

those U.S. CEP and CEP/Further Manufactured (CEP/FM) sales compared to sales in France through Ugine Service. We included a CEP offset for all sales in France which are compared with CEP and CEP/FM sales in the United States since the comparison of home market sales to CEP sales is at a different level of trade. We applied the CEP offset to normal value or constructed value, as appropriate.

Preliminary Results of Review

As a result of our review, we preliminarily determine the weighted-average dumping margins (in percent) for the period January 1, 1996, through December 31, 1996, to be as follows:

Manufacturer/exporter	Margin (percent)
Imphy/Ugine-Savoie	10.51

Parties to the proceeding may request disclosure within five days of the date of publication of this notice. Any interested party may request a hearing within 10 days of publication. Any hearing, if requested, will be held 44 days after the date of publication or the first business day thereafter. Case briefs and/or other written comments from interested parties may be submitted not later than 30 days after the date of publication. Rebuttal briefs and rebuttals to written comments, limited to issues raised in those comments, may be filed not later than 37 days after the date of publication of this notice. The Department will publish the final results of this administrative review, including its analysis of issues raised in any written comments or at a hearing, not later than 120 days after the date of publication of this notice.

The Department shall determine, and the U.S. Customs Service shall assess, antidumping duties on all appropriate entries. We have calculated importer-specific ad valorem duty assessment rates based on the ratio of the total amount of dumping margins calculated for the examined sales made during the POR to the total customs value of the sales used to calculate those duties. These rates will be assessed uniformly on all entries of each particular importer made during the POR. (This is equivalent to dividing the total amount of antidumping duties, which are calculated by taking the difference between statutory NV and statutory EP or CEP, by the total statutory EP or CEP value of the sales compared, and adjusting the result by the average difference between EP or CEP and customs value for all merchandise examined during the POR).

Furthermore, the following deposit requirements will be effective for all shipments of the subject merchandise entered, or withdrawn from warehouse, for consumption on or after the publication date of the final results of these administrative reviews, as provided by section 751(a)(1) of the Act: (1) The cash deposit rate for the reviewed companies will be the rate established in the final results of this review (except that no deposit will be required for firms with zero or *de minimis* margins, *i.e.*, margins less than 0.5 percent); (2) for previously reviewed or investigated companies not listed above, the cash deposit rate will continue to be the company-specific rate published for the most recent period; (3) if the exporter is not a firm covered in this review, a prior review, or the original LTFV investigation, but the manufacturer is, the cash deposit rate will be the rate established for the most recent period for the manufacturer of the merchandise; and (4) the cash deposit rate for all other manufacturers or exporters will continue to be 24.51 percent, the "All Others" rate made effective by the LTFV investigation. These deposit requirements, when imposed, shall remain in effect until publication of the final results of the next administrative reviews.

This notice also serves as a preliminary reminder to importers of their responsibility under 19 CFR 353.26 to file a certificate regarding the reimbursement of antidumping duties prior to liquidation of the relevant entries during this review period. Failure to comply with this requirement could result in the Secretary's presumption that reimbursement of antidumping duties occurred and the subsequent assessment of double antidumping duties.

These administrative reviews and notice are in accordance with section 751(a)(1) of the Act (19 U.S.C. 1675(a)(1)) and 19 CFR 353.22(c)(5).

Dated: January 16, 1998.

Robert S. LaRussa,

Assistant Secretary for Import Administration.

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COMMODITY FUTURES TRADING COMMISSION

Regulation of Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market

AGENCY: Commodity Futures Trading Commission.

ACTION: Concept release.

SUMMARY: The Commodity Futures Trading Commission ("CFTC" or "Commission") is reevaluating its approach to the regulation of noncompetitive transactions executed on or subject to the rules of a contract market. Accordingly, the Commission is soliciting comments on a broad range of questions concerning the oversight of transactions involving (i) the exchange of futures contracts for, or in connection with, cash commodities, (ii) other noncompetitive transactions, and (iii) the use of execution facilities for noncompetitive transactions. Following the receipt of public comments, the Commission will determine whether rulemaking is appropriate.

DATES: Comments must be received on or before March 27, 1998.

ADDRESSES: Interested persons should submit their written data, views, and opinions to Jean A. Webb, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street N.W., Washington, D.C. 20581. In addition, comments may be sent by facsimile transmission to facsimile number (202) 418-5221 or by electronic mail to secretary@cftc.gov. Reference should be made to "Regulation of Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market." Certain related materials described herein are available for inspection at the Office of the Secretariat at the above address. Copies of these materials also may be obtained through the Office of the Secretariat at the above address or by telephoning (202) 418-5100.

FOR FURTHER INFORMATION CONTACT: Rebecca Creed, Attorney, at (202) 418-5493, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street N.W., Washington, D.C. 20581.

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I. Introduction

A. Statutory and Regulatory Provisions

Section 4(a) of the Commodity Exchange Act ("Act") makes it unlawful for any person to enter into a contract for the purchase or sale of a commodity for future delivery "unless such transaction is conducted on or subject to the rules of a board of trade which has

been designated by the Commission as a 'contract market' for such commodity."¹ Although Congress has indicated that trading on contract markets be conducted generally in an open and competitive manner, it also has recognized the need for certain, limited exceptions to that requirement. Section 4c(a) of the Act prohibits various types of noncompetitively executed transactions but provides an exception for transfer trades, office trades, and exchanges of futures for physicals ("EFPs") that are executed in accordance with contract market rules that have been approved by the Commission.² With reference to these statutory provisions, the Senate Committee on Agriculture and Forestry stated:

Both the Commodity Exchange Act and the rules and regulations of the commodity exchanges require that futures transactions be executed openly in a competitive manner.

* * * * *

Certain carefully prescribed exceptions to competitive trading are allowed, but they do not nullify the general requirement of open and competitive trading.

The purpose of this requirement is to ensure that all trades are executed at competitive prices and that all trades are focused into the centralized marketplace to participate in the competitive determination of the price of futures contracts. This system also provides ready access to the market for all orders and results in a continuous flow of price information.³

Consistent with this policy, Commission Regulation 1.38(a) requires that contract market rules providing for the execution of noncompetitive transactions must be submitted to the Commission for approval. Commission Regulation 1.38(b) requires all noncompetitive transactions as well as all related orders, records, and memoranda to be identified and marked. Regulation 1.38 was adopted pursuant to Sections 4b and 8a(5) of the Act.⁴ Section 8a(5) authorizes the Commission to "make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this Act."

B. Purpose of This Release

The purpose of this release is to solicit comments on whether the

regulatory structure governing noncompetitive transactions executed on or subject to the rules of a contract market should be modified in light of recent developments in the marketplace. The impetus for this action comes from several sources, including the following.

First, ten years have passed since the Division of Trading and Markets ("Division") conducted a comprehensive study of EFPs.⁵ During this time, the use of EFPs has continued to grow and evolve.

Second, several organizations have developed computerized systems for basis trading of U.S. Treasury securities. Essentially, a basis trade involves the simultaneous acquisition of positions in actual Treasury securities and in offsetting futures contracts. Venues for basis trading simplify the trading process by enabling traders to obtain both cash and futures positions in a single transaction which is reported to a contract market as an EFP.

Third, the New York Mercantile Exchange ("NYMEX") has sought Commission approval for a proposed rule that would permit the exchange of futures contracts for, or in connection with, swap agreements ("EFS transactions").⁶ This proposal would establish provisions for EFS transactions that are parallel to, but separate from, those governing EFP transactions. Thus, an EFS transaction would follow the form of an EFP except that a swap agreement would be substituted for the physical component.

Fourth, the Chicago Board of Trade ("CBT"), through counsel, requested the Division of Economic Analysis to agree not to recommend that the Commission take any enforcement action against the CBT, its members or market participants in connection with the CBT's proposed implementation of a one-year pilot program facilitating the off-exchange transfer of futures contracts in agricultural products in exchange for related over-the-counter agricultural options.⁷

⁵ *Report of the Division of Trading and Markets: Exchanges of Futures for Physicals* (October 1987) ("EFP Report"). This document provides a detailed discussion on the history, use and regulation of EFPs. Interested parties may obtain a copy of the EFP Report by contacting the Commission's Office of the Secretariat at the address noted above.

⁶ Interested parties may obtain a copy of the NYMEX proposal permitting EFS transactions by contacting the Commission's Office of the Secretariat at the address noted above.

⁷ The Division of Economic Analysis staff advised counsel that, in light of the Commission's ongoing consideration of agricultural trade options in connection with its advance notice of proposed rulemaking, 62 FR 31375 (June 9, 1997), it was not currently appropriate to consider this request. The Commission has subsequently proposed removing

¹ 7 U.S.C. 6(a). As discussed below, Section 4(c) of the Act, 7 U.S.C. 6(c), vests the Commission with certain exemptive authority subject to specified qualifying criteria.

² 7 U.S.C. 6c(a).

³ *Report of the Senate Committee on Agriculture and Forestry*, S. Rep. No. 1131, 93rd Cong., 2d Sess. 16 (1974).

⁴ 7 U.S.C. 6b and 12a(5).

Finally, recent legislative proposals contemplate the establishment of separate, professional markets.⁸ The Commission wishes to explore whether it is possible to achieve some of the objectives of these proposals by expanding the boundaries of permissible noncompetitive trading on existing contract markets. In contrast to the legislative proposals, a revised structure governing noncompetitive transactions could act as an adjunct rather than as an alternative to existing regulated markets. Such an approach might improve the usefulness and efficiency of existing markets for institutional or professional users but with a reduced risk of market fragmentation. Thus, carefully designed revisions to the regulatory structure governing noncompetitive transactions could have a procompetitive effect.

C. Overview

For the foregoing reasons, the Commission has determined to seek comments on whether the existing regulatory structure should be revised to provide additional guidance concerning standards governing noncompetitive transactions executed on or subject to the rules of a contract market. In scope, the Commission's request includes transactions that currently are permitted, such as EFPs, as well as transactions that are not currently permitted, such as EFS transactions or block trades. Of course, if the Commission were to revise its regulatory structure relating to noncompetitive transactions, the choice of whether to permit these types of transactions on a particular contract market would remain, in the first instance, with that contract market.

In general, the Commission is soliciting comments on the following questions:

(1) Should the standards articulated in the EFP Report be codified in the Commission's regulations and/or refined in any way?

(2) Should other types of noncompetitive transactions, such as EFS transactions or block trades, be permitted to be executed on or subject to the rules of a contract market

the prohibition against off-exchange trade options on the enumerated agricultural commodities pursuant to a three-year pilot program. *Trade Options on the Enumerated Agricultural Commodities*, 62 FR 59624 (Nov. 4, 1997).

⁸ See, e.g., S. 257, 105th Cong., 1st Sess. § 6 (1997).

Part 36 of the Commission's regulations adopts certain exemptions under a pilot program for separate, professional markets. Included among the exemptions is a provision exempting certain noncompetitive trading subject to the rules of a professional market. However, no contract market has filed a proposal with the Commission pursuant to Part 36.

and, if so, what standards should apply to these transactions?

(3) What standards should be applicable to execution facilities for noncompetitive transactions executed on or subject to the rules of a contract market?

More specific questions addressing particular aspects of these topics are posed in the relevant sections of this release. A consolidated list of questions is set forth at the conclusion. The Commission recognizes, however, that its identification of the issues may not be exhaustive and therefore invites comments on other aspects of these topics even if not expressly set out below.

The Commission is asking these questions for the dual purpose of giving notice of its consideration of these issues and of obtaining input before proceeding with any specific initiatives. Commenters should set forth with particularity the bases for their views. After receiving input, the Commission will endeavor to strike an appropriate balance among the relevant concerns.

II. Standards Governing EFP Transactions

A. Background

1. Historic Uses of EFPs

An EFP involves simultaneous transactions in the futures and cash commodity markets. The futures market transaction consists of a noncompetitive transfer of a futures position between the parties to the EFP. Thus, one party buys the physical commodity and simultaneously sells (or gives up long) futures contracts while the other party sells the physical commodity and simultaneously buys (or receives long) futures contracts. Subject to applicable contract market rules, the quantity and price of the futures and cash commodity to be exchanged as well as other terms are negotiated privately by the parties rather than being executed openly and competitively on a contract market. Depending on the pre-existing market positions of EFP counterparties, an EFP transaction can create, transfer, or extinguish futures positions.

The EFP exception currently contained in Section 4c(a) of the Act first appeared in H.R. 12287, which was introduced in 1932. The report of the House Committee on Agriculture accompanying that bill indicates that this exception was intended to permit the continuation of what was described as an accepted commercial practice:

Transactions involving the exchange of cash commodities for futures in accordance with exchange rules applying to such exchanges are exempted, even though they take the form of office trades, it being

understood that the exchange of cash commodities for futures is a common and necessary practice.⁹

The EFP exception was ultimately adopted with the enactment of the Commodity Exchange Act in 1936. None of the amendments to Section 4c(a) since that time provides further guidance as to the scope of permissible EFP transactions.¹⁰

As discussed in detail in the EFP Report, the use of EFPs has evolved to include practices not contemplated at the time Section 4c(a) originally was enacted. Indeed, financial futures contracts, which now dominate futures trading at some exchanges, did not exist at the time the EFP exception was adopted. In the EFP Report, the Division concluded that it appeared appropriate to interpret Section 4c(a) to accommodate some of these practices, many of which arise out of trading practices in various cash markets and which accomplish a variety of commercial purposes.¹¹ However, the Division also stated that the historical context in which the EFP exception first was enacted and the statutory language of Section 4c(a) itself necessarily imply certain limits on the permissible scope of EFP transactions as an exception to the general requirement of competitive execution.¹²

2. Current EFP Volume

A comparison of statistical data regarding the level of EFP activity between the late 1980s (when the EFP Report was published) and recent years shows that EFP activity, in many major markets, has continued to grow. The following table summarizes such data for selected contracts between 1986 and 1996.

⁹ *Commodity Short Selling*, H.R. Rep. No. 1551, 72d Cong., 1st Sess. 3 (1932).

¹⁰ See Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (substituted the Commission for the Secretary of Agriculture and deleted state law preservation clause); Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865 (required contract market rules permitting EFPs to be approved by the Commission); Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (exempted transactions in foreign currency options traded on a national securities exchange from coverage of the Commodity Exchange Act).

¹¹ EFP Report at 144-145.

¹² *Id.* at 26. For example, the Division has expressed its opinion that the EFP "exemption was not designed to create an avenue for traders to use EFP transactions to accomplish what they could not otherwise legitimately do, that is, wash trades, accommodation trades, fictitious sales, or illegal off-exchange transactions." *Report of the Division of Trading and Markets: Volume Investors Corporation* 59 n. 54 (July 1985).

TABLE 1.—EFPs AS A PERCENT OF TRADING VOLUME IN SELECTED CONTRACTS 1986—1996¹³

Contract Market	1986	1996
CBT Wheat	2.32	2.35
KCBT Wheat	15.61	10.87
MGE Wheat	24.72	15.31
CBT Corn	8.14	6.81
CBT Soybeans	5.42	4.57
CBT Soybean Oil	6.52	4.89
CBT Soybean Meal	7.89	7.95
CME Live Cattle	0.06	0.04
CSC Coffee "C"	1.48	4.10
CSC Sugar #11	3.86	4.69
CSC Cocoa	6.24	3.17
CBT Treasury Bonds	0.75	5.00
CBT Treasury Notes	1.23	4.59
CME Japanese Yen	7.32	16.11
CME British Pound	7.76	21.53
CME Deutsche Mark	6.12	16.81
CME Swiss Franc	5.96	13.79
COMEX Gold	7.46	9.05
COMEX Silver	3.46	5.04
NYMEX Crude Oil	3.60	2.67
NYMEX Heating Oil #2	1.90	6.66

¹³The data shown in Table 1 is for calendar year 1986 and 1996.

As the table shows, EFP activity as a share of trading volume has been relatively stable in traditional agricultural markets and has declined in some cases. The trend for financial futures contracts has been just the opposite, with EFP activity continuing to increase, in some cases dramatically.

3. Current Oversight of EFPs

EFP transactions are currently subject to oversight through a variety of sources, including: (i) the Commission's review of contract market rules governing such transactions; (ii) the Commission's reporting and recordkeeping requirements; (iii) contract markets' enforcement of their own rules; (iv) the Commission's rule enforcement review program; and (v) the Commission's own enforcement program.

B. Elements of a Bona Fide EFP

The EFP Report described EFP practices in selected markets, analyzed the legislative and regulatory framework surrounding EFPs, and reviewed the contract market rules and interpretations that govern them. The EFP Report suggested possible criteria to be examined by contract markets in evaluating whether a particular EFP transaction is eligible for the Section 4c(a) exception. In particular, the Division enumerated three essential elements of a bona fide EFP as follows: (i) a futures transaction and a cash transaction which are integrally related; (ii) an "exchange" of futures contracts for cash commodity, where the cash commodity contract provides for the

transfer of ownership of the cash commodity to the cash buyer upon performance of the terms of the contract, with delivery to take place within a reasonable time thereafter in accordance with prevailing cash market practice; and (iii) separate parties to the EFP, where the accounts involved have different beneficial ownership or are under separate control.¹⁴

In addition, the Division developed a non-exclusive list of other indicia to assist contract markets in determining whether the essential elements of a bona fide EFP have been satisfied. These include: (i) the degree of price correlation between the futures and cash legs of the EFP; (ii) the prices of the futures and cash legs of the EFP and their relationship to the prevailing prices in their respective markets; (iii) whether the cash seller has possession, the right to possession, or the right to future possession of the cash commodity prior to the execution of the EFP; (iv) the cash seller's ability to perform on his delivery obligation in the absence of prior possession of the cash commodity, *i.e.*, the cash seller's access to the cash market; and (v) whether the cash buyer acquires title to the cash commodity.¹⁵

These elements can be analyzed in terms of four categories: (i) the relationship of the instruments; (ii) the relationship of the parties; (iii) the nature of the transaction; and (iv) the price of the transaction. The following discussion summarizes the elements and indicia of a bona fide EFP as set forth by the Division in the EFP Report. As noted above, the Commission is soliciting comments on whether these standards should be codified in the Commission's regulations and/or refined in any way.

1. Relationship of the Instruments

(a) Qualitative Correlation. In the EFP Report, the Division determined that the futures and cash legs of a bona fide EFP should be correlated with each other, both qualitatively and quantitatively.¹⁶ Qualitative correlation clearly exists when the cash commodity satisfies the delivery specifications of the associated futures contract. However, when the cash commodity is not deliverable against the relevant futures contract, questions arise as to its acceptability as the cash leg. While some contract markets focus on whether the cash commodity is the economic equivalent of, or is derived from, the particular commodity specified in the futures

contract, others also consider the price relationship between the cash and futures legs of the transaction.

In the EFP Report, the Division concluded that the cash commodity should have a reliable and demonstrable price relationship with the futures contract involved in the EFP.¹⁷ The cash leg should exhibit price movement that historically has paralleled the price movement of the futures contract, with the cash and futures prices typically moving in the same direction and at consistent relative rates of change. Although perfect price correlation is not required, a "strong correlation" should exist. Otherwise, the parties are at risk that the basis or price differential between the cash and futures legs will change significantly prior to the conclusion of the EFP, thus adversely affecting the utility of the transaction itself. The lack of a strong correlation may indicate that the parties' motive for the EFP was to circumvent the regulatory requirements of the Act or the Commission's regulations, such as the requirement of open and competitive execution, rather than to conduct a commercially appropriate transaction. The Division also concluded that hedgeable commodities are appropriate cash legs for EFPs.¹⁸

In the EFP Report, the Division noted that statistical correlation coefficients¹⁹ have been used to justify specific EFPs involving stock index futures contracts either before or after the transaction was consummated.²⁰ The Division also recommended that contract markets publicize their determinations regarding the acceptability of particular commodities as the cash leg of an EFP in order to provide more guidance to the market users of these transactions.²¹

(b) Quantitative Correlation.

For quantitative correlation to exist, the Division determined that the cash commodity position should be approximately equal in quantity or dollar value to the futures position and that appropriate hedge ratios may be

¹⁷ *Id.* at 155.

¹⁸ *Id.* at 157.

The Division referred to Administrative Determination 239, issued by the Commodity Exchange Authority on December 16, 1974, which advised that, "[i]f a commodity, product or by-product is hedgeable under the Act, it may be exchanged for futures. If it is not hedgeable, it may not be exchanged." See generally 17 CFR 1.3(z) (defines bona fide hedging transactions and positions); *Clarification of Certain Aspects of the Hedging Definition*, 52 FR 27195 (July 20, 1987).

¹⁹ A correlation coefficient measures the degree to which the movements of two variables are related. Here the variables consist of the price of the futures contracts and the price of the cash commodity.

²⁰ EFP Report at 158.

²¹ *Id.* at 159.

¹⁴ EFP Report at 146–150.

¹⁵ *Id.* at 150–151.

¹⁶ *Id.* at 152–160.

used to create such dollar equivalency.²² Again, the absence of such equivalency may indicate a motive to circumvent some requirement of the Act or the Commission's regulations rather than to conduct a commercially appropriate transaction.

(c) *Request for Comments.* The Commission is soliciting comments on the following questions:

(4) How should the "strong price correlation" standard articulated in the EFP Report be implemented?

(5) Should the Commission require contract markets to adopt a minimum statistical correlation coefficient to be used in assessing the acceptability of a particular cash commodity for use as the cash leg of an EFP?

(6) If a minimum correlation coefficient is required, should this coefficient apply to all EFPs, or should it be adjusted to account for the different commodities involved in EFPs?

(7) What is the appropriate type and scope of guidance contract markets should be required to provide to the general public concerning the acceptability of particular commodities as the cash leg of an EFP?

2. Relationship of the Parties

(a) *Separate Parties.* In the EFP Report, the Division concluded that a bona fide EFP must be executed between separate parties.²³ Determining if separate parties are involved in a particular transaction in turn depends upon whether the accounts have different beneficial owners or are under separate control. This standard permits separate profit centers of a futures commission merchant ("FCM") to engage in EFPs with each other in order to accomplish their trading strategies and to fulfill their business needs.

(b) *String Trades.* In the EFP Report, the Division discussed a method of effecting an EFP transaction in the grain markets called a "pass-through" or "string trade."²⁴ Under this method, the two parties to the EFP each have cash commodity contracts with a different party or parties which require them to buy/sell the cash commodity and sell/buy the corresponding futures contract in order to set the price for the cash transaction. All of the parties in the string have complementary cash

commitments and corresponding obligations to buy or sell futures contracts to the next party in the string. Instead of executing a series of EFP transactions in which the intermediate futures positions transferred among the parties would net out for the common parties, the first and last parties in the string execute a single EFP and the other mutually exclusive futures obligations are canceled.²⁵

(c) *Request for Comments.* The Commission is soliciting comments on the following questions:

(8) What is the appropriate scope of the separate parties requirement?

(9) Should the Commission address string trades as that practice is described in the EFP Report and, if so, how?

3. Nature of the Transaction

(a) *Exchanges of Futures Contracts for Cash Commodities.* As discussed previously, Section 4c(a) of the Act excepts EFPs from the prohibition against various types of noncompetitively executed transactions. A bona fide EFP must involve an "exchange" of futures contracts for cash commodity in which both legs of the transaction entail actual economic risk.

(b) *Futures Leg Requirements.* The futures leg of the EFP must be reported to and cleared by a contract market clearing organization. Therefore, it is subject to the same margin obligations, both original and variation, as any other exchange-traded futures transaction. If the futures leg were netted off-exchange, this conduct might constitute bucketing in violation of Section 4b(a) of the Act.²⁶

(c) *Cash Leg Requirements.* In the EFP Report, the Division concluded that the cash commodity contract must impose a real obligation to transfer ownership of the cash commodity from the cash seller to the cash buyer upon performance of the terms of the contract, with delivery taking place within a reasonable time thereafter in accordance with prevailing cash market practice.²⁷ The Division further asserted that, although the cash

commodity contract must contemplate the making and taking of delivery of the cash commodity, the parties may, subject to the terms of the contract and the principles of contract law, individually transfer their contractual rights or obligations with respect to the cash commodity to a third party or may offset these positions or obligations prior to delivery.²⁸

In the EFP Report, the Division discussed several factors to be considered in analyzing the parties' intent with respect to the transfer of cash commodity, including: (i) the ability of the cash seller to make delivery and of the cash buyer to take delivery of the cash commodity; (ii) the level of creditworthiness required of the cash seller and buyer; (iii) the form and terms of the cash commodity contract; (iv) the documentation underlying the transfer of cash commodity from the cash seller to the cash buyer; and (v) whether the cash buyer acquires an enforceable claim on the title to the cash commodity.²⁹

The Division expressed the view that the cash seller is not required to have possession, or the right to possession, of the cash commodity in order to undertake a contractual obligation to deliver it in the future by way of an EFP.³⁰ Nevertheless, the lack of: (i) possession, (ii) the right to possession, or (iii) access to the cash market may indicate that the parties lacked the requisite intent to execute a cash transaction in the first place. This would raise doubts about the legitimacy of the EFP. Similarly, evidence that the cash buyer was unable to accept delivery of the cash commodity may indicate that the parties never intended to execute the cash leg of the EFP. An examination of the documents underlying the cash transaction, including the form and the terms of the cash commodity contract, confirmation statements, and documents evidencing title, in light of the state law governing transfers of ownership is especially useful in determining the parties' intent.

In determining whether there has been, or will be, an actual transfer of ownership of the cash commodity, the critical inquiry is whether the buyer of the cash commodity has acquired or will acquire, upon completion of performance under the contract, title to the cash commodity associated with the

²⁵ For example, party A has agreed to sell grain to and buy futures contracts from party B. Meanwhile, party B has agreed to sell grain to and buy futures contracts from party C. When C is ready to sell futures contracts to B in order to fix the price of their cash transaction, B directs C to execute the futures trade with A instead, thus satisfying B's obligation to sell futures contracts to A. Thus, A and C execute an EFP in which C sells futures contracts to A, but there is no corresponding cash transaction between A and C. In the absence of this string trade, parties A and B and parties B and C must execute separate EFP transactions consistent with their contractual obligations. Thus, the string trade serves to match the mutually exclusive futures obligations so that only one EFP is reported to the contract market.

²⁶ 7 U.S.C. 6b.

²⁷ EFP Report at 146.

²⁸ *Id.* at 149. For example, under this approach, a third party could assume the seller's obligation to deliver the cash commodity, or the cash seller could contract to purchase the cash commodity from the third party and direct that delivery be made to the cash buyer in the EFP.

²⁹ *Id.* at 179-192, 196.

³⁰ *Id.* at 181.

²² *Id.* at 159-160.

For example, if the futures position established by the EFP transaction represents 50,000 bushels of corn, then the associated cash leg should also equal approximately 50,000 bushels of corn. With respect to the use of appropriate hedge ratios to create dollar equivalency, traders might cross-hedge a 182-day T-bill by using more than one 91-day T-bill futures contract since the risk exposure on the principal amount of the T-bill increases the higher the duration of the security. Other instruments with differing maturities and yields would require different ratios.

²³ *Id.* at 147, 149-150.

²⁴ *Id.* at 47, 148 n. 173.

EFP.³¹ In this regard, the Division stated that the cash commodity contract may contemplate an immediate transfer of title or a transfer of title at some subsequent time.³² Regardless of when title passes, however, delivery of the cash commodity should occur within a reasonable period of time in accordance with normal industry practice involving comparable cash market transactions. If delivery did not occur, the transaction would need to be scrutinized, the reasons for failure identified, and a determination made as to whether the EFP is bona fide.

(d) *Transitory EFPs.* In the EFP Report, the Division expressed concern about a practice, then occurring frequently in the gold and foreign currency markets, involving both an EFP and an offsetting cash commodity transfer.³³ For example, party A purchases the cash commodity from party B and then engages in an EFP whereby A sells the cash commodity back to B and receives a long futures position. As a result of this integrated transaction, the parties acquire futures positions but end up with the same cash market position as they had before the transaction. These transactions are sometimes referred to as transitory EFPs. In such cases, questions arise as to whether there has been a bona fide "exchange" of the cash commodity as is required by Section 4c(a) of the Act.

The Division concluded that, in reviewing transitory EFPs, the EFP and the cash commodity transfer should be examined both separately and as an integrated transaction.³⁴ The parties must incur actual economic risk in both legs of the EFP and in the cash commodity transfer, and the EFP itself must otherwise be bona fide.

The predominant consideration is whether the cash commodity transfer can stand on its own as a commercially appropriate transaction, with no obligation on either party to carry out the EFP.³⁵ One indication is whether the terms and structure of the cash commodity transfer are substantially the same in all material respects as other cash transactions in that market or more specifically for those particular participants. For example, if the price of the cash commodity is determined differently or if a lower level of capitalization is required of the buyer

than would otherwise be the case, then the cash commodity transfer may not be genuine. Another indication is whether the buyer acquires title to the cash commodity in accordance with customary cash market practices.

Additional issues to be considered in evaluating whether the integrated transaction is bona fide include: (i) The timing of the cash commodity transfer and the EFP; (ii) whether the same parties have executed a number of integrated transactions in which the cash commodity transfer never occurs independently of the EFP; (iii) whether there have been a series of transactions in which the same cash commodity is transferred repeatedly between the same parties, resulting in the liquidation of a futures position much larger than the exchanged cash commodity which ultimately remains with the original owner; and (iv) the relationship between the parties and their patterns of dealings, including evidence of money passes between them.³⁶

(e) *Contingent EFPs.* Contingent EFPs are an impermissible subset of transitory EFPs. The existence of conditions tying the cash commodity transfer and the EFP together may indicate that the transactions are not severable but are contingent upon each other.³⁷ A cash commodity transfer which cannot stand on its own may indicate that there was no actual economic risk in the initial cash transfer and may raise concerns about whether the EFP involved an "exchange" of futures contracts for cash commodity as is required by Section 4c(a) of the Act.

(f) *Request for Comments.* The Commission is soliciting comments on the following questions:

(10) What criteria are appropriate for judging whether the futures leg of an EFP is bona fide?

(11) What criteria are appropriate for judging whether the cash leg of an EFP is bona fide?

(12) What criteria are appropriate for determining whether a transitory EFP is bona fide?

(13) What criteria are appropriate for determining whether an EFP is contingent?

4. Price of the Transaction

(a) *Current Requirements.* As discussed previously, because EFPs are executed noncompetitively off-exchange, the prices of both the futures and cash legs are determined by mutual agreement of the parties. In the EFP Report, the Division concluded that the price differential between the futures and cash legs should reflect commercial realities and that at least one leg of the

transaction should be priced at the prevailing market.³⁸ Although pricing one leg of the EFP significantly away from the market may be justified by commercial necessity,³⁹ the Division expressed its concern that such aberrant pricing can be used to shift substantial sums of cash from one party to another or to allocate gains and losses between the futures and cash sides of the EFP.⁴⁰ Moreover, when both legs of an EFP are priced away from the market, the transaction may not be commercially appropriate, particularly when one party could obtain better prices for the futures and cash legs in another available market. In the EFP Report, the Division urged contract markets to determine whether the pricing of a particular EFP is supported by a business purpose.⁴¹

(b) *Request for Comments.* The Commission is soliciting comments on the following questions:

(14) Should the Commission require both the futures and cash legs of an EFP to be priced within the daily range of their current respective markets, should it require only one leg of an EFP to be priced within its daily range, or should it impose no restrictions on the price of either leg of an EFP?

(15) Should the Commission require contract markets to obtain documentation regarding the business purpose underlying the pricing of an EFP?

C. Other Regulatory Requirements Governing EFPs

1. Reporting and Recordkeeping

(a) *Current Requirements.* Under the Commission's current regulations EFPs are subject to broad reporting and recordkeeping requirements. Commission Regulation 1.35(a) generally requires every FCM, introducing broker ("IB"), and contract market member to keep full, complete and systematic records of all transactions relating to its business of dealing in commodity futures, commodity options, and cash commodities, to retain such records for a period of five years, and to produce them upon request of the Commission or the Department of Justice. Commission Regulation 1.38(b) requires every person handling, executing, clearing, or carrying EFPs to identify all related documents by appropriate symbol or designation. Similarly, under Commission Regulation 1.35(e), each

³¹ *Id.* at 185-186.

³² *Id.* at 186.

³³ *Id.* at 192-193.

³⁴ *Id.* at 195.

³⁵ *Id.* Evidence that the cash commodity transfer is severable from the EFP is necessary, but not sufficient, to establish the legitimacy of the integrated transaction. As noted above, the EFP itself must be bona fide.

³⁶ *Id.* at 200-201.

³⁷ *Id.* at 198.

³⁸ *Id.* at 174-175.

³⁹ The Division identified several such examples in the EFP Report including meeting a margin call, taking advantage of expected foreign exchange fluctuations, and complying with internal inventory policies. *Id.* at 169-173.

⁴⁰ *Id.* at 169.

⁴¹ *Id.* at 175.

contract market must maintain a record showing, by appropriate and uniform symbols, any transaction which is made noncompetitively in accordance with written rules of the contract market. Commission Regulation 1.35(a-2) requires FCMs, IBs, and other contract market members to ask their customers for documentation of the cash leg of an EFP upon request of the contract market, the Commission, or the Department of Justice and upon receipt to provide the documentation to the requesting body; requires customers to create, retain, and produce such documentation directly to the requesting body; and requires that all contract markets adopt, as necessary, corresponding rules requiring its members to provide the documentation to the contract market.

Under Part 16 of the Commission's regulations, each contract market must report the total quantity of futures contracts bought or sold in connection with EFPs to the Commission by clearing member and must publish the total quantity of EFPs executed on any given business day. Part 17 of the Commission's regulations requires FCMs, members of contract markets, and foreign brokers to report to the Commission the quantity of EFPs executed in each special account on the day it has a reportable futures position as well as on the first day the account is no longer reportable. Commission Regulation 18.05 requires each trader holding or controlling a reportable futures position ("large trader") to keep records of all futures and cash commodity positions and transactions. Finally, the Commission may issue a special call under Regulation 21.03(e)(1)(iii) to FCMs, IBs, or customers that requires information about EFPs to be submitted for the particular commodity, contract market, and delivery months named in the call.

(b) Request for Comments. The Commission is soliciting comments on the following question:

(16) Are the current reporting and recordkeeping requirements relating to EFPs adequate?

2. Disclosure

(a) Current Requirements. Commission Regulation 1.55(a)(1) prohibits an FCM or IB from opening a commodity futures account for any customer unless the FCM or IB first provides the customer with a written risk disclosure statement prepared by or approved by the Commission and receives a signed acknowledgment from the customer that he or she has received

and understood this statement.⁴² This risk disclosure statement, as set forth in Commission Regulation 1.55(b), does not specifically address EFPs. However, Commission Regulation 1.55(f) makes clear that compliance with the specific disclosure requirements of Regulation 1.55 does not relieve an FCM or IB from any other disclosure obligation it may have under applicable law. These disclosure obligations arise under Section 4b of the Act as well as under state and common law and require an FCM or IB to provide its customers with all material information relating to a transaction, including information relating to the risks involved in entering a particular transaction.⁴³

The Commission seeks to ensure full and fair disclosure of the requirements of and risks inherent in EFPs. Only when customers have complete information regarding EFPs can they effectively evaluate whether such transactions are consistent with their financial goals. The Commission believes that some guidance as to the form and content of disclosure concerning EFPs may be appropriate.

(b) Request for Comments. The Commission is soliciting comments on the following questions:

(17) What should be the form and content of disclosure concerning EFPs?

(18) Should the form and content of disclosure vary according to the commercial sophistication of the EFP participant similar to the Commission's proposed amendment to Regulation 1.55?

(19) Should the Commission explicitly require that customers must be informed that an EFP is executed noncompetitively, that it involves a cash transaction, and that their FCM might take the opposite side of the EFP?

(20) Should the Commission explicitly require Commission registrants to obtain customer consent before executing an EFP on the customer's behalf?

⁴²The Commission is currently proposing to amend Regulation 1.55 so that FCMs and IBs would no longer be required to furnish the specified written risk disclosure statement to certain categories of financially accredited customers or to obtain written acknowledgments of receipt of the risk disclosure statement before opening a commodity futures account for these customers. In addition, the Commission is currently proposing amendments to relieve FCMs and IBs from requirements to furnish disclosure statements to these financially accredited customers pertaining to foreign futures or foreign options (Regulation 30.6(a)), domestic exchange-traded commodity options (Regulation 33.7(a)), customers whose accounts are transferred to another FCM or IB other than at the customer's request (Regulation 1.65(a)(3)), and the treatment in bankruptcy of non-cash margin held by an FCM (Regulation 190.10(c)). *Distribution of Risk Disclosure Statements by Futures Commission Merchants and Introducing Brokers*, 62 FR 47612 (Sept. 10, 1997).

⁴³*Id.* at 47614.

3. Internal Controls

(a) Current Requirements. Commission Regulation 166.3 generally requires all Commission registrants, except associated persons who have no supervisory duties, to "diligently supervise the handling by its partners, officers, employees and agents * * * of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities * * * relating to its business as a Commission registrant." One basic purpose of the rule is to protect customers by ensuring that their dealings with employees of Commission registrants will be reviewed and overseen by other officials in the firm.⁴⁴ Although Commission Regulation 166.3 currently applies to EFPs, the Commission believes that some guidance as to the types of internal controls that Commission registrants should be required to maintain may be appropriate.

(b) Request for Comments. The Commission is soliciting comments on the following question:

(21) What internal controls are appropriate for Commission registrants to ensure compliance with regulatory requirements concerning the essential elements of bona fide EFPs, reporting and recordkeeping, and disclosure?

4. Transparency

(a) Current Requirements. The current reporting requirements for EFPs are outlined above. Exchanges do not require, and generally do not have a mechanism for providing, timely information about EFP bids, offers, and transactions.

(b) Request for Comments. The Commission is soliciting comments on the following questions:

(22) Do existing price reporting standards provide adequate transparency concerning EFPs to the marketplace and, if not, are there alternative methods of achieving improved price transparency?

(23) Should the Commission require contract markets to publicize information about bids and offers, as well as consummated EFP transactions?

III. Other Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market

A. Types of Eligible Transactions

Although EFPs have raised many issues and concerns, they have proven to be useful commercial tools. As noted above, the Commission seeks to explore whether there are other types of noncompetitive transactions that also could enhance the usefulness of

⁴⁴ *Adoption of Customer Protection Rules*, 43 FR 31886, 31889 (July 24, 1978).

designated contract markets without compromising necessary regulatory safeguards. The Commission has identified three potential candidates: (i) EFS transactions; (ii) exchanges of options for physicals ("EOPs"); and (iii) block trades. The Commission welcomes the identification by commenters of any other potential types of transactions.

1. Exchanges of Futures for Swaps

(a) *The New York Mercantile Exchange Proposal.* As noted, the NYMEX has applied to the Commission for approval of a rule that would permit the execution of EFS transactions. As proposed by the NYMEX, EFS transactions would involve the noncompetitive exchange of futures contracts for separately negotiated swap agreements. In this respect, the proposal would establish for EFS transactions provisions that are parallel to, but separate from, those governing EFP transactions.⁴⁵ Thus, an EFS transaction would follow the structural form of an EFP transaction except that a swap agreement would be substituted for the physical component of the transaction.⁴⁶

Under the NYMEX proposal, the swap component of the EFS transaction must comply with the requirements of Part 35 of the Commission's regulations or with the Commission's 1989 Policy Statement concerning cash-settled swap transactions or must otherwise qualify for or fall within other exemptions or jurisdictional exclusions under the Act or Commission regulations. This initiative represents the first proposal the Commission has received for approval of EFS transactions.

The NYMEX states that the rule proposal in part responds to the substantial growth that has occurred in the swaps market during recent years. In this respect, the NYMEX asserts that

⁴⁵ As noted above, pursuant to Section 4c(a) of the Act, EFPs are explicitly permitted as an exception to the usual open and competitive execution requirements established by the Act, but only to the extent provided for by contract market rules approved by the Commission. Also as noted, Commission Regulation 1.38(a) authorizes noncompetitive transactions if executed in accordance with contract market rules that have received Commission approval. All domestic commodity exchanges permit the execution of EFP transactions, although there is some variation among exchange rules.

⁴⁶ In general, a simplified swap agreement may be characterized as an agreement between two parties to exchange a series of cash flows measured by different interest rates, exchange rates, or prices, with payments calculated by reference to a principal base (or notional amount). See *Policy Statement Concerning Swap Transactions*, 54 FR 30695 (July 21, 1989). Part 35 of the Commission's Regulations defines swap agreements by reference to the Bankruptcy Code. See 17 CFR 35.1(b)(1).

swap transactions, though not "physical" in the traditional sense, subject market participants to the same type of price risk. Thus, the NYMEX claims that the proposal could aid in linking the on-exchange futures and off-exchange swap markets.

The NYMEX believes that allowing EFS transactions would increase market efficiency and enhance the use of the exchange as a risk transfer medium. Specifically, the NYMEX believes that both traditional market users and swap dealers (banks, trading companies, and energy companies) would benefit from the availability of EFS transactions. By a similar line of reasoning, the NYMEX notes that commodity swap instruments continue to play an increasingly important role in providing a risk management function in crude oil and other markets, in part because they can be individually tailored to a user's commercial needs and thereby reduce substantially the presence of basis risk. Because of this, the NYMEX concludes that permitting EFS transactions would reduce basis risk for NYMEX market participants, enhance competition among exchange and over-the-counter markets, and facilitate greater usage of NYMEX as a centralized market.

The NYMEX affirms that it has not identified any evidence suggesting that adoption of the proposal would harm existing liquidity in NYMEX markets. Moreover, the NYMEX concludes that the rule proposal would make the liquidity present in NYMEX energy markets accessible to swap market participants via the EFS process. Additionally, the NYMEX identifies the ability of swap participants to close out futures positions more readily, as the underlying futures contracts approach expiration, and thus utilize the exchange in managing price risk associated with swap market transactions as a potential benefit of the proposal.

The NYMEX also views the financial safeguards of the on-exchange trading environment as potentially beneficial, and attractive to, swap market participants. The NYMEX concludes that access to these financial safeguards, including those associated with the position limit and margining systems, either for purposes of creating or extinguishing swap agreements, would enable swap market participants to enhance the credit quality of swap positions. Thus, in summary, the NYMEX concludes that several benefits would accrue to market participants from adoption of the proposed rule, including improvements in liquidity and price transparency, and reductions in basis and credit risk.

(b) *Request for Comments.* The Commission is soliciting comments on the following questions:

(24) What are the economic reasons firms might have for engaging in EFS transactions and what benefits might accrue thereunder, including the potential benefits to domestic futures markets, to over-the-counter markets, and to financial markets generally?

(25) What are the potential costs or risks of permitting EFS transactions, particularly with respect to the effect on price discovery, risk transfer, and the competitive character of "on-exchange" transactions?

(26) Should the Commission approve the NYMEX rule proposal permitting EFS transactions?

(27) Should EFS transactions be limited to particular markets, participants or types of transactions?

(28) Should special provisions be established to ameliorate any competitive costs or otherwise safeguard the competitive conditions of the on-exchange market?

2. Exchanges of Options for Physicals

(a) *Background.* The EFP Report included an examination of EOPs.⁴⁷ The Division noted that the statutory sections governing options trading, Sections 4c(b) and 4c(c) of the Act,⁴⁸ do not provide for the extension of the Section 4c(a) exception for EFPs to options. The Division acknowledged that Regulation 1.38 provides for the execution of noncompetitive transactions pursuant to Commission-approved contract market rules and, on that basis, concluded that EOP transactions could potentially fall within the noncompetitive trade exception found in that regulation.

The EFP Report's investigation of contract market rules found that most were silent on the question of whether EOP transactions were acceptable, with only the Chicago Mercantile Exchange ("CME") rules expressly prohibiting EOP transactions.⁴⁹ Although the Amex Commodities Corporation ("ACC") adopted a rule permitting EOPs,⁵⁰ it subsequently withdrew that rule, apparently prior to the execution of any EOP transactions.

The Division staff that prepared the EFP Report were unable to discover any instances in which an option on a futures contract was exchanged for a cash commodity, and the Commission is not aware that any of these transactions have occurred since the publication of the report. The Division observed that the absence of these transactions could be due to the fact that market participants had not yet been able to design a plan to execute EOPs, perhaps

⁴⁷ EFP Report at 235-240.

⁴⁸ 7 USC 6c(b) and 6c(c).

⁴⁹ CME Rule 538.

⁵⁰ ACC Rule 908.

because of difficulty in establishing an appropriate basis relationship between the option and the cash commodity.

The EFP Report indicated that commentary from contract market officials and market participants on the EOP issue was divided. Some commenters objected on the basis that an option does not involve a delivery commitment. However, others indicated that EOPs could be appropriate in some circumstances. These commenters indicated that an EOP might be appropriate for the grantor of an option, who has a delivery commitment upon exercise, or in the case of a deep-in-the-money option, which as a practical matter appears to be the equivalent of a futures position. One commenter stated that EOPs were conceptually viable but that the instability associated with option deltas (and therefore option value) could create great risk for a person accepting an option in exchange for a cash commodity. This commenter also indicated that, assuming this risk was reflected in the price, EOP transactions could be very expensive.

(b) *Request for Comments.* The Commission is soliciting comments on the following questions:

(29) Are EOPs viable and do these transactions offer genuine risk management benefits?

(30) If so, should EOPs be permitted, and should there be limitations on EOPs that reflect the particular risk characteristics of options?

3. Alternative Execution Procedures

(a) *Current Procedures.* (1) Contract Market Large Order Procedures. The Commission has approved several contract market rules that establish alternative execution procedures for certain transactions. These procedures generally preserve the competitive forces available on a centralized market and thereby comply with the "open and competitive" requirement of Commission Regulation 1.38(a).

The CME, the New York Cotton Exchange ("NYCE") and the New York Futures Exchange ("NYFE") have adopted similar procedures providing for the execution of large orders.⁵¹ These

⁵¹ CME Rule 521 ("All-Or-None Transactions"); NYCE Rule 1.10-B ("Block Order Execution"); NYFE Rule 312 ("Block Order Execution").

The CME all-or-none procedures apply to a variety of products, including currency futures, South African Rand options, 28-day Mexican TIE futures, 91-day Mexican CETES futures, Brady Bond futures, IPC futures, Three-month Eurodollar futures bundle combinations, 13-week U.S. Treasury Bill futures, British Pound/Deutsche Mark and Deutsche Mark/Japanese Yen futures, and Argentine Par Bond futures. The minimum contract size eligible for execution under these procedures ranges from 20 contracts to 100 contracts. The NYCE limits its block order execution procedures

procedures may be used only upon customer request or if the large order bid or offer is the best price available to satisfy the terms of the order. A member makes a request for a large order bid and/or offer in the appropriate trading area. Responding members may make bids and/or offers at, above or below the current prevailing bid or offer in the underlying market for regular size orders. Only the best bid and/or offer shall prevail, and the large order must be filled on an all-or-none basis. The large order execution price does not trigger conditional orders in the underlying market, such as stop or limit orders.

The NYCE and NYFE expressly prohibit an initiating floor broker from bundling customer orders to meet the minimum contract size required for eligibility under the large order execution procedures, but allow a responding broker to bundle customer limit orders and to add orders from his or her own account to match the quantity of futures or options in the large order request. Under the CME all-or-none procedures, both the initiating floor broker and the responding floor broker may bundle customer orders to meet the minimum contract size as long as the customers specifically request execution under these procedures or the all-or-none bid or offer is the best price available to satisfy the terms of the orders. Although cross trades are not permitted at the NYCE and NYFE under these procedures, they are permitted at the CME. Large order transactions executed at all three exchanges must be reported to a designated Exchange official who records and publishes the quantity and prices separately from reports of transactions in the regular market.

The CME also has adopted separate large order execution ("LOX") procedures for transactions involving 300 or more futures contracts in the Standard & Poor's 500 Stock Price Index or the Nikkei Stock Average.⁵² These procedures, which include the pre-execution solicitation of interest and discussion of price, have only been used once in the several years they have been available.

The CME also has adopted request for size ("RFS") quotations for the GLOBEX

to transactions involving 50 or more FINEX futures or futures spreads, options spreads or futures/options combinations in the same contract. The NYFE limits its block order execution procedures to transactions involving 15 or more NYSE Large Composites, 30 or more NYSE Composite Index or 50 or more CRB futures or options, futures spreads, options spreads or futures/options combinations in the same contract.

⁵² CME Rule 549.

system. These procedures supplement the GLOBEX request for quote ("RFQ") procedures. As originally configured, RFQ messages were distributed without any contract quantity indication. Thus, the adoption of RFS procedures permits requests for large size transactions for all contracts traded through GLOBEX, subject to a minimum threshold quantity for RFS quotations of 100 contracts.⁵³

(2) Section 4(c) Contract Market Transactions. As noted previously, Section 4(c) of the Act vests the Commission with certain exemptive authority from the general requirement that all futures transactions must be executed on designated contract markets, subject to specified qualifying criteria. Part 36 of the Commission's regulations adopts certain exemptions under a pilot program for the establishment of separate professional markets which would have less restrictive requirements governing trading, reporting, and risk disclosure for eligible transactions than are applicable to current contract markets. Subject to certain recordkeeping and audit trail requirements, Part 36 procedures provide for the execution of noncompetitive transactions, regardless of size. In addition, these transactions are limited to certain Commission registrants and sophisticated and/or institutional traders which meet certain minimum asset requirements, including banks, trust companies, savings associations, credit unions, investment companies, commodity pools, certain business associations, employee benefit plans, government entities, broker-dealers, FCMs, floor brokers, floor traders, and certain other natural persons. A contract market may adopt trading rules permitting the execution of Part 36 transactions using any combination of noncompetitive execution procedures and competitive on-floor trading procedures.

No contract market has filed a proposal with the Commission pursuant to Section 4(c) and Part 36. Significantly, Part 36 only permits noncompetitive executions in specially-designated, stand-alone, professional markets. In contrast, the other noncompetitive trading methods discussed in this release are adjuncts to regular trading on or subject to the rules of a contract market.

(3) Securities Market Block Trading Procedures. Block trading in securities markets differs substantially from that on Commission designated contract

⁵³ The CME recently lowered the minimum threshold quantity for RFS quotations for currency futures traded through GLOBEX to 50 contracts.

markets. Blocks may be traded on securities exchanges, in over-the-counter securities markets, or through "principal-to-principal" trade execution venues. In the securities industry, a block trade is commonly defined as a transaction involving 10,000 or more shares or a quantity of stock having a market value greater than or equal to \$200,000. In recent years, block trading in securities markets has increased as a percentage of reported trading volume.⁵⁴

The New York Stock Exchange ("NYSE") and the Chicago Board Options Exchange ("CBOE") have rules providing for block trading.⁵⁵ A customer desiring to trade a block of NYSE-listed stocks contacts a block trader. Depending on the block trader's assessment of market demand and supply, the block trader may notify the Specialist of the pending block trade.⁵⁶ If notified, the Specialist may indicate an interest in participating in the block. The block trader then must decide whether to "position" the entire block by serving as the counterparty or "shop the block" by seeking customers to take the other side of the trade. The block trader may also combine these strategies by positioning part of the block and seeking customers for the remaining shares. Upon agreement of a price for the block,⁵⁷ the block order is transmitted to the NYSE floor for crossing against the block trader's house account or against other customer orders as arranged in "shopping the block."

Block orders crossed on the NYSE floor must comply with NYSE rules, including the following. Block orders within the current market quotation must first be offered publicly at a price higher than the member's bid by the minimum variation applicable to that stock so that the trading crowd may

participate in the block at that publicly offered price, before the member may proceed with the cross transaction.⁵⁸ Block orders crossed outside the current market quotation must be disclosed to the Specialist.⁵⁹ Where the member is holding agency orders on both sides of the market, he or she must probe the market to determine whether more stock would be lost than is reasonable under the circumstances to orders in the crowd.⁶⁰ Where the member is serving as the counterparty of the block and where all or any portion of the block establishes or increases his or her position, the member must fill all limit orders at the post for the clean-up price or better at the clean-up price, before any amount may be retained for the member's account.⁶¹ As an anti-manipulation safeguard, when a member holds any part of a long position in a stock in its trading account as a result of a block trade it completed with a customer, the member is precluded from effecting certain transactions in this stock on the same trading day in which the block trade was executed.⁶²

At the CBOE, a member or member organization may solicit another member, member organization, non-member customer or broker-dealer ("solicited person") to take the opposite side of a large-sized order ("original order").⁶³ The member representing the

⁵⁸ NYSE Rule 76.

⁵⁹ NYSE Rule 127(b).

⁶⁰ NYSE Rule 127(c). If the member representing the block orders decides that the amount of stock that would be lost is not excessive, then he or she announces the clean-up price to the crowd and fills at such price all agency limit orders at the post for the clean-up price or better. The member then crosses the remaining block orders at the clean-up price.

If the member decides that the amount of stock that would be lost is excessive, then he or she either may return to the block customers to negotiate a new clean-up price or may limit participation in the block by members at the post. The member limits participation merely by informing the crowd that they cannot participate freely in the block. After such an announcement, the member follows the crossing procedures set forth in NYSE Rule 76 and makes a bid and offer for the full amount of the block. A "reasonable" time must elapse before the cross is completed in order to provide the crowd, including the Specialist, the opportunity to execute superior priced bids or offers to provide price improvement. Thereafter, the member crosses the orders for the remaining shares at the clean-up price. The member is not required to fill at the clean-up price orders limited to the clean-up price or better. The block is entitled to priority at the proposed clean-up price.

⁶¹ NYSE Rule 127(d)(1).

⁶² NYSE Rule 97.

⁶³ CBOE Rule 6.9. CBOE Rule 6.9 specifically allows solicited transactions by "a member or member organization representing an order respecting an option traded on the Exchange * * * including a spread, combination, or straddle order as defined in Rule 6.53 and a stock-option order as defined in Rule 1.1(ii)."

original order must disclose the terms and conditions of that order to the trading crowd before it can be executed.⁶⁴

In order to promote disclosure at the inception of the solicitation period and to encourage solicited persons to bid or offer at prices that improve the current market, the CBOE rule establishes a series of priority principles for these solicited transactions. Priority depends upon whether the original order is disclosed throughout the solicitation period, whether the solicited order improves the best bid or offer in the crowd and whether the solicited order matches the original order's limit.

If the terms and conditions of the original order are disclosed to the trading crowd prior to any solicitation and the order is continuously represented in the crowd throughout the solicitation process, then the following rules apply. If the solicited order matches the original order's limit and improves the best bid or offer in the trading crowd, then the solicited order has priority over the crowd and may trade with the original order at the improved bid or offered price subject to the customer limit order book priorities set forth in CBOE Rule 6.45.⁶⁵ If the solicited order does not match the original order's limit, but improves the best bid or offer in the crowd and the original order is subsequently modified to match the solicited order's bid or offer, then the terms of the original order, as modified, must be disclosed to the trading crowd. The crowd has priority to trade with the modified original order before this order may be crossed with the solicited order.⁶⁶ If the solicited order does not match the original order's limit and meets but does not improve the best bid or offer in the trading crowd and the original order is subsequently modified to match the solicited order's bid or offer, then the trading crowd has priority to trade with

⁶⁴ CBOE Rule 6.9(d). However, the member is not required to announce to the trading crowd that another person has been solicited to participate in the order. The initiating member simply must disclose all the terms and conditions of the original order and any modifications to the trading crowd.

⁶⁵ CBOE Rule 6.9(a).

Under CBOE Rule 6.45, the highest bid or lowest offer has priority. Where two or more bids (offers) for the same option contract represent the highest (lowest) price, the bid (offer) that is displayed in the customer limit order book shall have priority over any other bid at the post. If two or more bids (offers) represent the highest (lowest) price and the customer limit order book is not involved, then priority is determined according to the sequence in which the bids (offers) were made.

The procedures set forth in CBOE Rule 6.74 govern the crossing of original orders with solicited orders, except when the solicited party has priority as is the case under CBOE Rule 6.9(a).

⁶⁶ CBOE Rule 6.9(b).

⁵⁴ In 1996, block trading on the New York Stock Exchange comprised 55.9% of the exchange's reported volume, or 2,348,457 transactions accounting for 58.5 billion shares. *New York Stock Exchange Fact Book 1996*, at 16 (May 1997).

⁵⁵ NYSE Rule 127; CBOE Rule 6.9.

⁵⁶ NYSE Rule 127(a).

⁵⁷ When positioning a block, the block trader quotes a tentative price for the stock to the block customer, and the customer may tentatively accept this price. Barring an extreme and unexpected movement in the price of the stock, the customer may be reasonably assured of execution at the quoted price.

When a block trader "shops a block," the trader contacts one or more potential customers to take the opposite side of the block at a specified price. The block trader might be willing to negotiate this price depending on how interested other investors are in participating in the block. The block trader continues to "shop the block" until he or she has a sufficient quantity of orders for the opposite side at a single price. At this point, the block trader returns to the block customer and confirms the customer's interest in the block transaction at the negotiated price, also known as the "clean-up" price.

the modified original order at the best bid or offered price subject to the customer limit order book priorities.⁶⁷ Finally, where the terms and conditions of the original order have not been disclosed in advance of the solicitation, the trading crowd has priority to trade with the original order at the best bid or offered price subject to the customer limit order book priorities before the original order may be crossed with the solicited order.⁶⁸

CBOE members and their associated persons who have knowledge of all the material terms and conditions of an imminent, undisclosed solicited transaction are prohibited from certain trading in an option of the same class that is the subject of the solicited transaction, the underlying security or any related instrument. That prohibition is in effect until the original order and any modifications are disclosed to the trading crowd or until the solicited transaction can no longer reasonably be considered imminent in view of the passage of time since the solicitation.⁶⁹

Block trading also is carried out on regional securities exchanges and in over-the-counter securities markets. The procedures governing block trades in these markets are generally less complex than those applicable at the NYSE. Block trades for stocks listed on regional exchanges are negotiated off-floor and in most cases must be crossed on the floor of the exchange. Moreover, traders generally do not have to accommodate limit orders. Over-the-counter block trades are arranged by a block trader who then crosses the resulting orders.

Another venue for securities block trading involves "principal-to-principal" systems. Generally, block customers directly enter trade quantities and bid/ask prices into a computerized system, which matches the orders according to the availability of bids and offers at matching prices. In addition, block customers may execute block trades themselves, off-exchange, without the assistance of a broker or block trader.

(b) *Potential Procedures.* Certain participants in the futures markets have suggested that the competitive execution requirements under the Commission's regulations be relaxed to permit block trading procedures similar to those in the securities exchange and over-the-counter markets. As noted previously, the proviso to Commission

Regulation 1.38(a) permits noncompetitive transactions if executed pursuant to contract market rules that have been approved by the Commission.

One of the purposes of this release is to investigate whether there are alternative, noncompetitive execution procedures that would further the policies and purposes of the Act. If so, the Commission seeks to determine the extent to which these procedures could be structured to serve the purposes of market participants while not sacrificing customer protection. The procedures might be limited according to order size, class of participant, contract, or some other category. In addition, the Commission seeks to determine the extent to which the procedures would be, and should be, similar to securities market procedures.

The following examples, while not exhaustive, illustrate the range of possibilities. The least significant modification of current open and competitive procedures would expressly permit market participants to alert potential counterparties of their interest in trading in a particular market at a particular time. Actual execution would occur pursuant to existing competitive procedures.

A more significant departure from current procedures would permit market participants to divulge not only a general interest in trading but also specific information about quantity and price to potential counterparties. Again, actual execution would occur competitively. This might be analogous to the practice of "shopping the block" in securities markets.

A further variation would permit negotiation between market participants. This would permit some degree of prearrangement although the execution price would to some extent remain subject to prices in the competitive market.

Yet another variation would adjust execution procedures to confer a degree of priority on particular orders that they might not attain in the open and competitive process. Such priority could be conferred, for example, on certain retail orders or on certain marketmaker orders.

Finally, market participants could be permitted to execute certain transactions bilaterally, away from the centralized marketplace, and simply report them to the exchange and clearing house. This would be similar to the way EFPs are handled currently.

Each of these alternatives potentially raises concerns, including, among others:

the impact on liquidity; the potential for manipulation; and the potential for mispricing, frontrunning, or other customer fraud.

Any proposed procedure would have to address such concerns. The need for safeguards is discussed further below.

(c) *Request for Comments.* The Commission is soliciting comments on the following questions:

(31) Should alternative, noncompetitive execution procedures be permitted on or subject to the rules of a contract market?

(32) If so, how should these procedures be structured to address regulatory concerns?

(33) Should these procedures be limited by order size, participant class, contract, or some other criteria?

(34) Can adequate safeguards be devised in connection with these procedures to prevent manipulation?

(35) Can adequate safeguards be devised in connection with these procedures to prevent fraud?

B. Qualifying Standards

1. The Need for Standards

The preceding discussion identifies particular types of transactions that might be appropriate for noncompetitive execution, such as EFS transactions or block trades. The common thread connecting these types of transactions with one another and with EFPs is their potential ability to fulfill some particularized need of market participants that the traditional open and competitive execution methods cannot fulfill as well. Congress has implicitly found with respect to EFPs that, at least under some circumstances, they provide certain benefits although their pricing and execution occurs outside of the centralized, open and competitive marketplace. To permit other types of noncompetitive transactions, the Commission would have to make a similar finding. For example, a contract market seeking approval of new procedures could address the effect of the proposal on the contract market's usefulness as a vehicle for price discovery and risk transfer. If the proposal had the potential to affect those functions adversely, the contract market could try to demonstrate countervailing benefits. The contract market also could address, pursuant to Section 15 of the Act,⁷⁰ whether its proposal was the least anticompetitive means of achieving its objective. Moreover, a contract market might show that these transactions are structured in such a way as to complement the competitive market, not to supplant it.

⁶⁷ CBOE Rule 6.9(c).

⁶⁸ CBOE Rule 6.9(d).

⁶⁹ CBOE Rule 6.9(e). This trading restriction applies to the solicited party as well as to any other member or associated person who has knowledge of all the material terms and conditions of both the original and solicited orders, including the price.

the impact on price discovery;

⁷⁰ 7 U.S.C. 19.

2. Request for Comments

The Commission seeks input on the general qualifying standards that should govern a proposal's eligibility for approval and how compliance with such standards would be demonstrated. The Commission is soliciting comments on the following questions:

- (36) What are the appropriate qualifying standards for noncompetitive transactions concerning:
- the effect on the usefulness of a designated futures contract as a hedging mechanism?
 - the effect on the price discovery function of a designated futures contract?
 - the effect on the level of financial integrity in a designated contract market?
 - the effect on the level of customer protection in a designated contract market?
- (37) Should access to noncompetitive transactions be limited to commercials or sophisticated investors?
- (38) Should noncompetitive transactions be subject to contract market rules?
- (39) Are there other appropriate qualifying standards?

C. Continuing Regulatory Requirements

1. The Need for Requirements

As discussed above, in addition to determining whether an EFP is bona fide, there is a need for appropriate regulatory oversight in areas such as reporting and recordkeeping, disclosure, and internal controls. Similar considerations apply to other types of noncompetitive transactions.

2. Request for Comments

The Commission seeks input on any additional requirements that should apply to a potential noncompetitive transaction, once it is determined that the transaction meets basic eligibility standards. To that end, the Commission has identified the following areas where it appears that additional qualifying requirements would be required in order to maintain systemic integrity and to provide guidance to self-regulatory entities. The Commission seeks input both as to whether the prospective requirement is necessary and, if so, how the requirement could be structured to provide a meaningful test. The Commission is soliciting comments on the following questions:

- (40) What are the appropriate standards to ensure that noncompetitive transactions are bona fide and meet basic qualifying requirements on an ongoing basis?
- (41) What are the appropriate reporting and recordkeeping requirements applicable to these transactions?
- (42) What are the appropriate disclosure requirements applicable to these transactions?
- (43) What are the appropriate internal controls applicable to these transactions?

(44) What are the appropriate safeguards to maintain an adequate level of transparency?

(45) What are the appropriate safeguards to prevent manipulation?

(46) What are the appropriate safeguards to prevent fraud?

IV. Execution Facilities for Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market

A. Current, Proposed and Potential Facilities

As noted in the Introduction, several organizations have developed execution facilities for transactions that are executed off-exchange and reported to contract markets as EFPs. As with the procedures discussed in the previous section, these facilities expand the opportunity for market participants to engage in the negotiation of transactions off the floor of the exchange. It appears, however, that there are significant structural differences between these facilities and traditional methods for the execution of EFPs. The latter generally appear to take a bilateral, over-the-counter approach to the negotiation of trades.

Unlike traditional approaches, these execution facilities provide a formal market environment for the negotiation and arrangement of transactions, are typically operated by third parties, and may be beyond the operational and regulatory purview of contract markets to some extent. In this respect, however, the Commission also recognizes that these facilities perhaps should be characterized as noncompetitive only in the sense that the transactions executed thereon are completed outside of designated contract markets. Thus, unlike the execution procedures on a contract market, the execution procedures on one of these facilities have not been formally reviewed and approved by the Commission for compliance with the open and competitive requirements of the Act and other statutory requirements. The Commission acknowledges that an execution facility's centralized structure may provide a market environment that facilitates the competitive execution of transactions and also may provide competitive benefits for the underlying contract markets.

This section includes a discussion of existing facilities, proposed facilities, and potential facilities and presumes that the futures leg of the transaction is reported to and cleared by an existing contract market clearing organization. Generally, the request for comments relative to this section seeks input as to whether the regulatory environment applicable to such transactions

continues to be appropriate in light of the growth and evolution of activity on such facilities or whether some form of additional oversight is needed. As more fully set out below, the Commission's request for comments also seeks input on the appropriate form of any prospective regulatory actions applicable to these facilities.

1. Interdealer Brokers

There are six major interdealer brokers in the cash U.S. Treasury securities market.⁷¹ All or most offer basis trading facilities. As noted above, a basis trade involves the simultaneous acquisition of positions in actual Treasury securities and in offsetting futures contracts. Transactions through these facilities must meet minimum trade sizes as well as other qualifying requirements.

It appears that at least a minimal level of transparency is maintained for basis trading on these facilities, although it is not clear whether that level is completely adequate. Information on these basis trades is obtained through reports published over screen-based news reporting services, such as Govpx or Bloomberg. The screens are anonymous, except that firms may be identified for basis trade quotations.

It also appears that these firms restrict their activities to dealing only with primary dealers and other large institutional entities. The interdealer brokers do not reveal counterparty names, and anonymity is thereby maintained. Trades generally are cleared through the Government Securities Clearing Corporation ("GSCC"), and anonymity is maintained even after a trade is consummated. GSCC nets the cash market legs of the basis trades.

2. The Chicago Board Brokerage

The CBT is developing a computerized system for, among other things, basis trading of U.S. Treasury securities. The system will be operated by the Chicago Board Brokerage ("CBB"), a subsidiary of the CBT, which is registered with the Securities and Exchange Commission ("SEC") as a broker/dealer.

Pricing of basis trades on the CBB system will be carried out according to a standardized formula. The futures leg will be assigned a price equal to the last sale price for the futures contract. The cash Treasury leg will be assigned a price according to the basis spread relative to the price of the futures leg. The price of the cash Treasury leg also will be adjusted to account for

⁷¹ The six are Cantor Fitzgerald, Liberty, RMI, Tullet & Tokyo, Garban, and Hilliard & Farber.

differences between the coupon rate of the actual Treasury security and the standardized 8 percent coupon rate of the futures contract. The cash leg will be cleared through the Clearing Corporation for Options and Securities ("CCOS"), a subsidiary of the Board of Trade Clearing Corporation ("BOTCC") which is registered as a clearing agency with the SEC. The futures leg will be cleared through the CBT and BOTCC pursuant to rules governing EFP transactions.

3. Potential Facilities for Transactions Other Than EFPs

The interdealer brokers and the CBB are facilities for the execution of EFPs. If the Commission were to permit other types of noncompetitive trading, such as block trading, facilities might be established for the execution of those types of transactions. For example, a computerized, bulletin board system might be established in connection with the execution of blocks. The Commission, of course, before approving relevant contract market rules, would have the opportunity to review procedures relating to these trades. Nonetheless, as discussed below, the Commission is requesting comments as to the appropriate form of regulatory oversight for these facilities.

B. Qualifying Standards

1. Current Requirements

Basis trades executed through these facilities currently are subject to the same regulatory requirements as any other EFP transaction. The Commission's oversight of these facilities does not differ in any way from its oversight of the EFP markets generally. The Commission is concerned that the nature of the transactions executed on these facilities and the environment in which they are executed may differ enough from the nature of traditional EFPs as to warrant differing regulatory treatment. Indeed, it could be argued that some of these facilities have evolved to the extent that they are functionally the equivalent of designated contract markets.

2. Request for Comments

The Commission seeks input on the regulatory structure appropriate for these execution facilities. At a threshold level, this area of inquiry seeks comments on whether the existing regulatory structure appears adequate as currently organized and administered. To the extent that a commenter believes the current approach is adequate, a supporting rationale should be set forth. To the extent that a commenter believes

the current approach is deficient, the Commission seeks comments identifying the nature of the deficiency and whether new guidelines or standards are required. Where a commenter believes that new regulatory initiatives are required, the Commission seeks comments on the form and nature of any such initiatives. Any such comments should include a supporting rationale.

Specifically, the Commission is soliciting comments on the following questions:

(47) What characteristics distinguish execution facilities for EFPs from contract markets?

(48) Is the current regulatory approach concerning these facilities adequate?

(49) If not, what modifications are appropriate?

(50) If execution facilities were established for noncompetitive transactions other than EFPs, how, if at all, should the regulatory approach that would apply to those facilities vary from that currently applicable to contract markets?

(51) Should execution facilities for EFPs and other noncompetitive transactions that are operated by non-contract markets be subject to oversight by the relevant contract market?

(52) Should these facilities limit access to commercials or sophisticated investors?

(53) Should these facilities be subject to procedures to prevent manipulation?

(54) Should these facilities be subject to procedures to prevent fraud?

(55) Should these facilities be subject to procedures to ensure that transactions executed thereon are bona fide?

(56) Should these facilities be subject to procedures to provide for market transparency?

(57) Should these facilities be subject to procedures related to reporting and recordkeeping?

V. Summary of Request for Comments

After reviewing the comments, the Commission will determine whether rulemaking or other action is appropriate. Commenters are invited to discuss the broad range of concepts and approaches described in this release. The Commission specifically invites commenters to compare the advantages and disadvantages of the possible changes discussed above with those of the existing regulatory framework. In addition to responding to the specific questions presented, the Commission encourages commenters to submit any other relevant information. In sum, the Commission is soliciting comments on the following questions:

Overview

(1) Should the standards articulated in the EFP Report be codified in the Commission's regulations and/or refined in any way?

(2) Should other types of noncompetitive transactions, such as EFS transactions or block trades, be permitted to be executed on or subject to the rules of a contract market and, if so, what standards should apply to these transactions?

(3) What standards should be applicable to execution facilities for noncompetitive transactions executed on or subject to the rules of a contract market?

Elements of a Bona Fide EFP: Relationship of the Instruments

(4) How should the "strong price correlation" standard articulated in the EFP Report be implemented?

(5) Should the Commission require contract markets to adopt a minimum statistical correlation coefficient to be used in assessing the acceptability of a particular cash commodity for use as the cash leg of an EFP?

(6) If a minimum correlation coefficient is required, should this coefficient apply to all EFPs, or should it be adjusted to account for the different commodities involved in EFPs?

(7) What is the appropriate type and scope of guidance contract markets should be required to provide to the general public concerning the acceptability of particular commodities as the cash leg of an EFP?

Elements of a Bona Fide EFP: Relationship of the Parties

(8) What is the appropriate scope of the separate parties requirement?

(9) Should the Commission address string trades as that practice is described in the EFP Report and, if so, how?

Elements of a Bona Fide EFP: Nature of the Transaction

(10) What criteria are appropriate for judging whether the futures leg of an EFP is bona fide?

(11) What criteria are appropriate for judging whether the cash leg of an EFP is bona fide?

(12) What criteria are appropriate for determining whether a transitory EFP is bona fide?

(13) What criteria are appropriate for determining whether an EFP is contingent?

Elements of a Bona Fide EFP: Price of the Transaction

(14) Should the Commission require both the futures and cash legs of an EFP to be priced within the daily range of their current respective markets, should it require only one leg of an EFP to be priced within its daily range, or should it impose no restrictions on the price of either leg of an EFP?

(15) Should the Commission require contract markets to obtain documentation regarding the business purpose underlying the pricing of an EFP?

Other Regulatory Requirements Governing EFPs: Reporting and Recordkeeping

(16) Are the current reporting and recordkeeping requirements relating to EFPs adequate?

Other Regulatory Requirements Governing EFPs: Disclosure

(17) What should be the form and content of disclosure concerning EFPs?

(18) Should the form and content of disclosure vary according to the commercial sophistication of the EFP participant similar to the Commission's proposed amendment to Regulation 1.55?

(19) Should the Commission explicitly require that customers must be informed that an EFP is executed noncompetitively, that it involves a cash transaction, and that their FCM might take the opposite side of the EFP?

(20) Should the Commission explicitly require Commission registrants to obtain customer consent before executing an EFP on the customer's behalf?

Other Regulatory Requirements Governing EFPs: Internal Controls

(21) What internal controls are appropriate for Commission registrants to ensure compliance with regulatory requirements concerning the essential elements of bona fide EFPs, reporting and recordkeeping, and disclosure?

Other Regulatory Requirements Governing EFPs: Transparency

(22) Do existing price reporting standards provide adequate transparency concerning EFPs to the marketplace and, if not, are there alternative methods of achieving improved price transparency?

(23) Should the Commission require contract markets to publicize information about bids and offers, as well as consummated EFP transactions?

Types of Eligible Transactions: Exchanges of Futures for Swaps

(24) What are the economic reasons firms might have for engaging in EFS transactions and what benefits might accrue thereunder, including the potential benefits to domestic futures markets, to over-the-counter markets, and to financial markets generally?

(25) What are the potential costs or risks of permitting EFS transactions, particularly with respect to the effect on price discovery, risk transfer, and the competitive character of "on-exchange" transactions?

(26) Should the Commission approve the NYMEX rule proposal permitting EFS transactions?

(27) Should EFS transactions be limited to particular markets, participants or types of transactions?

(28) Should special provisions be established to ameliorate any competitive costs or otherwise safeguard the competitive conditions of the on-exchange market?

Types of Eligible Transactions: Exchanges of Options for Physicals

(29) Are EOPs viable and do these transactions offer genuine risk management benefits?

(30) If so, should EOPs be permitted, and should there be limitations on EOPs that reflect the particular risk characteristics of options?

Types of Eligible Transactions: Alternative Execution Procedures

(31) Should alternative, noncompetitive execution procedures be permitted on or subject to the rules of a contract market?

(32) If so, how should these procedures be structured to address regulatory concerns?

(33) Should these procedures be limited by order size, participant class, contract, or some other criteria?

(34) Can adequate safeguards be devised in connection with these procedures to prevent manipulation?

(35) Can adequate safeguards be devised in connection with these procedures to prevent fraud?

Qualifying Standards

(36) What are the appropriate qualifying standards for noncompetitive transactions concerning:

- the effect on the usefulness of a designated futures contract as a hedging mechanism?
- the effect on the price discovery function of a designated futures contract?
- the effect on the level of financial integrity in a designated contract market?
- the effect on the level of customer protection in a designated contract market?

(37) Should access to noncompetitive transactions be limited to commercials or sophisticated investors?

(38) Should noncompetitive transactions be subject to contract market rules?

(39) Are there other appropriate qualifying standards?

Continuing Regulatory Requirements

(40) What are the appropriate standards to ensure that noncompetitive transactions are bona fide and meet basic qualifying requirements on an ongoing basis?

(41) What are the appropriate reporting and recordkeeping requirements applicable to these transactions?

(42) What are the appropriate disclosure requirements applicable to these transactions?

(43) What are the appropriate internal controls applicable to these transactions?

(44) What are the appropriate safeguards to maintain an adequate level of transparency?

(45) What are the appropriate safeguards to prevent manipulation?

(46) What are the appropriate safeguards to prevent fraud?

Execution Facilities for Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market: Qualifying Standards

(47) What characteristics distinguish execution facilities for EFPs from contract markets?

(48) Is the current regulatory approach concerning these facilities adequate?

(49) If not, what modifications are appropriate?

(50) If execution facilities were established for noncompetitive transactions other than EFPs, how, if at all, should the regulatory approach that would apply to those facilities vary from that currently applicable to contract markets?

(51) Should execution facilities for EFPs and other noncompetitive transactions that are operated by non-contract markets be subject to oversight by the relevant contract market?

(52) Should these facilities limit access to commercials or sophisticated investors?

(53) Should these facilities be subject to procedures to prevent manipulation?

(54) Should these facilities be subject to procedures to prevent fraud?

(55) Should these facilities be subject to procedures to ensure that transactions executed thereon are bona fide?

(56) Should these facilities be subject to procedures to provide for market transparency?

(57) Should these facilities be subject to procedures related to reporting and recordkeeping?

Issued in Washington, DC, on January 16, 1998.

Jean A. Webb,

Secretary.

[FR Doc. 98-1672 Filed 1-23-98; 8:45 am]

BILLING CODE 6351-01-P

DEPARTMENT OF DEFENSE

Office of the Secretary

Submission for OMB Review; Comment Request

ACTION: Notice.

The Department of Defense has submitted to OMB for clearance, the following proposal for collection of information under the provisions of the Paperwork Reduction Act (44 U.S.C. Chapter 35).

Title, Associated Form, and OMB Number: Customer Comments; AF Form 3211; OMB Number 0701-(to be determined).

Type of Request: New Collection.

Number of Respondents: 200.

Responses Per Respondent: 1.

Annual Responses: 200.

Average Burden per Response: 5 minutes.

Annual Burden Hours: 17.

Needs and Uses: Each guest of Air Force lodging and its contract lodging operations are provided access to AF Form 3211. AF Form 3211 gives each guest the opportunity to comment on facilities and service received.

Completion of the form is optional. The information collection requirement is necessary for Wing leadership to access the effectiveness of their lodging program. AF Form 3211 is useful as background documentation and supporting material for various management decisions. The information is reviewed by higher headquarters during lodging assistance and Innkeeper Award competitions.