF. I am not comfortable with this after-the-fallout remedy, and I cannot imagine potential market participants or domestic or international regulators being any more pleased.

[4] *See* A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations, p. 11, citing H.R. Rep. No. 978, 102d Cong., 2d Sess. 82–83 (1992).

[5] *See* Department of Treasury letter, Aug. 16, 2000, p. 4.

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 3, 4, 140, 155 and 166

RIN 3038–AB56

Rules Relating to Intermediaries of Commodity Interest Transactions

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: As part of a comprehensive regulatory reform process, the Commodity Futures Trading Commission (CFTC or Commission) has revised its rules relating to intermediation of commodity futures and commodity options (commodity interest) transactions. These new rules and rule amendments will provide greater flexibility in several areas. For example, to ease barriers to entry for persons seeking registration as futures commission merchants (FCMs) or introducing brokers (IBs), the Commission has established a simplified registration procedure for those persons who are regulated by other federal financial regulatory agencies and who limit their customer base to institutional customers only, regardless of the type of market involved.

With respect to trading on recognized derivatives transaction facilities (DTFs), the Commission has determined to permit non-institutional customers to enter into transactions thereon, provided that such non-institutional customer business is transacted either through a registered FCM that is a clearing member of at least one designated contract market or recognized futures exchange (RFE), and that has adjusted net capital of at least $20 million or by a registered commodity trading advisor (CTA) who has discretionary authority over the non-institutional customer's account, and who has assets under management of not less than $25 million. The latter circumstance is an expansion of the proposal.

As proposed, the Commission is expanding the range of instruments in which FCMs may invest customer funds. In response to various comments concerning the expansion of permissible investments, the Commission is making certain adjustments to the proposals relating to, among other things, concentration limits as applied to securities held in connection with repurchase transactions, permissible investments in FCMs and their affiliates by money market mutual funds meeting the requirements of Rule 2a–7 under the Investment Company Act of 1940 (Investment Company Act), and investment in foreign sovereign debt. Separately, the Commission also is considering proposing risk-based capital rules for FCMs. Further, the Commission recently adopted a revised interpretation concerning the treatment of customer funds on deposit with