International Monetary Fund – Financial Sector Assessment Program
Self Assessment of IOSCO Objectives and Principles of Securities Regulation

United States Commodity Futures Trading Commission

August 2009

INTRODUCTION

The CFTC is providing this self-assessment as part of the assessment of the United States being conducted by the International Monetary Fund ("IMF") under its Financial Sector Assessment Program ("FSAP"). One key component of the FSAP is an evaluation of the policies, practices, laws, and regulations administered by the CFTC against the IOSCO Core Principles of Securities Regulation ("Principles").

The Principles represent an agreed set of high-level principles against which a jurisdiction's securities[1] regulatory framework can be benchmarked and assessed. IOSCO has developed an extensive methodology to provide an assessment process for evaluating a jurisdiction's compliance with each Principle.

In preparation for the IMF's assessment, CFTC staff prepared a self-assessment as of August 25, 2009, of the Commission's compliance with the Principles, based upon IOSCO's assessment methodology. This paper sets forth CFTC staff's responses to key questions contained in the methodology, and is being provided by the CFTC to the IMF to facilitate review of the CFTC's compliance with the Principles.

An evaluation of compliance with the Principles must evaluate compliance at a particular point in time, must be governed by a regulatory agency's statutory mandate at that point in time, and must be based on the Principles and methodology as currently drafted. Notwithstanding these inherent characteristics of the evaluation process, the CFTC recognizes that the IMF assessment is being conducted in the midst of the most severe financial crisis since the Great Depression. The U.S. financial regulatory system failed. Structural weaknesses must be examined, and financial regulation and supervision in the U.S. must be strengthened. The CFTC is initiating regulatory reform within the parameters of its enabling statute, and also is pursuing legislative amendments to, among other things, bring currently unregulated OTC derivatives under a comprehensive regulatory structure and examine potential areas for harmonization of futures and securities markets regulation.

Notwithstanding the broad powers afforded the CFTC under the CEA and the CFTC's current compliance with the Principles, areas of regulatory interest include the following:

- **Promoting the regulation of over-the-counter derivatives**

  The CFTC is actively engaged in developing a comprehensive regulatory framework for OTC derivatives.

- **Strengthening requirements for clearing organizations**

  The CFTC is pursuing the adoption of stronger, more detailed core principles for derivatives clearing organizations to enhance the CEA regulatory regime for central

[1] As indicated in the Principles, the term "securities" should be understood to include derivatives where the context permits.

counterparties ("CCPs") and to assure that U.S. law is consistent with international standards for CCPs.

- **Ensuring greater transparency of the marketplace**

  The CFTC recently announced several initiatives designed to bring greater transparency to participation by non-commercial participants such as commodity index funds, swaps dealers, and others; positions of traders of contracts determined to perform a significant price discovery function; and positions for foreign contracts linked to the settlement price of domestic contracts.

- **Applying consistent position limits**

  The CFTC recently held public hearings on whether federal speculative limits should be set by the Commission for commodities of finite supply, in particular energy commodities. The CFTC also recently requested public comment on whether a "*bona fide* hedge exemption" should continue to apply to persons using the futures markets to hedge risks other than risks arising from the actual use of a commodity, and CFTC staff is considering the extent to which swap dealers should continue to be granted exemptions from position limits.

- **Enhancing conditions for foreign boards of trade trading energy contracts**

  To enhance its ability to conduct market surveillance and to maintain market integrity, the CFTC recently announced additional amendments to the terms under which a foreign board of trade ("FBOT") is permitted to make its electronic trading and order matching system available to exchange members in the U.S.

- **Strengthening regulation of retail off-exchange commodity transactions**

  The CFTC is working on legislative amendments to extend the Commission's fraud authority for off-exchange retail foreign exchange transactions to transactions in other commodities.

The CFTC understands that recent market events and the need for an enhanced regulatory framework may provide guidance for IOSCO to consider in the future when updating the Principles. The Commission is committed to working with other U.S. financial regulatory authorities and with regulators around the world to make meaningful progress on the critical issues facing financial markets. The CFTC also supports and is committed to IOSCO's ongoing work to update the Principles, as necessary, to better reflect today's financial markets and regulatory landscape.

To assist in reviewing this self-assessment, the CEA and CFTC regulations can be found on the Commission's Web site, *http://www.cftc.gov/lawandregulation/index.htm*.

BACKGROUND

The mission of the CFTC is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity futures and options, and to foster open, competitive, and financially sound commodity futures and option markets.

Commodity Futures Industry

Futures contracts on agricultural commodities have been traded in the United States for more than 150 years and have been under Federal regulation since the 1920s. At the time the Commission was established in 1974, the vast majority of futures trading took place on commodities in the agricultural sector. These contracts gave farmers, ranchers, distributors, and end users of everything from corn to cattle an efficient and effective set of tools to hedge against price movements.

Over the years, however, the futures industry has become increasingly diversified. While farmers and ranchers continue to use the futures markets as actively as ever to effectively lock in prices for their crops and livestock months before they come to market, highly complex financial contracts based on interest rates, foreign currencies, Treasury bonds, securities indices, and other products have far outgrown agricultural contracts in trading volume. The latest statistics show that approximately eight percent of on-exchange commodity futures and option trading activity occurs in the agricultural sector, while financial commodity futures and option contracts make up approximately 79 percent, and other contracts, such as those on metals and energy products, make up about 13 percent. Moreover, the electronic integration of cross-border markets and firms, as well as cross-border alliances, mergers, and other business activities, has transformed the futures markets and firms into a global industry.

These trillion-dollar futures markets, with massive economic force, are expanding steadily in both volume and new users and their complexity is rapidly evolving with new technologies, cross-border activities, product innovation, and greater competition.

How the CFTC is Organized and Functions

The CFTC consists of five Commissioners who are appointed by the President to serve staggered five-year terms. All Commissioners are confirmed by the Senate. No more than three sitting Commissioners may be from the same political party. The President designates one of the Commissioners to serve as Chairman, with the advice and consent of the Senate.

The Commission's functions are divided between program policy and internal management. The Office of the Chairman oversees the Commission's principal divisions and offices that administer the policies, regulations, and guidance regarding the Commodity Exchange Act, as amended. The Office of the Executive Director, by delegation of the Chairman, directs the internal management of the Commission, ensuring that funds are responsibly accounted for and that program performance is measured and improved effectively.

Attorneys at the Commission work on complex and novel legal issues in areas such as enforcement investigations and litigation, regulation, and policy development. Among other things, they prosecute administrative and civil enforcement proceedings; assist U.S. Attorneys in criminal proceedings charging futures law violations; develop regulations governing clearinghouses, exchanges, and intermediaries; provide a wide range of analysis, technical assistance, and guidance on regulatory, legislative, and supervisory issues; and provide legal advice to the Commission on policy and adjudicatory matters. In recognition of the globalization of the futures markets, attorneys represent the CFTC internationally in multilateral regulatory organizations, bilaterally with individual foreign regulators, and participate in country dialogues organized by the Treasury.

Auditors examine records and operations of futures exchanges, clearinghouses, and firms for compliance with financial requirements, while futures trading specialists perform regulatory and compliance oversight to detect potential fraud, market manipulations, and trade practice violations.

Economists evaluate filings for new futures and option contracts and amendments to existing contracts, to ensure they meet the Commission's regulatory standards. Economists also analyze the economic effect of various Commission and industry actions and events and advise the Commission accordingly. In addition, economists monitor trading activity and price relationships in futures markets to detect and deter price manipulation and other potential market disruptions.

The CFTC is headquartered in Washington, D.C. Regional offices are located in Chicago, Kansas City, and New York. Additional information about the Commission and its history can be obtained from the Commission's Office of External Affairs or through its Web site, *http://www.cftc.gov*.

LIST OF ABBREVIATIONS

U.S. Federal Law

APA	Administrative Procedures Act
CEA	Commodity Exchange Act
CFMA	Commodity Futures Modernization Act of 2000
CRA	CFTC Reauthorization Act of 2008
1974 Act	CFTC Act of 1974
1933 Act	Securities Act of 1933
1934 Act	Securities Exchange Act of 1934

CFTC Divisions and Offices

DCIO	Division of Clearing and Intermediary Oversight
DMO	Division of Market Oversight
DOE	Division of Enforcement
OGC	Office of the General Counsel
OHR	Office of Human Resources

U.S. Federal Departments and Agencies

CFTC or Commission	Commodity Futures Trading Commission
DOJ	Department of Justice
EPA	Environmental Protection Agency
FERC	Federal Energy Regulatory Commission
Federal Reserve	Board of Governors of the Federal Reserve System
FTC	Federal Trade Commission
SEC	Securities and Exchange Commission
Treasury	Department of Treasury
USDA	Department of Agriculture

Other Abbreviations

AML	Anti-Money Laundering
CDS	Credit Default Swaps
CME	Chicago Mercantile Exchange
CPO	Commodity Pool Operator
CTA	Commodity Trading Advisor
COT Report	*Commitment of Traders* report
DCM	Designated Contract Market
DCO	Derivatives Clearing Organization
DSRO	Designated Self-regulatory Organization
DTEF	Derivatives Transaction Execution Facility
ECM	Exempt Commercial Market
ECP	Eligible Contract Participant

EBOT	Exempt Board of Trade
FCM	Futures Commission Merchant
GAAP	Generally Accepted Accounting Principles
IB	Introducing Broker
ICE	Intercontinental Exchange
IOSCO	International Organization of Securities Commissions
IOSCO MMOU	IOSCO Multilateral Memorandum of Understanding
NFA	National Futures Association
OTC	Over-the-counter
PWG	President's Working Group
RER	Rule Enforcement Review
RFA	Registered Futures Association
SRO	Self-regulatory Organization
Staff	Staff of the CFTC

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THE REGULATOR

PRINCIPLES 1-5

Principle 1. The responsibilities of the regulator should be clear and objectively stated

Assessment: Fully Implemented

1) Are the regulator's responsibilities, powers and authority:

a) Clearly defined and transparently set out, preferably by law, and in the case of powers and jurisdiction, enforceable?

Yes. The CFTC is an independent federal agency established pursuant to the CEA. The responsibilities, powers and authority of the CFTC are clearly defined and transparently set forth in the CEA and CFTC regulations promulgated thereunder.[2] In particular, the jurisdiction of the CFTC is established under Section 2(a) of the CEA while the powers of the CFTC are set forth in Section 8a of the CEA.

It is the mission of the CFTC to protect the public interest by providing a means for managing and assuming price risks, discovering prices and/or disseminating pricing information through trading in liquid, fair and financially secure trading facilities. In order to foster the public interest, consistent with the CEA, the CFTC endeavors to detect and prevent price manipulation or any other disruptions to market integrity; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation.

The CEA vests the CFTC with exclusive jurisdiction over futures and commodity option transactions.[3] Subject to certain exceptions, and to the CFTC's authority to exempt certain transactions or categories of transactions from most provisions of the CEA, all

[2] *See* 7 U.S.C. 1, *et seq.*, and 17 C.F.R. 1, *et seq.*

[3] Section 2(a)(1)(A) of the CEA, 7 U.S.C. 2(a)(1)(A), grants the CFTC exclusive jurisdiction with respect to "accounts, agreements (including any transaction which is of the character of . . . an "option" . . .) and "transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated or derivatives transaction execution facility registered pursuant to section 7 or 7a of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 23 of this title." Section 1a(4) of the CEA defines the term "commodity" to mean wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in section 13–1 of this title, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in. The CEA specifically excepts from the CFTC's exclusive jurisdiction security futures products and the setting of margin levels for stock index futures contracts. In addition, certain financial products such as OTC derivatives, swap agreements and hybrid instruments are largely left outside of the CFTC's jurisdiction under the CEA.

transactions in commodity futures contracts and all commodity option transactions are required to occur on or subject to the rules of DCMs or DTEFs. Certain transactions, agreements and/or contracts may be traded on exempt markets that are exempt from substantive regulation by the CFTC. These markets, however, are generally subject to the CFTC's anti-fraud and anti-manipulation authority.[4]

Security Futures. Section 2(a)(1)(D) of the CEA,[5] and related securities laws, allocate jurisdiction over certain derivative products between the CFTC and the SEC. The SEC has authority to regulate options on securities, on groups and indices of securities, on certificates of deposit and on foreign currencies when traded on a national securities exchange.[6] The CFTC has exclusive jurisdiction over futures trading on government securities, foreign currency[7] and on certain non-narrow-based groups or indices of securities,[8] and over options on such futures.[9] In addition, security futures products—futures on individual stocks and narrow-based securities indexes—are subject to the joint jurisdiction of the CFTC and SEC.[10] Security futures products may be traded on any DCM or DTEF that also is notice registered with the SEC as a national securities exchange.[11] Security futures products may also be traded on any SEC-registered national securities exchange, national securities association, or alternative trading system that is notice designated as a DCM by the CFTC.[12]

Dealer/Trade Options. "Dealer options" are certain off-exchange options on physical commodities granted by persons domiciled in the U.S. who on May 1, 1978 were in the business of granting options on a physical commodity and in the business of buying, selling, producing, or otherwise using that commodity. "Trade options" are off-exchange commodity options which can be offered only to a commercial person or entity solely for purposes related to that person's commercial business.

Although the CEA regulatory framework generally contemplates that transactions in commodity options will take place on DCMs and DTEFs, CFTC regulations have made dealer/trade options exempt from most CEA regulatory provisions.[13]

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[4] *See infra*, section entitled *Trading Organizations*.

[5] 7 U.S.C. 2.

[6] *See* Section 9(g) of the 934 Act, 15 U.S.C. 78i. Section 4c(f) of the CEA, 7 U.S.C. 6c(f), provides that the CEA is inapplicable "to any transaction in an option on foreign currency traded on a national securities exchange."

[7] CEA 2(c)(1) and 2(c)(2)(A), 7 U.S.C. 2(c)(1) and 2(c)(2)(A).

[8] CEA 2 (a)(1)(c)(ii), 7 U.S.C. 2(a)(1)(c)(ii).

[9] *Id.*

[10] *See* Title II of the CFMA, Public Law 106-554 (December 21, 2000).

[11] *See* SEC, Securities Exchange Act Release No. 44692 (August 13, 2001), 66 FR 43721 (August 20, 2001).

[12] *See* 17 C.F.R. 41, 140; 66 FR 44960 (August 27, 2001).

[13] *See* Section 4c(d) of the CEA and Part 32 of the CFTC Regulations, 17 C.F.R. 32 (permitting off-exchange options that are offered and sold to commercial counterparties).

Treasury Amendment. Section 2(c)(1) of the CEA specifically excludes from the operation of the CEA transactions in foreign currency, government securities, security warrants, security rights, resale or installment loan contracts, repurchase transactions in excluded commodities, or mortgages, unless conducted on an organized exchange. The 1974 Act originally exempted from the CFTC's jurisdiction, among other things, contracts based on foreign currency and Treasury securities so long as the transactions did not involve the sale of a futures contract (or option thereon) or commodity options executed or traded on a futures exchange. This provision has been the subject of legal and regulatory uncertainty resulting in amendments through the CFMA[14] and the CRA.[15] As a result, the Treasury Amendment has been clarified so that the CFTC retains jurisdiction to regulate transactions in futures contracts (and options thereon) and commodity options based on Treasury Amendment instruments to the extent that such transactions occur on a DCM or DTEF. Certain OTC markets for Treasury Amendment instruments are accordingly excluded from regulation by the CFTC under the CEA. However, as set forth below,[16] the CRA has further detailed the CFTC's jurisdiction relating to off-exchange retail foreign currency transactions.

Foreign Currency Transactions. The CFTC has jurisdiction over foreign currency futures or options on foreign currencies (unless traded on a national securities exchange) entered into by persons who are not ECPs,[17] unless the counterparty is a bank, broker-dealer, FCM, or other specified regulated entity.[18] In addition, any agreement, contract or transaction in foreign currency that is offered on a leveraged or margined basis to someone who is not an ECP is subject to the CFTC's antifraud provisions as if the foreign currency contracts were "futures contracts."[19] However, the CFTC does not have jurisdiction over retail forex transactions that are entered into by a financial institution (except an FCM), a registered broker-dealer, an insurance company, a financial holding company or an investment bank holding company. In addition, the CFTC does not have jurisdiction over transactions that (1) result in actual delivery of the foreign currency in two days or less, or (2) create an enforceable obligation to deliver between a buyer and a seller who can effectuate such delivery in their line of business.

Hybrid Instruments. A "hybrid instrument" is defined in Section 1a(21) of the CEA to mean a security having one or more payments indexed to the value, level or rate of, or providing for the delivery of one or more commodities. The CFTC is not permitted to regulate hybrid instruments that are predominantly securities.[20] This provision enacted

[14] Public Law 106-554 (December 21, 2000).

[15] Public Law 110-246 (June 18, 2008).

[16] *See infra*, section entitled *Foreign Currency Transactions*.

[17] ECP is defined in Section 1a(12) of the CEA, 7 U.S.C. 1a(12), to included financial institutions, insurance companies, registered investment companies, highly-capitalized commodity pools, entities and employee benefit plans, governmental entities, certain broker-dealers, FCMs and floor brokers/traders and high net worth individuals.

[18] *See* Section 2(c)(2)(B) of the CEA, 7 U.S.C. 2(c)(2)(B).

[19] *See* Section 2(c)(2)(C)(iv) of the CEA, 7 U.S.C. 2(c)(2)(C)(iv).

[20] *See* Section 2(f) of the CEA, 7 U.S.C. 2(f).

as part of the CFMA effectively expanded the exemption provided by the CFTC's 17 C.F.R. 34 hybrid exemption.[21] A hybrid instrument is deemed to be predominantly a security and thus excluded from regulation under the CEA if: the issuer receives full payment of the purchase price of the instrument substantially contemporaneously with delivery of the instrument; the purchaser is not required to make any payment to the issuer in addition to the purchase price during the life of the instrument; the issuer is not subject, under the terms of the instrument, to mark-to-market margining requirements; and the hybrid is not marketed as a futures contract.

DCMs. DCMs are boards of trade that operate under the regulatory oversight of the CFTC, pursuant to Section 5 of the CEA, 7 U.S.C. 7.[22] DCMs are traditional futures exchanges that permit access to their facilities by all types of traders, including retail customers. DCMs may list for trading futures or options contracts based on any underlying commodity, index or instrument.

To obtain and maintain its designation, a DCM must comply with the following Designation Criteria established in Section 5(b) of the CEA, 7 U.S.C. 7(b), and Part 38 of the CFTC's Regulations:

- General demonstration of adherence to Designation Criteria;
- Prevention of market manipulation;
- Fair and equitable trading;
- Enforcement of rules on the trade execution facility;
- Financial integrity of transactions;
- Disciplinary procedures;
- Public access to information on the contract market; and
- Ability of the contract market to obtain trading information.

To obtain and maintain its designation, a DCM must also comply with 18 core principles established in Section 5(d) of the CEA, 7 U.S.C. 7(d), and Part 38 of the CFTC's regulations. Specifically, DCMs must comply on an initial and continuing basis with the following core principles: (1) general matters; (2) compliance with rules; (3) contracts not readily subject to manipulation; (4) monitoring of trading; (5) position limits or accountability rules; (6) emergency authority; (7) availability of general information; (8) daily publication of trading information; (9) execution of transactions; (10) trade information; (11) financial integrity of contracts; (12) protection of market participants; (13) dispute resolution; (14) governance fitness standards; (15) conflicts of interest; (16) composition of boards of mutually owned markets; (17) record keeping and (18) antitrust considerations.

[21] CFTC Regulation 34.2(a), adopted prior to the CFMA, defines "hybrid instrument" to mean an equity or debt security or depository instrument with one or more commodity-dependent components that have payment features similar to commodity futures or commodity options contracts or combinations thereof.

[22] Part 38 of the CFTC's regulations, 17 C.F.R. 38, details the procedures and requirements for operating a DCM.

DCMs may implement new rules or rule amendments or list new products by filing with the CFTC a certification that the rule or rule amendment complies with the CEA and CFTC Regulations and policies and/or by requesting approval from the CFTC.

DTEFs. DTEFs are trading facilities that limit access primarily to institutional or otherwise eligible traders and limit the products traded.[23] DTEFs, therefore, are able to operate under a lower level of regulation than a DCM. Two types of DTEF markets are provided for by Section 5a of the CEA, 7 U.S.C. 7a: regular DTEFs (or eligible participant DTEFs) and commercial DTEFs (or eligible commercial entity DTEFs).

All registered DTEFs must meet specified requirements set forth in Section 5a of the CEA and must adhere to 9 core principles on an ongoing basis: (1) general matters; (2) compliance with rules; (3) monitoring of trading; (4) disclosure of general information; (5) daily publication of trading information; (6) fitness standards; (7) conflicts of interest; (8) recordkeeping and (9) antitrust consideration.

Regular DTEFs. Regular DTEFs must limit the products that are traded. However, access is available to all eligible traders. Participants eligible to trade on a regular DTEF are generally limited to institutional traders and non-institutional traders trading through certain highly capitalized FCMs. Products eligible for listing on a regular DTEF are specified in Section 5a of the CEA, 7 U.S.C. 7a, which provides that DTEFs may list contracts based on underlying products that: have a nearly inexhaustible deliverable supply; have a deliverable supply that is sufficiently large that the contract is highly unlikely to be susceptible to the threat of manipulation; have no cash market;[24] are security futures products and the registered DTEF is a national securities exchange registered under the 1934 Act; or are futures and option contracts on commodities that the Commission may determine, on a case-by-case basis, are highly unlikely to be susceptible to the threat of manipulation, based upon characteristics of the market and the trading facility on which the product would be traded.

Exempt commodities[25] (*e.g.*, metals, energy products, and other nonagricultural commodities) would be eligible to trade on a regular DTEF, only as determined by the Commission.

Commercial DTEFs. Commercial DTEFs are available only to eligible commercial entities, as defined in Section 1a(11) of the CEA, 7 U.S.C. 1a(11), trading for their own accounts. The futures and option contracts eligible for trading on a commercial DTEF may be based on any commodity other than the enumerated agricultural commodities set

[23] Section 5a of the CEA, 7 U.S.C. 7a, and Part 37 of the CFTC's Regulations, 17 C.F.R. 37, set forth the requirements and procedures governing both types of DTEFs.

[24] The CFTC has determined that the commodities described in this bullet are defined as "excluded commodities" under Section 1a(13) of the CEA, 7 U.S.C. 1a(13). Section 1a(13) defines an "excluded commodity" to mean, among other things, an interest rate, exchange rate, currency, credit risk or measure, debt instrument, measure of inflation, or other macroeconomic index or measure.

[25] *See* Section 1a(14) of the CEA, 7 U.SC. 1a(14).

forth in Section 1a(4) of the CEA. Participants eligible to trade on a commercial DTEF include "eligible commercial entities," as defined in Section 1a(11) of the CEA, 7 U.S.C. 1a(11), trading for their own accounts, as well as registered floor brokers or floor traders trading for their own accounts whose trading obligations are guaranteed by a registered FCM.

Exempt Markets. Exempt markets are exempted from most regulatory requirements of the CEA and the CFTC regulatory framework. There are two kinds of exempt markets—ECMs and EBOTs.

Exempt markets are not registered with, or designated, recognized, licensed or approved by the CFTC. To be exempt from most CFTC regulatory oversight, the exempt market must satisfy the conditions for the exemption, including a requirement to notify the CFTC of the market's intention to rely on the exemption. If the exempt market is performing a price discovery function, the market must provide certain pricing information to the public.

ECMs. Agreements, contracts, and transactions in exempt commodities that are traded on a principal-to-principal basis on electronic trading facilities between eligible commercial entities may be traded on an ECM and be exempt from regulation.[26] ECMs transactions are generally not subject to the CFTC's enforcement jurisdiction, except for fraud and manipulation authority.

Although ECMs trading exempt commodities are generally exempt from regulation, Section 2(h)(7) of the CEA, 7 U.S.C. 2(h)(7), recently enacted as part of the CRA, does provide CFTC regulation and oversight relating to significant price discovery contracts ("SPDCs")[27] that may be traded on ECMs. The CFTC will determine whether a particular contract is a SPDC based on the following factors: price linkage, arbitrage, material price reference and material liquidity.[28] If a contract is determined to be a SPDC, the ECM must show it complies with 9 core principles, which provide that any ECM, with regard to SPDCs traded on that ECM, shall: (1) list only SPDCs that are not readily susceptible to manipulation; (2) monitor trading in SPDCs to prevent market manipulation, price distortion and disruptions of the delivery or cash-settlement process; (3) establish and enforce rules that allow the ECM to obtain any necessary information to maintain regulatory compliance; (4) adopt position limits or position accountability for speculators in SPDCs; (5) adopt rules to provide for the exercise of emergency authority; (6) make public daily information on price, trading volume and other trading data to the extent appropriate for SPDCs; (7) monitor and enforce compliance with the rules of the

[26] *See* Section 2(h) of the CEA, 7 U.S.C. bgate.access.gpo.gov/the CFTC Regulations.

[27] A "SPDC" is an agreement, contract or transaction that is traded or effected on an ECM and which exhibits certain characteristics indicating that it serves a significant price discovery function.

[28] *See* Section 2(h)(7) of the CEA, 7 U.S.C. 2(h)(7) and CFTC Regulation 36.3 and Appendix A to Part 36. CFTC Regulation 36.3 sets forth the process of determining whether a particular contract is a SPDC. *See also* CFTC, 17 C.F.R. Parts 15, 16, 17, 18, 19, 21, 36 and 40, *Significant Price Discovery Contracts on Exempt Commercial Markets*, 74 FR 12178 (March 23, 2009).

ECM; (8) establish and enforce rules to minimize conflicts of interest in the decision-making process of the ECM; and (9) avoid adopting any rules or taking any actions that result in any unreasonable restraints of trade.

EBOTs. Transactions by ECPs in a certain narrow list of selected commodities may be conducted on an EBOT and be exempt from regulation if such commodities have a nearly inexhaustible deliverable supply; have a deliverable supply that is sufficiently large that the contract is highly unlikely to be susceptible to the threat of manipulation; or have no cash market.[29] EBOT transactions that meet the requirements for the Section 5d exemption are not subject to the CFTC's regulatory or enforcement jurisdiction except for certain limited fraud and manipulation authority.

Commodity Pools. The solicitation of funds for investment in a commodity pool[30] constitutes the offer of a "security" that necessitates compliance with certain provisions of the 1933 Act and the 1934 Act.[31] Separately, the CFTC maintains jurisdiction over the operation of commodity pools and has issued regulations mandating, among other things, certain required disclosures in connection with the offer of a pool.[32] As a practical matter, public offers for commodity pools generally are made by one prospectus that complies with both the securities laws and the CFTC's commodity pool regulations. Although the majority of all commodity pools are private placements, and therefore, only subject to CFTC substantive regulation,[33] increasingly, issuers of exchange-traded funds ("ETFs") have launched commodity-based ETFs for trading on national securities exchanges. As a result, these funds are subject to "dual" regulation by both the CFTC and SEC consisting of CPO registration and regulation, disclosure requirements under both the CEA and federal securities laws and securities exchange regulation.

CFTC Regulation 4.5, 17 C.F.R. 4.5, excludes from the definition of CPO, and therefore application of the CEA and CFTC regulations related to pools and their related advisors, certain collective investment vehicles that are otherwise regulated entities, such as registered investment companies, insurance company separate accounts, banks and trust companies and certain defined benefit (pension) plans. CFTC Regulation 4.13, 17 C.F.R. 4.13, also provides exemptions from CPO registration for CPOs that meet specified criteria, including small or family pools, pools that engage in minimal futures trading, or those that limit participation to certain sophisticated investors. The CFTC, pursuant to Regulation 4.12, 17 C.F.R. 4.12, also can exempt entities from the application of Part 4 of the CFTC's regulations in appropriate cases.

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[29] *See* Section 5d of the CEA, 7 U.S.C. 7a-3.

[30] Although the CEA does not define the term "commodity pool," CFTC Regulation 4.10(d)(1) defines "pool" to mean any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests.

[31] *See* Section 4(m) of the CEA.

[32] *See* CFTC Regulations 4.21, 4.24, 4.25 and 4.26, 17 C.F.R. 4.21, 4.24, 4.25 and 4.26.

[33] The SEC, however, does retain anti-fraud and anti-manipulation authority over the securities of such commodity pool offerings.

Intermediaries. The CFTC regulates the following categories of intermediaries:

- "FCM" is defined as any person who solicits or accepts orders to buy or sell futures or options contracts, and who, in connection with the order, accepts any money or other property (or extends credit) to margin, guarantee, or secure the contracts resulting from the order.

- "IB" is any person who solicits or accepts orders to buy or sell futures or option contracts, but who does not accept any money or property (or extend credit) to margin, guarantee or secure the contracts.

- "Agricultural trade option merchant" is any person that is in the business of soliciting, offering, confirming or maintaining a position in off-exchange option contracts in certain enumerated agricultural commodities.

- "Floor trader" is a person who trades contracts on DCMs and/or DTEFs for his own account.

- "Floor broker" is a person who trades contracts on DCMs and/or DTEFs for the account of others.

- "Foreign futures and options broker" is any non-U.S. person that is a member of a non-U.S. exchange or SRO and subject to regulation in such foreign jurisdiction. Also included are foreign affiliates of U.S. firms that are licensed and subject to regulation in such non-U.S. jurisdiction.

- "CTA" is defined as any person who, for compensation or profit, is engaged in the business of providing commodity interest advisory services to others.

- "CPO" is defined as any person who solicits funds from others for the purpose of pooling the funds for use in investing in commodity interests. As noted above, pools also may be regulated by the SEC if publicly offered or under the Investment Company Act of 1940, under certain circumstances, if not excluded under CFTC Regulation 4.5.

The CEA and CFTC Regulations impose requirements related to licensing, conduct of business, mandatory firm capital and custodianship of customer assets. In addition, the CEA requires the officers of the above registered entities and persons who solicit funds or supervise such persons within such registered entities to register as "associated persons."

In addition to the standards established by the American Institute of Certified Public Accountants ("AICPA"), and the Financial Accounting Standards Board ("FASB"),[34]

[34] The FASB, a private sector organization, authorizes and establishes the uniform financial accounting and reporting standards and guidelines of the United States under the auspices of the SEC.

CFTC regulations establish requirements pertaining to independent public accountants who audit CFTC registrants. For example, under CFTC Regulation 1.16, 17 C.F.R. 1.16, the CFTC will recognize only a licensed CPA or licensed public accountant who is in good standing under the laws of the place of his or her residence or principal place of business and an "accountant's report" that has been prepared consistent with the requirements of CFTC Regulation 1.16. The CFTC also has worked with AICPA to provide guidance on the application of accounting standards to CFTC registrants.

Foreign Brokers. Part 30 of the CFTC Regulations govern the offer and sale of foreign futures and options contracts to customers located in the U.S. As set forth in CFTC Regulation 30.4, any domestic or foreign person engaged in activities like those of an FCM, IB, CPO or CTA must register in the appropriate capacity or seek an exemption from registration under CFTC Regulations 30.5 or 30.10.

CFTC Regulation 30.5 provides an exemption from registration for any person located outside of the U.S. who is required to be registered with the CFTC under Part 30 other than a person required to be registered as an FCM. A foreign futures or options broker in such case is required to consent to the jurisdiction of the U.S. courts and the CFTC with respect to dealings with U.S. customers, and engage in all transactions subject to regulation under Part 30 through a registered FCM or foreign broker who has received confirmation of exemption from registration as an FCM under CFTC Regulation 30.10.

CFTC Regulation 30.10 permits a person affected by any of the requirements contained in Part 30 of the Commission's regulations to petition the Commission for an exemption from such requirements. If the CFTC determines that compliance with the foreign jurisdiction's regulatory program would offer "comparable" protection to persons located in the U.S. and there is an information sharing agreement between the Commission and the firm's home country regulator, the CFTC will consider issuance of an order to the foreign regulator or SRO granting general relief, subject to certain conditions.

Margin Authority. Section 2(a)(1)(C)(v) of the CEA requires any DCM or DTEF that trades stock index futures contracts (or options thereon) to file with the Federal Reserve any rule establishing or changing the levels of margin (initial and maintenance) for that contract and authorizes the Federal Reserve to set the margin levels. Under the authority of that section, the Federal Reserve delegated such margin authority to the CFTC in 1993, subject to an annual reporting requirement to the Federal Reserve.

Dual Registration. Securities broker-dealers registered with the SEC may also dually register in the above-referenced CFTC categories. In cases of such dual registration as an FCM, CFTC Regulation 1.17 (a)(1)(i)(C), 17 C.F.R. 1.17 (a)(1)(i)(C), recognizes compliance with the SEC net capital rule as satisfaction of the CFTC's minimum financial requirements (although the minimum requirement is the higher of the CFTC or SEC rule in any given case). Banks typically establish subsidiaries due to the requirements of banking regulators, as well as the liquidity requirements of CFTC capital rules. FCM subsidiaries of bank holding companies are subject to Federal Reserve examination and certain other requirements.

Swap Agreements. Swap agreements[35] on all commodities other than agricultural commodities are generally excluded from regulation by the CFTC if the agreement is entered into between ECPs, is subject to individual negotiation by the parties, and is not executed or traded on a trading facility.[36] Swap agreements on agricultural commodities are allowed under the terms of Part 35 of the Commission's regulations.

b) If the regulator can interpret its authority, are the criteria for interpretation clear and transparent?

Yes. The CFTC can interpret how to apply the authority granted to it by the CEA. The CEA also grants the CFTC broad exemptive authority under Section 4(c) as well as broad rulemaking authority under Section 8a(5).

The criteria for interpreting the CFTC's authority are clear and transparent. The CFTC largely interprets the CEA based on the plain meaning of the statute and available legislative history as related to relevant markets and market participants. CFTC rulemaking is employed to administer and implement various provisions of the CEA as provided for in Section 8a(5) of the CEA. The rulemaking process is governed by the APA and other various statutes that prescribe the manner in which the CFTC may adopt rules and regulations. As set forth below in 1.1(c), this process is fully transparent with CFTC rule proposals and adoptions, concept releases and interpretations published in the Federal Register. CFTC staff may also provide guidance to market participants and practitioners on a variety of legal and regulatory matters. Although not legally binding on the CFTC, these staff interpretations provide guidance on a host of CEA and related issues.

c) Is the interpretative process transparent enough to preclude situations in which an abuse of discretion can occur?

Yes. 5 U.S.C. 553 of the APA requires agencies to incorporate a concise general statement of the basis and purpose for adopted rules. Generally, all CFTC Orders, Exemption Letters and Advisories contain written explanations of the basis for such actions. These CFTC actions are publicly disclosed in the *Federal Register* and/or the CFTC's Web site at *http://www.cftc.gov*. Parties affected by any such CFTC actions may also seek judicial review by the federal courts.

2) When more than one domestic authority is responsible:

a) Does the legislation ensure that any division of responsibility avoids gaps or inequities in regulation?

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[35] *See* Section 206A of the Gramm-leach-Bliley Act, Pub. L. 106-102, 15 U.S.C. 78c note.

[36] *See* Section 2(g) of the CEA, 7 U.S.C. 2(g).

President Barack Obama called on the SEC and CFTC to recommend changes to their statutes and regulations that would eliminate differences with respect to similar types of financial instruments so that the agencies' regulations are harmonized. To ensure regulatory harmonization between the CFTC and SEC, the agencies will hold joint meetings on September 2-3, 2009 to seek input from the public. The discussion from these meetings will contribute to a report from the CFTC and SEC to the US Congress that will identify existing conflicts in each agency's statutes and regulations. The Report will also explain why certain statutory and regulatory differences should be retained to achieve underlying policy objectives, or recommend changes that would eliminate the differences.

Foreign Currency Transactions. Unlike most other financial products, the regulation of off-exchange retail forex transactions depends upon the entity offering the product. The CFTC has jurisdiction over such transactions where the counterparty is an FCM, but transactions with other permissible counterparties such as banks, broker-dealers and insurance companies are overseen by their respective regulators. There are no unifying standards for forex trading activities across regulators, leading to possible inconsistencies in the regulation of the counterparties.

b) Is substantially the same type of conduct generally subject to consistent regulatory requirements?

Yes. *See supra*, response to Principle 1, Question 2(a).

3) When more than one domestic authority is responsible:

a) Are there effective arrangements for cooperation and communication of information between responsible authorities through appropriate channels?

b) Are responsible authorities required to cooperate and communicate in areas of shared responsibility?

c) Are cooperation and communication occurring between responsible authorities without significant limitations?

Yes, to all of the above. Domestically, the CFTC participates in the PWG, a key forum for the coordination of regulation across financial markets. It brings together the leaders of the federal financial regulatory agencies, including the Secretary of the Treasury and the chairmen of the Federal Reserve, CFTC, and SEC. Meetings of the principals also include the heads of the National Economic Council, Council of Economic Advisors, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation and Federal Reserve Bank of New York.

Staff also works through various established intergovernmental partnerships to share information and to consult on issues of importance both to the CFTC and to other financial regulators. Meetings are typically held among the CFTC, SEC, Treasury,

Federal Reserve, the New York Federal Reserve Bank, Department of Energy, USDA and FERC. Other meetings are event driven.

The working relationships with federal law enforcement entities are also fundamental to an effective law enforcement effort. The CFTC coordinates its enforcement efforts with agencies such as DOJ, the Federal Bureau of Investigation, FTC, SEC, the U.S. Postal Inspection Service and FERC. Enforcement efforts are coordinated with state authorities as well, including state commissions responsible for the regulation of corporations, securities, insurance and banking.

The CFTC also is represented on several interagency task forces designed to keep participants abreast of new developments in financial crimes and to coordinate the government's response. In this area, the CFTC participates in the Money Laundering Working Group ("MLWG"), a forum for discussing money laundering issues among relevant US governmental agencies, chaired by Treasury and DOJ and attended by US banking, securities and futures regulators and state and federal law enforcement agencies. Through the MLWG, the CFTC also lends advice to Treasury's Financial Crimes Enforcement Network regarding the work undertaken by the Financial Action Task Force ("FATF"), an international organization created to formulate recommendations for combating money laundering.

Section 12(g) of the CEA, 7 U.S.C. 16, requires the CFTC to cooperate with the Office of the United States Trade Representative, Treasury, the Department of Commerce, and the Department of State to remove any trade barriers that may be imposed by a foreign nation on the international use of electronic trading systems.

Cooperation with other government agencies also is mandated by the CEA. *See infra*, response to Principle 2, Question 2.

Principle 2. The regulator should be operationally independent and accountable in the exercise of its powers and functions

Assessment: Fully Implemented

1) Does the securities regulator have the ability to operate on a day-to-day basis without:

a) External political interference?

Yes. The 1974 Act established the CFTC as an independent regulatory commission of the U.S. Government (i.e., the CFTC does not operate as a division of any Executive Branch department or other agency). Also, as noted below in response to Principle 2, Question 5, the CEA mandates that no more than three CFTC Commissioners may be members of the same political party. However, the CFTC is accountable to, and subject to the oversight of, the U.S. Congress.

b) Interference from commercial or other sectoral interests?

Yes. As set forth below in response to Principle 2, Question 7, interested parties may comment on various CFTC rulemaking proposals. In this manner, persons that may be affected by adoption of new or amended regulations by the CFTC may provide input and voice any concerns.

2) Where particular matters of regulatory policy require consultation with, or even approval by, a government minister or other authority:

a) Is the consultation process established by law?

Yes. Section 2(a)(9)(B)(ii) of the CEA, 7 U.S.C. 2(a)(9)(B)(ii), requires the CFTC to deliver a copy of any application by a board of trade for designation or registration as a DCM or DTEF to trade futures based on any security issued or guaranteed by the U.S. or any agency thereof to Treasury and the Federal Reserve. In addition, Sections 2(a)(9)(A) and (B)(i) of the CEA, 7 U.S.C. 2(a)(9), require the CFTC to maintain a liaison with USDA, and to maintain communications with Treasury, the Federal Reserve, and SEC for the purpose of keeping such agencies fully informed of CFTC activities that relate to the responsibilities of those agencies and for considering the relationships between the volume and nature of investment and trading in futures contracts and in securities and financial instruments under the jurisdiction of those agencies.

Section 2(a)(9)(B)(ii), 7 U.S.C. 2(a)(9)(B)(ii), prohibits the CFTC from designating or registering a board of trade as a DCM or DTEF in U.S. government issued or guaranteed securities until forty-five days after the CFTC provides a copy of the application to

Treasury and the Federal Reserve or until the CFTC receives comments from those agencies, whichever period is shorter. This section requires the CFTC to take into account any comments received from those agencies, not only in designation decisions but also in refusing, suspending, or revoking the designation of a contract market trading futures contracts based on U.S. government issued or guaranteed securities.

Security futures products may be traded either on a national securities exchange, national securities association, alternative trading system, DCM or DTEF (collectively, "Exchanges"), however, in each case, the entity must become registered with both the CFTC and SEC solely for the purpose of trading security futures. This additional registration for a national securities exchange, national securities association or alternative trading system is accomplished through an immediately effective notice filing pursuant to CFTC Regulation 41.31, 17 C.F.R. 41.31.[37] Comparatively, a DCM or DTEF would submit its notice filing with the SEC pursuant to SEC Rule 19b-7, 17 C.F.R. 240.19b-7. Thus, a facility that lists security futures for trading must be registered with the SEC as a national securities exchange, national securities association or alternative trading system *and* be designated by the CFTC as a DCM or registered with the CFTC as a DTEF. In addition, Exchanges trading security futures are required to file with the SEC and the CFTC proposed rule changes relating to higher margin levels, fraud or manipulation, recordkeeping, reporting, listing standards, decimal pricing, sales practices for security futures products or rules effectuating such SRO's obligation to enforce the securities laws. A DCM or DTEF that is "notice-registered" with the SEC would submit such proposed rule changes with the SEC pursuant to Rule 19b-7 under the 1934 Act while at the same time filing with the CFTC under Regulation 41.24, 17 C.F.R. 41.24 (rule amendments), and/or Regulation 41.23, 17 C.F.R. 41.23 (listing of new security futures products). Alternatively, a national securities exchange, national securities association or alternative trading system that is "notice-registered" with the CFTC would submit proposed rule changes with the SEC under Rule 19b-4 under the 1934 Act and concurrently provide a notice filing with the CFTC under Regulation 41.32, 17 C.F.R. 41.32.

A clearing agency that is associated with a DCM for security futures and that would be required to register as a clearing agency under Section 17A(b)(1) of the 1934 Act only because it performs clearing functions for security futures products is exempt from registration as a clearing agency under the 1934 Act. However, DCOs regulated by the CFTC through their association with DCMs for security futures products (other than cash-settled contracts) that are national securities exchanges for trading of security futures products must have arrangements in place with a registered clearing agency to effect payment and delivery of the securities underlying the security futures product. Further, any clearing agency for security futures products must develop linkages with all other clearing agencies for security futures products to permit the product to be purchased

[37] A national securities exchange, national securities association or alternative trading system subject to Regulation ATS under the 1934 Act that only lists and trades security futures products may be designated as a contract market in security futures pursuant to Section 5f of the CEA by filing a notice with the CFTC.

on one market and offset on another. SEC-registered clearing agencies are exempted from registration by the CFTC as DCOs.

FCMs, IBs, floor brokers and floor traders engaging in security futures transactions are subject to periodic and special examinations by the CFTC. However, Section 2(a)(1)(D)(iv) of the CEA requires that the CFTC provide the SEC with notice of such examinations for the purpose of coordinating efforts.

Pursuant to an MOU between the CFTC and SEC regarding Coordination in Areas of Common Regulatory Interest (dated March 11, 2008), the agencies in connection with the review of "novel" derivative products have agreed to (i) recognize their mutual regulatory interests and encourage innovation, competition, and legal certainty, (ii) share information relating to novel derivative products and act on any related requests in a timely manner, (iii) permit the trading of novel derivative products (for products that implicate overlapping areas of regulatory concern) in either or both a CFTC- or SEC-regulated environment in a manner consistent with each agency's regulatory structure, and (iv) meet on a quarterly basis to discuss particular regulatory matters and novel derivative products. As a result of this MOU, the listing and trading of the streetTracks ® Gold Trust Shares (symbol: GLD) as both an options contract on the options exchanges regulated by the SEC and as a single stock futures contract on OneChicago, LLC commenced in mid-2008.

In connection with the establishment of centralized clearing for CDSs, the Federal Reserve, CFTC and SEC entered into an MOU on November 14, 2008. The MOU establishes a framework for consultation and information sharing on issues related to CDS central counterparties and reflects the agencies' intent to cooperate, coordinate and share information.

The CFTC and FERC also executed an MOU on October 12, 2005 for the purpose of sharing information relating to the regulation of energy markets. The CFTC has exclusive jurisdiction, among other things, over futures and options contracts based on natural gas, electricity or any other energy products,[38] while FERC also has jurisdiction over the transportation and sale of natural gas and electricity.[39] Congress directed the agencies to enter into this MOU as part of the Energy Policy Act of 2005.

In 2007, Congress also directed the FTC to adopt an anti-manipulation rule for the physical, wholesale, crude oil, gasoline and other petroleum distillates markets as part of the Energy Independence and Security Act of 2007 ("EISA"). Section 811 of EISA specifically provides:

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[38] *See* Section 2(a)(1)(A) of the CEA, 7 U.S.C. 2(a)(1)(A).

[39] *See* Section 1 of the Natural Gas Act, 15 U.S.C. 717; Section 601(a) of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. 3431(a); Section 311 of the NGPA, 15 U.S.C. 3371; and Section 201 of the Federal Power Act, 16 U.S.C. 824.

> "It is unlawful for any person, directly or indirectly, to use or employ, in connection with the purchase or sale of crude oil gasoline or petroleum distillates at wholesale, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the FTC may prescribe as necessary or appropriate in the public interest or for the protection of United States citizens."[40]

In addition to its exclusive jurisdiction over futures trading on regulated exchanges, the CFTC also has anti-manipulation authority over cash markets as set forth in Section 9(a)(2) of the CEA, 7 U.S.C. 13(a)(2). As a result, the CFTC and FTC each have concurrent jurisdiction over the underlying cash petroleum markets while the CFTC retains its exclusive jurisdiction over futures trading set forth in Section 2(a)(1)(A) of the CEA, 7 U.S.C. 2(a)(1)(A). It is expected that the agencies will closely coordinate efforts to efficiently deter and prosecute illegal activity in petroleum markets consistent with each agencies' statutory mandate.

Federal agencies also must comply with certain general rulemaking requirements such as the Regulatory Flexibility Act ("RFA") (that requires agencies to take into account the impact of proposed rules on small businesses), and the Paperwork Reduction Act ("PRA") (that requires agencies to review rules to evaluate the information collection burden such rules would impose on the public), and with the Congressional Review of Agency Rulemaking Act ("CRARA") (which requires agencies to submit rules to Congress and the General Accounting Office with a report that includes a cost-benefit analysis). *See also* the PRA, 44 U.S.C. 3501 *et seq*., the RFA, 5 U.S.C. 601-611, and the CRARA, 5 U.S.C. 804(2).

b) Do the circumstances, in which consultation is required, exclude decision making on day-to-day technical matters?

Yes. Consultation with other appropriate federal agencies and bodies, as described in responses to Principle 2, Question 2(a) and (c), is narrowly-tailored to specific issues of concurrent or shared jurisdiction.

c) Are the circumstances in which such consultation or approval is required or permitted clear and the process sufficiently transparent, or the failure to observe procedures and the regulatory decision or outcome subject to sufficient review, to safeguard its integrity?

Yes. *See supra*, response to Principle 2, Question 2(a). Regarding the PRA and RFA, federal agencies submit certain filings to the Office of Management and Budget ("OMB") (regarding the PRA) and to the General Services Administration (regarding the RFA) that

[40] The FTC has proposed such an anti-manipulation rule that has not yet been adopted. *See* FTC, 16 C.F.R. Part 317, *Prohibitions on Market Manipulation in Subtitle B of Title VIII of The Energy Independence and Security Act of 2007*, 74 FR 18304 (April 22, 2009). Similar to the anti-manipulation rule found under Section 10(b) of the 1934 Act (Rule 10b-5), the FTC proposal prohibits fraudulent and deceptive practices which may include "intentional acts that obstruct or impair wholesale petroleum markets." Proof that fraudulent or deceptive conduct actually had an effect on the market is not required under the proposed FTC rule.

essentially document compliance with the requirements of those statutes. Before an agency rule can take effect, the CRARA requires federal agencies to submit to each House of Congress and to the Comptroller General a report containing a copy of the rule, a concise statement relating to the rule (including a cost-benefit analysis, including whether it is a major rule), and the proposed effective date. A "non-major" rule becomes effective as proposed by an agency if Congress and the GAO receive the required report. A "major" rule will generally become effective 60 days after Congressional receipt of an agency's report.

In addition, as set forth above in response to Principle 1, Question 3, the CFTC as a member of the PWG consults with other federal financial regulators regarding significant issues of intermarket coordination. Recent work includes a review of the recent financial crisis and proposed regulatory responses. CFTC staff also works with other US agencies on an as-needed basis and has commented on various financial stability initiatives of the Treasury Department.

As noted above, the regulatory decisions and outcomes of the CFTC are subject to judicial review in the federal courts.

3. Does the securities regulator have a stable and continuous source of funding sufficient to meet its regulatory and operational needs?

Yes. Section 2(a)(10)(A) of the CEA, 7 U.S.C. 2(a)(10), requires that whenever the CFTC submits any budget request to the President or OMB (the agency within the office of the President which analyzes and makes recommendations to the President on budget matters), the CFTC shall concurrently transmit copies of the request to the House and Senate Appropriations Committees and the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition and Forestry. The CFTC's initial budget request may be revised during its consideration by OMB and then, after submission to Congress, by the appropriate House and Senate committees (which may hold hearings, request additional testimony by CFTC Commissioners or staff, or request additional documentation). The specific vehicle to authorize the CFTC's budget funds is through the adoption by the Congress of a specific bill authorizing and funding the CFTC's operations (as part of the President's budget).

Determinations regarding the sufficiency of the CFTC's requested resources are made by the U.S. Congress during its consideration of the CFTC's formal budget request. Information regarding specific needs of the CFTC is communicated by the formal budget document and related written submissions, direct testimony by the Chairman and/or CFTC Commissioners to Congress and by CFTC and Congressional staff communications and meetings.

4) Are the regulatory authority, the head and members of the governing body of the regulatory authority, as well as its staff, accorded adequate legal protection for the *bona fide* discharge of their governmental, regulatory and administrative functions and powers?

Yes. The Federal Employees Liability Reform and Tort Compensation Act of 1988[41] provides federal employees with immunity from individual liability for torts committed in the scope of their employment. In order to insulate CFTC staff from individual liability for possible violation of constitutional or statutory duties that are not shielded by the Federal Liability Reform and Tort Compensation Act of 1988, the CFTC adopted indemnification rules.[42]

5) Are the head and governing board of the regulator subject to mechanisms intended to protect independence, such as: procedures for appointment; terms of office; and criteria for removal?

Yes. Section 2(a)(2)(A) of the CEA, 7 U.S.C. 2(a)(2)(A), provides that each of the five commissioners of the CFTC are to be appointed by the President of the United States, by and with the advice and consent of the United States Senate. Each CFTC Commissioner holds office for a term of five years. The terms of the Commissioners are staggered due to the CEA's initial requirement that the first Commissioners' terms were to expire one, two, three, four and five years from the date the CFTC began operations on April 21, 1975. Not more than three Commissioners may be members of the same political party.

The President of the United States appoints, by and with the advice and consent of the Senate, a member of the CFTC as Chairman, who serves as Chairman at the pleasure of the President. The President may appoint at any time, with the advice and consent of the Senate, a different Chairman, and the CFTC Commissioner previously appointed as Chairman may complete his or her term as a CFTC Commissioner.

6) With reference to the system of accountability for the regulator's use of its powers and resources:

a) Is the regulator accountable to the legislature or another government body on an ongoing basis?

Yes. The CFTC is accountable for its conduct to the U.S. Congress. The House Committee on Agriculture and its Subcommittee on Risk Management and Specialty Crops, and the Senate Agriculture, Nutrition and Forestry Committee and its Subcommittee on Research, Nutrition and General Legislation have the principal responsibility for oversight of the CFTC. In general, these Committees handle, in the first instance, the reauthorization, budget and funding decisions for the CFTC, as well as bills affecting the CEA.

Section 8(i) of the CEA requires the Comptroller General of the United States to conduct reviews and audits of the CFTC and make reports thereon. Section 8(i) of the CEA directs the CFTC to make available to the Comptroller General (generally through its OMB) any information regarding the powers, duties, organization, transactions,

[41] 28 U.S.C. 2671.

[42] 17 C.F.R. 142.

operations and activities of the CFTC, as well as access to any books and records (subject to confidentiality requirements), as the Comptroller General may require.

b) Is the regulator required to be transparent[43] in its way of operating and use of resources and to make public its actions that affect users of the market and regulated entities, excluding confidential or commercially sensitive information?

Yes. Section 8(h) of the CEA requires the CFTC to submit to Congress a written report within 120 days after the end of each fiscal year detailing the operations of the CFTC during that fiscal year. The CFTC is required to include in this annual report such information, data and legislative recommendations as it deems advisable with respect to the administration of the CEA and its powers and functions under the CEA. Section 18(b) of the CEA requires that the annual report contain plans and findings regarding implementation of Section 18(a) of the CEA, which mandates certain research and information programs. *See infra*, response to Principle 4, Question 2.

c) Is the regulator's receipt and use of funds subject to review or audit?

Yes. Externally, the CFTC's budget and available resources are subject to oversight by the U.S. Congress through the exercise of its authorization and funding procedures. In addition, the Comptroller General of the U.S. periodically audits the CFTC. *See supra*, response to Principle 2, Question 6(a-b).

Internally, the CFTC Office of the Executive Director and the Office of Financial Management oversee the use of resources provided to the CFTC by Congress and report directly to the Office of the Chairman. In particular, the Office of Financial Management manages the CFTC's financial and budget programs by coordinating development of the CFTC's strategic plan, annual performance plan and annual performance report; formulates and executes the CFTC's budget; provides contracting and purchasing of services; ensures proper use of, and accounting for, agency resources; and manages the CFTC's travel services.

In addition, the operations of the CFTC are subject to ongoing review by an independent Office of the Inspector General ("OIG") with offices in the CFTC headquarters. OIG was established in April 1989 and conducts and supervises audits and investigations of programs and operations of the CFTC and reviews existing and proposed legislation and regulations. OIG recommends policies to promote economy, efficiency, and effectiveness in CFTC programs and operations, and to prevent and detect fraud and abuse. OIG keeps the Chairman of the CFTC and Congress informed about any problems, deficiencies and the progress of corrective action in programs and operations.

[43] The regulator must be accountable as a matter of law; The regulator may be considered to be "required" to be transparent, if, as a general principle of administrative law, procedure or practice, its use of its powers and resources generally is transparent.

7) Are there means for natural or legal persons adversely affected by a regulator's decisions or exercise of administrative authority ultimately to seek review in a court, specifically:

a) Does the regulator have to provide written reasons for its material decisions?

Yes. CFTC rulemaking must comply with the procedural requirements of the APA, which are intended to provide public notice and opportunity for public comment in the rulemaking. 5 U.S.C. 553 (subject to certain exceptions) specifically requires Federal administrative agencies such as the CFTC to publish a Notice of Proposed Rulemaking in the *Federal Register* and to provide interested persons an opportunity to participate in the rulemaking through submission of written data, views or arguments with or without an opportunity for oral presentations. 5 U.S.C. 553 requires agencies to incorporate in the rules adopted a concise general statement of their basis and purpose.

b) Does the decision-making process for such decisions include sufficient procedural protections to be meaningful?

Yes. *See supra*, response to Principle 2, Question 7(a).

Part 147 of the CFTC's regulations, 17 C.F.R. 147, implements the open meetings requirement of the Government in the Sunshine Act, 5 U.S.C. 552b, which mandates the conditions under which CFTC Commissioners must conduct open meetings. As stated in rule 147.1(b), "among the primary purposes of these rules is the CFTC's desire to inform the public to the fullest extent possible of its activities as an aid to its properly carrying out its responsibility for administering and enforcing the CEA . . ."

The CFTC also has adopted regulations that provide objective due process procedures to ensure that various aspects of its programs are conducted with fairness and impartiality. *Se infra*, response to Principle 5, Question 1.

As previously noted (*see supra*, response to Principle 2, Question 2(a)), Federal agencies such as the CFTC also must comply with certain general rulemaking requirements (*e.g.*, the RFA that requires agencies to take into account the impact of proposed rules on small businesses, and the PRA that requires agencies to review rules to evaluate the information collection burden such rules would impose on the public).

c) Are affected persons permitted to make representations prior to such a decision being taken by a regulator in appropriate cases?

Yes. *See infra*, response to Principle 4, Question 2.

d) Are all such decisions taken by the regulator subject to a sufficient, independent review process, ultimately including judicial review?

Yes. Aggrieved parties may challenge agency actions under the APA (5 U.S.C. 702) in U.S. Federal District Court.

8) Where accountability is through the government or some other external agency, is confidential and commercially sensitive information subject to appropriate safeguards to prevent inappropriate use or disclosure?

Yes.

Use. Section 2(a)(8) of the CEA, 7 U.S.C. 2(a)(8), prohibits any CFTC Commissioner or employee of the CFTC from accepting employment or compensation from any person, exchange, or clearinghouse subject to regulation by the CFTC and from participating, directly or indirectly, in any contract market operations or transactions of a character subject to CFTC regulation.

Section 9(c) of the CEA, 7 U.S.C. 13(c), makes it a felony punishable by a fine of not more than $500,000 or imprisonment for up to 5 years, or both, for a CFTC employee or CFTC Commissioner to trade commodity futures and options or to participate directly or indirectly in any investment transaction in an actual commodity if nonpublic information is used in the transaction or if prohibited by CFTC regulations. CFTC Regulation 140.735-2 provides, subject to very limited exceptions, that no member or employee of the CFTC may participate directly or indirectly in any transaction involving commodity futures and commodity options, among other things. Section 9(d) of the CEA, 7 U.S.C. 13(d), similarly makes it a punishable felony for a CFTC employee or CFTC Commissioner to pass on or otherwise benefit from information such employee or Commissioner receives in the course of employment which may affect or tend to affect the price of commodities.

Disclosure. Section 8(a)(1) of the CEA, 7 U.S.C. 12(a), provides that except as otherwise specified in the CEA, the CFTC may not publish data and information that would separately disclose market position, business transactions, trade secrets or names of customers (*i.e.*, "Section 8 Material"), and that the CFTC may withhold from public disclosure any data or information concerning or obtained in connection with any pending investigation of any person. Section 8(a)(1) of the CEA also furnishes protection from compelled disclosure for confidential information received from foreign futures authorities. The effect of this provision is to eliminate the possibility that confidential information provided to the CFTC under an MOU would be disclosed in response to a request under the Freedom of Information Act of the United States, 5 U.S.C. 552, or third party subpoena.

CFTC Regulation 145.5, 17 C.F.R. 145.5, provides that the CFTC may decline to publish or make available to the public any "non-public" records as defined in Regulation 145.5(a)-(i). In general, this type of information concerns trade secrets, national defense or foreign policy concerns, personal privacy, various financial statement forms and pending investigations. In addition, Regulation 145.9 outlines the procedures by which a person submitting information to the CFTC may request confidential treatment of that information.

Part 146 of the CFTC rules, 17 C.F.R. 146, implements the Privacy Act of 1974, which provides protections for information concerning an individual. Among the primary purposes of these rules are to permit individuals to determine whether information about

them is contained in Government files and, if so, to obtain access to that information; to establish procedures whereby individuals may have inaccurate and incomplete information corrected; and to restrict access by unauthorized persons to that information.

Sanctions. CEA 9(f)(1), 7 U.S.C. 13(f), makes it a felony for any person who is an employee, member of the governing board, or member of any committee of a board of trade, contract market or registered futures association, in violation of a regulation issued by the CFTC, willfully and knowingly to trade for such person's own account, or for or on behalf of any other account in futures contracts or options thereon, on the basis of, or willingly and knowingly to disclose for any purpose inconsistent with the performance of such person's official duties, any material nonpublic information obtained through special access related to the performance of duties. Violations are punishable by a fine of up to $500,000 in the case of an individual plus the amount of any gains realized from such trading or disclosures and/or prison of up to five years.

CEA 9(a)(5), 7 U.S.C. 13(a), makes it a felony, punishable by a fine of up to $500,000 in the case of an individual and/or prison of up to five years, for any person willfully to violate any other provision of the CEA, or any rule or regulation thereunder.

Permissible Disclosures. The CEA specifies the circumstances for the permissible disclosure of information. CEA Section 8(a) also contains a provision that explicitly sets forth certain permissible disclosures of confidential information (referred to as "Section 8 Material"). This provision includes reference to confidential information received from a foreign futures authority. This explicit list is necessary because, under the CEA, Section 8 Material may not be disclosed by the CFTC "except as otherwise specifically authorized in this Act."

Specifically, the CEA provides, in relevant part, that nothing in CEA 8(a) shall:

> [P]revent the CFTC from disclosing publicly any information or data obtained by the CFTC from a foreign futures authority when such disclosure is made in connection with a congressional proceeding, an administrative or judicial proceeding commenced by the United States or the CFTC, in any receivership proceeding commenced involving a receiver appointed in a judicial proceeding by the United States or the CFTC, or any proceeding under title 11 of the United States Code in which the CFTC has intervened or in which the CFTC has the right to appear and be heard. Nothing in this subsection shall be construed to authorize the CFTC to withhold information or data from Congress.

Principle 3. The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers

Assessment: Broadly Implemented

1) Are the powers and authorities of the regulator sufficient, taking into account the nature of a jurisdiction's markets and a full assessment of these Principles to meet the responsibilities of the regulator(s) to which they are assigned?

Yes. The mission of the CFTC is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity futures and options, and to foster open, competitive, and financially sound commodity futures and option markets.

The CFTC has the power to conduct direct surveillance of those markets and financial institutions that fall within its regulatory jurisdiction.[44] The CFTC also can obtain certain information on unregulated affiliates of FCMs or affiliates of FCMs subject to regulation by other authorities such as the SEC, the banking regulators, and the relevant foreign authorities.[45] In addition, the CFTC has the power to obtain information regarding regulated markets, institutions, financial products, customers and parties to transactions.[46]

Section 8a(6) of the CEA, 7 U.S.C. 12(a)(6), authorizes the CFTC to communicate to the proper committee or officer of any DCM, RFA, or SRO as defined in Section 3(a)(26) of the 1933 Act, notwithstanding Section 8 of the CEA, the full facts concerning any transaction or market operation, including the names of parties thereto, which in the judgment of the CFTC disrupts or tends to disrupt any market or is otherwise harmful or against the best interests of producers, consumers, or investors, or which is necessary to effectuate the purposes of the CEA. Section 8a(6) of the CEA further provides that any information so provided must not be disclosed except in any self-regulatory proceeding or action.[47]

The CFTC has the power to conduct investigations.[48] The CFTC has the power to sanction violations of the CEA. Administrative sanctions may include orders suspending, denying, revoking, or restricting registration and exchange trading privileges and imposing civil monetary penalties and orders of restitution (CEA Section 6(c), 7 U.S.C.

[44] *See* Sections 4g and 4n of the CEA, 7 U.S.C. 6g and 6n.

[45] *See* Section 4f(c) of the CEA, 7 U.S.C. 6f(c).

[46] *See* Sections 4g and 4n of the CEA, 7 U.S.C. 6g and 6(n).

[47] *See also* CFTC Regulation 140.72, 17 C.F.R. 140.72 (delegating such authority to certain Staff).

[48] *See* Section 8(a)(1) of the CEA.

9, 15) as well as cease and desist orders (CEA Section 6(d), 7 U.S.C. 13(b)). The CFTC also may obtain temporary restraining orders and preliminary and permanent injunctions in federal court for violations, as well as to impose civil monetary penalties (CEA Section 6c, 7 U.S.C. 13a-1). Other relief may include appointment of a receiver, the freezing of assets, restitution, and disgorgement of unlawfully acquired benefits.

The CEA also provides that the CFTC may obtain certain temporary relief on an *ex parte* basis (that is, without notice to the other party) including restraining orders preserving books and records, freezing assets, and appointing a receiver.[49] When those enjoined violate court orders, the CFTC may seek to have the offenders held in contempt.

The CFTC has the power to direct "registered entities"[50] to alter or supplement their rules and to take such action as it deems to be necessary to maintain or restore orderly trading. *See* Section 2(h)(7) of the CEA, 7 U.S.C. 2(h)(7), and Sections 8a(7) and (9) of the CEA, 7 U.S.C. 12(a)(7), 12(a)(9). CEA Section 5e, 7 U.S.C. 7b, authorizes the CFTC to suspend or revoke the designation of a contract market, DTEF or DCO based on a failure or refusal to comply with any of the provisions of the CEA, CFTC regulations or CFTC orders.

Section 8(e) of the CEA, 7 U.S.C. 12(e), provides that "upon the request of any department or agency of any State or any political subdivision thereof, acting within the scope of its jurisdiction, any foreign futures authority, or any department or agency of any foreign government or any political subdivision thereof, acting within the scope of its jurisdiction, the CFTC may furnish to such foreign futures authority, department or agency any information in the possession of the CFTC obtained in connection with the administration of this Act."

Section 12(a) of the CEA, 7 U.S.C. 16(a), provides that the CFTC "may cooperate with any department or agency of the Government, any State, territory, district, or possession, or department, agency, or political subdivision thereof, any foreign futures authority, any department or agency of a foreign government or political subdivision thereof, or any person."

Section 12(f)(1) of the CEA, 7 U.S.C. 16(f), authorizes the CFTC to provide investigative assistance upon request from a foreign futures authority.

Despite these significant powers and authorities, the recent financial crisis has illustrated the need to modernize consumer and investor protection requirements, expand those requirements to previously unregulated areas, and establish structural mechanisms to ensure that gaps are addressed as soon as new products are developed.

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[49] *See* Section 6c of the CEA.

[50] The term "registered entity" is defined in Section 1a(29) of the CEA, 7 U.S.C. 1a(29), to mean (i) a board of trade designated as a contract market under Section 5; (ii) a DTEF registered under Section 5a; (iii) a DCO registered under Section 5b; (iv) a board of trade designated as a contract market under Section 5f; and (v) with respect to a contract that the Commission determines is a SPDC, any electronic trading facility on which the contract is executed or traded.

OTC Derivatives. Section 2(d) of the CEA, 7 U.S.C. 2(d), excludes, from CFTC jurisdiction, agreements, contracts or transactions in an "excluded commodity" entered into by ECPs ("OTC Derivatives"). Excluded commodities consist of interest rates, exchange rates, currencies, securities, security indices, credit risks or measures, and other indices based solely on commodities that have no cash market or on prices, rates, values, or levels that are not within the control of any party to the relevant transaction.[51] In addition, Section 2(d)(2) further provides an exclusion from CFTC jurisdiction over electronic trading facilities that execute OTC Derivatives traded on a principal-to-principal basis between ECPs.

Although this section discloses the current state of jurisdiction of the CFTC, recent developments in the financial markets suggest that changes to the CFTC's jurisdiction may be forthcoming.[52] Treasury, on June 17, 2009, issued a plan to reform the U.S. financial regulatory system that directly encompasses swaps, OTC derivatives and hedge funds.[53] On August 11, 2009, Treasury released draft legislation, the "Over the Counter Derivatives Markets Act of 2009," based on this plan.[54]

Strengthening requirements for clearing organizations. The CFTC is pursuing the adoption of stronger, more detailed core principles for DCOs to enhance the CEA regulatory regime for central counterparties ("CCPs") and to assure that U.S. law is consistent with international standards for CCPs.

Ensuring greater transparency of the marketplace. The CFTC recently announced several initiatives designed to bring greater transparency to participation by non-commercial participants such as commodity index funds, swaps dealers, and others; positions of traders of contracts determined to perform a significant price discovery function; and positions for foreign contracts linked to the settlement price of domestic contracts.

Applying consistent position limits. The CFTC recently held public hearings on whether federal speculative limits should be set by the Commission for commodities of finite supply, in particular energy commodities. The CFTC also recently requested public comment on whether a "*bona fide* hedge exemption" should continue to apply to persons using the futures markets to hedge risks other than risks arising from the actual use of a commodity, and CFTC staff is considering the extent to which swap dealers should continue to be granted exemptions from position limits.

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[51] *See* 1a(13) of the CEA, 7 U.S.C. 1a(13).

[52] *See* letter from Timothy F. Geithner, Secretary of the Treasury, to the Honorable Nancy Pelosi, Harry Reid, Mitch McConnell and John Boehner (May 13, 2009).

[53] *See* Treasury, "Financial Regulatory Reform: A New Foundation Rebuilding Financial Supervision and Regulation" (June 17, 2009).

[54] *http://www.financialstability.gov/docs/regulatoryreform/titleVII.pdf. See also*, Treaury Web site section on Financial Regulatory Reform, *available at http://www.ustreas.gov/initiatives/regulatoryreform/*.

Enhancing conditions for foreign boards of trade trading linked energy contracts. To enhance its ability to conduct market surveillance and to maintain market integrity, the CFTC recently announced additional amendments to the terms under which a foreign board of trade ("FBOT") is permitted to make its electronic trading and order matching system available to exchange members in the U.S.

Strengthening regulation of retail off-exchange commodity transactions. The CFTC is working on legislative amendments to extend the Commission's fraud authority for off-exchange retail foreign exchange transactions to transactions in other commodities.

2) With regards to funding:

a) Does the regulator's funding reflect the needs of the regulator in supervising a given market, taking into account the size, complexity and types of functions subject to its regulation, supervision or oversight?

Determinations regarding the sufficiency of the CFTC's requested resources are made by the U.S. Congress during its consideration of the CFTC's formal budget request. Information regarding specific needs of the CFTC is communicated by the formal budget document and related written submissions, direct testimony by the Chairman and/or CFTC Commissioners to Congress and by CFTC and Congressional staff communications and meetings.

The CFTC currently employs roughly 500 career staff. This is a decline from the CFTC's peak staffing levels, reached in the late 1990s. In the last ten years, the agency has shrunk more than 20% in head count while the markets grew five-fold and the number of contracts grew six-fold. Working with Congress, the CFTC has received funding for FY2009 to allow it to return to its headcount-level in 1999. For FY 2009, the CFTC received a budgetary increase to $146 million. However, given expanded responsibilities, President Obama recognized that this budgetary increase was insufficient. The President's budget recommends $160.6 million for the CFTC for FY 2010, and the CFTC is seeking $177.7 million.

b) Can the regulator affect the operational allocation of resources once funded?

An allocation request is submitted by the CFTC to Congress. The request contains a specific breakdown of resource allocation within the CFTC. The final allocation may be revised as part of discussions between the Congress and the CFTC. The final allocation is established when the Congress adopts the bill funding the CFTC's operations.

c) Does the level of resources recognize the difficulty of attracting and retaining experienced and skilled staff?

Section 12 of the CEA authorizes the CFTC to employ personnel and obtain necessary technical resources; Section 12(b)(1) of the CEA authorizes the CFTC to employ such investigators, special experts, Administrative Law Judges, clerks and other employees as it may from time to time find necessary for the proper performance of its duties and as

may be from time to time appropriated by Congress; Section 12(b)(2) of the CEA authorizes the CFTC to employ experts and consultants; and Section 12(b)(3) of the CEA authorizes the CFTC to make and enter into contracts with respect to all matters which in the judgment of the CFTC are necessary and appropriate to effectuate the purposes of the CEA. Section 2(a)(7) of the CEA, 7 U.S.C. 2(a)(7), permits the CFTC to provide additional compensation and benefits to employees "if the same type of compensation or benefits are provided by any agency referred to in section 1206(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. 1833b(a), or could be provided by such an agency under applicable provisions of law (including rules and regulations)." In effect, Section 2(a)(7) of the CEA enables the CFTC to maintain comparative compensation and benefits in relation to other federal financial regulators for the purpose of retaining and attracting employees.

OHR manages the CFTC's personnel recruitment and development functions, pursuant to the direction of the Chairman. Specifically, OHR develops and implements the CFTC's human resources policies, programs and procedures; provides recruitment, staffing, pay and classification services; advises on issues of performance management, employees and labor relations; offers employees development and training services; and administers the CFTC's employee benefits and payroll functions.

3) Does the regulator ensure that its staff receives adequate ongoing training?

Yes. Throughout the year, OHR and the Training Advisory Group provide a series of educational/training seminars keyed to the primary mission of the CFTC. These training seminars are focused on the financial and legal aspects of the futures/options markets as well as various OTC derivatives markets. Technical and computer skills are also provided to employees as needed. In addition, employees may also use various on-line, web-based and in-house educational materials to maintain and increase proficiency. Off-site educational seminars provided by third parties (such as continuing legal education) are also made available.

Principle 4. The regulator should adopt clear and consistent regulatory processes

Assessment: Fully Implemented

1) Is the regulator subject to reasonable procedural rules and regulations?

Yes. The CFTC is subject to the APA. In addition, the CEA and CFTC Regulations also provide various procedural rules in connection with, among other things, disciplinary proceedings and the reparations program. *See infra*, response to Principle 4, Question 3.

2) Does the regulator:

a) Have a process for consultation with the public, or a section of the public, including those who may be affected by the policy, for example, by publishing proposed rules for public comment, circulating exposure drafts or using advisory committees or informal contacts?

b) Publicly disclose and explain its policies, not including enforcement and surveillance policies, in important operational areas, such as through interpretations of regulatory actions, setting of standards, or issuance of opinions stating the reasons for regulatory actions?

c) Publicly disclose changes and reasons for changes in rules or policies?

Yes, to all of the above. CFTC rulemaking must comply with the procedural requirements of the APA, which are intended to provide public notice and opportunity for public comment in the rulemaking. 5 U.S.C. 553 generally requires Federal administrative agencies such as the CFTC to publish a notice of proposed and final rulemaking in the *Federal Register* and to provide interested persons an opportunity to participate in the rulemaking through submission of written data, views or arguments with or without an opportunity for oral presentations. The CFTC sometimes holds open forums to permit public oral communication of views on proposed rules of particular significance.

As noted previously, CFTC Regulation 140.98 requires that all interpretative legal advice with respect to the CEA or any rule, regulation or order issued or adopted by the CFTC under such authority, a statement by staff that staff would not recommend that the CFTC take enforcement action (*i.e.*, no-action letters) or an exemption from the provisions of the CEA must be made available for inspection and copying by any person.

As noted, the APA requires an agency to give its rationale and policy purpose in proposing or adopting a rule. In addition, the CFTC generally articulates the rationale

for all interpretations, exemptions, orders or policy changes. *See infra*, response to Principle 4, Question 4(d), regarding the types of communications published by the CFTC that explain the CFTC's program.

The CFTC has from time to time created various advisory committees as a mechanism for public consultation with interested members of the commodities industry and users of the futures markets. Such advisory committees include: (i) an Agricultural Advisory Committee with 25 member organizations representing a major portion of the American agricultural community; (ii) a Global Markets Advisory Committee with 30 members representing futures exchanges, self-regulators, financial intermediaries, traders and market users; (iii) a Technology Advisory Committee with 28 individuals representing electronic markets, electronic communication systems, U.S. futures exchanges, an SRO, financial intermediaries, market users and traders; and (iv) an Energy and Environmental Markets Advisory Committee consisting of 33 members representing industry professionals, futures exchanges, market participants, academics, consumer advocates and environmental organizations. The CFTC also holds informal roundtables and formal public hearings on issues from time to time.

d) Have regard, in the formulation of policy, to the costs of compliance with regulation?

Yes. Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its action before issuing a new Regulation or certain Orders under the Act. By its terms, Section 15(a) does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the proposed regulation outweigh its costs. Rather, Section 15(a) simply requires the Commission to ''consider the costs and benefits'' of its action in light of five broad areas of market and public concern: protection of market participants and the public; efficiency, competitiveness, and financial integrity of futures markets; price discovery; sound risk management practices; and other public interest considerations.

e) Make all rules and regulations available to the public?

Yes. All CFTC regulations are published in the U.S. Code of Federal Regulations, 17 C.F.R. Part 1 *et. seq*. and available at *http://www.gpoaccess.gov*.

f) Make its rulemaking procedures readily available to the public?

Yes. *See supra*, response to Principle 4, Question 2(a-c).

3) In assessing procedural fairness:

a) Are there rules in place for dealing with the regulator that are intended to ensure procedural fairness?

CFTC rulemaking must comply with the procedural requirements of the APA, which are intended to provide public notice and opportunity for public comment in the rulemaking. 5 U.S.C. 553 (subject to certain exceptions) specifically requires Federal administrative agencies such as the CFTC to publish a Notice of Proposed Rulemaking in the *Federal Register* and to provide interested persons an opportunity to participate in the rulemaking through submission of written data, views or arguments with or without an opportunity for oral presentations.

Part 147 of the CFTC's rules, 17 C.F.R. 147, implements the open meetings requirement of the Government in the Sunshine Act, 5 U.S.C. 552b, which mandates the conditions under which CFTC Commissioners must conduct open meetings. As stated in Rule 147.1(b), "among the primary purposes of these rules is the CFTC's desire to inform the public to the fullest extent possible of its activities as an aid to its properly carrying out its responsibility for administering and enforcing the CEA . . ."

The CFTC also has adopted regulations that provide objective due process procedures to ensure that various aspects of its programs are conducted with fairness and impartiality. *See infra*, response to Principle 5, Question 1(d).

As previously noted (*see infra*, response to Principle 2, Question 2(a)), Federal agencies such as the CFTC also must comply with certain general rulemaking requirements (*e.g.*, the RFA that requires agencies to take into account the impact of proposed rules on small businesses, and the PRA that requires agencies to review rules to evaluate the information collection burden such rules would impose on the public).

b) Is the regulator required to give reasons in writing for its decisions that affect the rights or interests of others?

Yes. 5 U.S.C. 553 requires agencies to incorporate in the rules adopted a concise general statement of their basis and purpose.

c) Are all material actions of the regulator in applying its rules subject to review?

Yes. Procedural challenges to agency actions under the APA may be brought by aggrieved parties in U.S. Federal District Courts.

d) Are such decisions subject to judicial review where they adversely affect legal or natural persons?

Yes. *See supra*, response to Principle 4, Question 3(c).

e) Are the general criteria for granting, denying, or revoking a license made public, and are those affected by the licensing process entitled to a hearing with respect to the regulator's decision to grant, deny, or revoke a license?

Yes. The general criteria for granting the various categories of registration (*i.e.*, registration as an FCM, IB, CTA, CPO, leverage transaction merchant, agricultural trade

option merchant, floor trader and floor broker) are made public in Part 3 of the CFTC's regulations, 17 C.F.R. 3.

The general criteria for the denial, conditioning or revocation of a registration, as well as conditions concerning the opportunity for a hearing, are contained in Section 8a(2), (3) and (4) of the CEA, 7 U.S.C. 12a and in Subpart C, Part 3 of the CFTC regulations, 17 C.F.R. 3.

Section 5e of the CEA, 7 U.S.C. 7b, authorizes the CFTC to suspend or revoke the designation of a registered entity based on a failure to comply with any of the provisions of the CEA or any rules, regulations or orders of the CFTC.

Section 17(l) authorizes the CFTC, after notice and opportunity for a hearing, to suspend or revoke the registration of a registered futures association[55] if the CFTC finds, among other enumerated reasons, that the association violated the CEA or CFTC rules.

4) **If applicable, are procedures for making reports on investigations public consistent with the rights of individuals, including confidentiality and data protection?**

Yes. *See supra*, response to Principle 2, Questions 7 and 8.

5) Does the regulator play an active role in promoting education in the interest of protecting investors?

Yes. The CFTC (Commissioners and staff including the Office of External Affairs) communicates with the news media, producer and market user groups, educational groups, and the general public. The CFTC provides information about the regulatory mandate of the CFTC, the economic role of the futures markets, new market instruments, market regulation, international regulatory developments and cooperative initiatives, enforcement actions, customer protection issues, the CFTC's Web site, and the diverse functions of the CFTC.

In addition to issuing press releases and advisories covering the CFTC's regulatory and enforcement activities, the CFTC's Web site at *http://www.cftc.gov* provides an Education Center. The Education Center highlights and explains important policy issues and initiatives and salient aspects of the CFTC's regulatory mandate.

The CFTC publishes brochures and educational materials about the CFTC, the futures industry, and the futures and option markets. The CFTC conducts research and publishes reports from time to time on major policy issues facing the futures markets. Information is posted on the CFTC's Web site, including speeches by the Chairman and CFTC

[55] NFA is the only registered futures association. The NFA is the SRO for the futures industry that regulates every firm or individual who conducts futures trading business with public customers, subject to CFTC oversight. FCMs, IBs, CPOs, CTAs and associated persons are generally required, unless otherwise exempt, to be registered with the CFTC. However, the CFTC has delegated the registration function to the NFA so that FCMs, IBs, CPOs, CTAs and their associated persons submit their registration applications to NFA and NFA approves/denies registration, subject to CFTC oversight. Section 17 of the CEA, 7 U.S.C. 21, and Part 170 of CFTC Regulations govern registered futures associations.

Commissioners, biographies of the CFTC Commissioners, press releases, a summary of exemptive, no-action and interpretative letters and a glossary of industry terms.

CFTC staff conducts briefing sessions for foreign authorities, exchange officials, market professionals, market users, academic representatives, and foreign-based media representatives to acquaint them with the CFTC's functions, regulatory responsibilities, and mandate. Staff also conducts briefings for media representatives on proposed and final rules, regulations, and enforcement activities, as well as other ongoing and technical issues.

As part of its ongoing efforts to support the CFTC's customer education effort, the CFTC informs the general public and potential customers of the availability of current CFTC enforcement and disciplinary information on its Web site at *http://www.cftc.gov/customerprotection/disciplinaryhistory/index.htm*. The CFTC's Web site provides disciplinary history relating to reparations sanctions and administrative sanctions. Information regarding the registration status and disciplinary history of CFTC registrants may be accessed by visiting the NFA's Web site at *http://www.nfafutures.org/basicnet*. In addition, the CFTC publishes a Proceedings Bulletin on its Web site providing information about CFTC enforcement actions and statutory disqualification proceedings.

The CFTC also provides Technical Assistance to other jurisdictions upon request.

6) Are the regulator's exercise of its powers and discharge of its functions consistently applied?

Yes. *See supra*, response to Principle 4, Question 3.

Principle 5. The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality

Assessment: Fully Implemented

1) **Are the staff of the regulator required to observe legal requirements or a "Code of Conduct" or other written guidance, pertaining to:**

a) The avoidance of conflicts of interest?

Yes. Subpart C of Part 140 of the CFTC's regulations, 17 C.F.R. 140, establishes general ethical standards of conduct for CFTC employees and CFTC Commissioners. Regulation 140.735-2 restricts business and financial transactions and interests; Regulation 140.735-3 restricts non-governmental employment and outside activities; Regulation 140.735-4 restricts the receipt and disposition of foreign gifts and decorations; Regulation 140.735-5 prohibits the disclosure of non-public commercial, economic or official information to any unauthorized person; and Regulation 140.735-6 restricts the scope of former CFTC employees to practice or otherwise represent a person before the CFTC.

Regulations issued by the U.S. Office of Government Ethics, 5 C.F.R. 2635, also apply to CFTC employees and cover the following areas: basic obligations of public trust; gifts from outside sources; gifts between employees; conflicting financial interests; impartiality in performing official duties; seeking other employment; misuse of position; and outside activities.

Executive Order #12674 (dated April 12, 1989) issued by the President of the United States also mandates high principles of ethical conduct for government employees.

While greatly detailed, in substance all of these ethical requirements establish that public service is a public trust and that all government employees must avoid both explicit conflicts of interests as well as even the appearance of impropriety in the conduct of their official business.

See supra, response to Principle 2, Question 8, regarding penalties for CFTC employees and Commissioners trading on inside information and/or misusing insider information.

b) Restrictions on the holding or trading in securities subject to the jurisdiction of the regulatory authority and/or requirements to disclose financial affairs or interests?

Yes. *See supra*, response to Principle 5, Question 1(a).

c) Appropriate use of information obtained in the course of the exercise of powers and the discharge of duties?

Yes. The regulations cited in response to Principle 5, Question 1(a), above, also would prohibit the inappropriate use of information obtained in the course of employment at the CFTC. *See*, in particular, the prohibitions on use of non-public information by CFTC employees in Section 9 of the CEA.

d) Observance of confidentiality and secrecy provisions and the protection of personal data?

Yes. Except as otherwise provided in the CEA, Section 8(a) of the CEA prohibits the CFTC from disclosing publicly data and information that would separately disclose the business transactions, or market positions of any person and trade secrets or names of customers. Section 9(a)(5) makes it a felony punishable by a fine of up to $500,000 for an individual and/or imprisonment up to five years if any person willfully violates any other provision of the CEA.

Part 145 of the CFTC rules, 17 C.F.R. 145, contains recordkeeping and access requirements, including requirements governing the handling and protection of nonpublic information. In order to prevent a clearly unwarranted invasion of personal privacy, CFTC Regulation 145.4 authorizes the CFTC to delete identifying details when it makes available "public records" as defined in 145.0. CFTC Regulation 145.5 authorizes the CFTC to withhold from public disclosure any "nonpublic records, including: records specifically exempted from disclosure by statute such as data and information which would separately disclose the business transactions or market positions of any person and trade secrets or names of customers; any data or information concerning or obtained in connection with any pending investigation of any person; trade secrets and commercial or financial information obtained from a person and privileged or confidential; and certain enumerated sections of financial reports required to be submitted to the CFTC.

Part 146 of the CFTC rules, 17 C.F.R. 146, implements the Privacy Act of 1974, which provides protections for information concerning an individual. Among the primary purposes of these rules is to permit individuals to determine whether information about them is contained in Government files and, if so, to obtain access to that information; to establish procedures whereby individuals may have inaccurate and incomplete information corrected; and to restrict access by unauthorized persons to that information.

e) Observance by staff of procedural fairness in performance of their functions?

Yes. As discussed in response to Principle 4, Question 3, above, the APA imposes mandatory procedures (notice and public comment) on the CFTC to ensure procedural fairness in the proposal and adoption of rules. The APA also establishes procedures in the adjudicatory context.

In addition, the CFTC has adopted rules of procedure addressing various aspects of the CFTC's program. For example:

- 17 C.F.R. 9 procedural regulations relating to the review of exchange disciplinary, access denial or other adverse actions;

- 17 C.F.R. 10 regulations of practice that are generally applicable to adjudicatory proceedings before the CFTC under the CEA (such as denial, suspension, revocation, conditioning, restricting or modifying registration, the issuance of cease and desist orders, the denial of trading privileges, the assessment of civil penalties, the issuance of restitution orders) and any other proceeding where the CFTC declares them to be applicable;

- 17 C.F.R. 11 regulations relating to investigatory proceedings conducted by the CFTC or its staff;

- 17 C.F.R. 12 regulations relating to reparation applications (i.e., claims against registrants for violations of the CEA and CFTC regulations resolved by administrative law judges or hearing officers) pursuant to Section 14 of the CEA;

- 17 C.F.R. 14 regulations relating to the suspension or disbarment of persons from appearance and practice before the CFTC as an attorney or accountant;

- 17 C.F.R. 147 regulations specifying the conditions for conduct of CFTC business, with a presumption of open CFTC meetings; and

- 17 C.F.R. 171 procedures applicable to the review of NFA decisions.

2) Are there:

a) Processes to investigate and resolve allegations of violations of the above standards?

Yes. *See supra*, response to Principle 5, Question 1(e).

b) Legal or administrative sanctions for failing to adhere to these standards?

As noted above in response 5.1(a) above, the CFTC has adopted ethics regulations. Annual seminars and/or the dissemination of printed materials or films communicate such ethical standards to employees. As further noted in response to Principle 5, Question 1(a), above, criminal penalties attach to certain ethical violations.

SELF REGULATORY ORGANIZATIONS

PRINCIPLES 6-7

Principle 6. The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence and to the extent appropriate to the size and complexity of the markets

Assessment: Fully Implemented

1) Are there organizations that:

a) Establish rules of eligibility that must be satisfied in order for individuals or firms to participate in any significant securities activity?

Yes. There are several categories of organizations authorized by the CFTC which have self-regulatory responsibilities: futures exchanges (*e.g.*, DCMs and DTEFs), DCOs, and registered futures associations (*e.g.*, NFA). CFTC Regulation 1.3(ee) defines the term self-regulatory organization as a contract market or a registered futures association.

DCMs (futures exchanges). In order to trade futures contracts (the regulated activity), a market must be designated as a "contract market" under Section 5 of the CEA. DCMs are subject to continuing statutory self-regulatory obligations.

A DCM designs the terms and conditions of futures contracts (consistent with CFTC Guideline 1), and determines the mechanism and terms of trading and execution, clearing and settlement and approved depositories. A DCM must also carry out surveillance of the operation of its market.

Current DCMs:

- CBOE Futures Exchange
- Chicago Climate Futures Exchange
- Chicago Mercantile Exchange
- Chicago Board of Trade
- COMEX Division of New York Mercantile Exchange
- ELX Futures
- North American Derivatives Exchange, Inc.
- ICE Futures U.S.
- Kansas City Board of Trade
- Minneapolis Grain Exchange
- Nasdaq OMX Futures Exchange
- New York Mercantile Exchange

- NYSE Liffe Futures Exchange
- OneChicago, LLC
- U.S. Futures Exchange

Currently there are no DTEFs.

NFA. Section 17 of the CEA establishes a framework for one or more registered futures associations to exist under the oversight of the CFTC. Part 170 of the CFTC's regulations addresses such registered futures associations. As mentioned previously, the NFA is the only existing registered futures association. Section 17(m) of the CEA provides that the CFTC may approve rules that require persons eligible for membership to become members of at least one registered futures association. Under CFTC Regulation 170.15, most FCMs (the type of financial intermediary for U.S. commodity futures transactions that is permitted to hold customer funds) are required to be members of a registered futures association.

Under Part 3 of CFTC regulations, registration functions for most commodity futures intermediaries under the CEA and CFTC regulations are delegated to be performed by NFA on behalf of the CFTC.

Under CFTC Regulation 1.52, certain examination and monitoring functions (for members' compliance with financial and reporting requirements) may be performed under agreement of certain SROs to reduce duplicative/multiple monitoring and auditing for compliance. DCMs and the NFA are participants in the existing Joint Audit Agreement that has been approved by the CFTC. The CEA provides Designation Criteria for DCMs, including that such a contract market establish trading rules, discipline violators, and ensure the financial integrity of transactions and member intermediaries. Through the Joint Audit Agreement, DCMs and the NFA divide up primary SRO responsibility for monitoring the financial condition and rule compliance of joint members.

Registered futures associations and DCMs fulfill all of (a)-(c) and perform SRO functions under the U.S. statutory and regulatory scheme governing commodity futures transactions and intermediaries.

Consistent with its obligations under Section 17 of the CEA and Part 170 of the CFTC's regulations, NFA has promulgated rules fulfilling its statutory and regulatory requirements. *See* NFA's Member Rules, available at *http://www.nfa.futures.org/nfamanual/NFAManual.aspx*.

Overview of NFA. The CFTC has delegated certain responsibilities to the NFA, which became a "registered futures association" in 1981. This delegation includes requiring NFA to: adopt rules establishing training standards and proficiency testing for persons involved in the solicitation of transactions subject to the CEA, supervisors of such persons, and all persons for whom it has registration responsibilities and to create a program to audit and enforce compliance with such standards; establish minimum capital, segregation, and other financial requirements applicable to its members for whom such

requirements are imposed by the CFTC and to implement a program to audit and enforce compliance with such requirements; establish minimum standards governing the sales practices of its members and members' associated persons; and establish special supervisory guidelines to protect the public interest relating to the solicitation by telephone of new futures or options accounts.

NFA has incorporated into its rules, by reference, the CFTC's segregation, recordkeeping, and related reporting requirements for FCMs, CPOs, IBs, and CTAs. In addition, NFA has adopted net capital rules for FCMs and IBs which, as required by the CEA, are no less stringent than those of the CFTC. NFA's member audit program primarily applies to registrants that are not members of a DCM.

The CFTC has delegated to NFA registration processing functions and the authority to take adverse action, such as to revoke or to deny registration, against registrants and applicants for registration based upon disqualifying conduct set forth in Sections 8a(2) and (3) of the CEA. The CFTC also retains authority to take such actions. The NFA also has certain delegated functions with respect to ethics training required of registrants.

In addition, the CFTC delegated to NFA the responsibility generally to review CPO and CTA Disclosure Documents as well as certain other tasks related to activities in the foreign futures and foreign options area and functions concerning agricultural trade option merchants and their associated persons; authorized NFA to revoke, after 30 days written notice, the confirmation of Regulation 30.10 relief for any firm that fails to comply with the terms and conditions upon which relief was confirmed; and authorized NFA to withdraw the confirmation of Regulation 30.10 relief from any firm that notifies NFA of its decision to forfeit such relief. Regulation 30.10 permits certain market professionals to conduct business in the U.S. based on substantial compliance with the rules of their home jurisdiction.

The CFTC has general oversight responsibility for all NFA functions and full access to information it maintains and obtains to ensure compliance with the CEA and rules thereunder and assure that these functions are carried out fairly and effectively. The CFTC also monitors NFA for enforcement of its own rules and by-laws.

In performing its delegated authority, the NFA "stands in the shoes" of the CFTC and is subject to all relevant confidentiality requirements applicable to the CFTC.

b) Establish and enforce binding rules of trading or business conduct for individuals or firms engaging in securities activities?

Yes. *See* response to Principle 7, Question 1(a) and (c).

c) Establish disciplinary rules and/or conduct disciplinary proceedings, which have the potential to impose enforceable fines, or other penalties, or to bar or suspend a legal or natural person from participating in securities activities or professional activities related to securities activities?

Yes. *See* response to Principle 7, Question 1(f).

Principle 7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities

Assessment: Fully Implemented

1) As a condition to authorization, does the legislation or the regulator require the SRO to demonstrate that it:

a) Has the capacity to carry out the purposes of governing laws, regulations and SRO rules consistent with the responsibility delegated to the SRO, and to enforce compliance by its members and associated persons subject thereto those laws, regulations and rules?

Exchanges. Yes. Generally, as a condition to designation, CEA Section 5 and CFTC Regulation 38.3 require the applicant to demonstrate that it complies with eight Designation Criteria (set forth in CEA Section 5(b)) and 18 core principles (set forth in CEA Section 5(d)), with which all DCMs must comply. Additionally, DCM Designation Criterion 1, set forth in Section 5(b) of the CEA, requires a board of trade to demonstrate to the Commission that the board of trade meets initially and on an on-going basis the criteria specified in Section 5(b). Moreover, DCM Core Principle 1, set forth in Section 5(d) of the CEA, requires a board of trade, in order to maintain designation, to comply with the core principles specified in Section 5(d).

Furthermore, DCM Core Principle 2–Compliance with Rules, set forth in Section 5(d) of the CEA, requires a DCM to monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market. DCM Designation Criterion 4—Trade Execution Facility, set forth in Section 5(b) of the CEA, requires a DCM to establish and enforce rules defining the manner of operations of the trade execution maintained by the DCM, and to demonstrate that the trade execution facility operates in accordance with the rules of the DCM.

Criteria for Designation as a DCM. The criteria for designation as a contract market are set forth in Section 5(b) of the CEA and Part 38 of the CFTC's regulations. The criteria relate to the following standards:

(1) General Demonstration of Adherence to Designation Criteria;

(2) Prevention of Market Manipulation;

(3) Fair and Equitable Trading;

(4) Enforcement of Rules on the Trade Execution Facility;

(5) Financial Integrity of Transactions;

(6) Disciplinary Procedures;

(7) Public Access to Information on the Contract Market; and

(8) Ability of the Contract Market to Obtain Information.

Appendix A to Part 38 provides more specific information on these designation requirements as well as guidance to applicants seeking to become DCMs.

Ongoing compliance with core principles. A DCM must comply, on a continuing basis, with the following 18 core principles. Appendix B to Part 38 provides additional information and guidance to applicants on how DCMs can remain in compliance with these core principles.

1. In general	*7. Availability of general information*	*13. Dispute resolution*
2. Compliance with rules	*8. Daily publication of trading information*	*14. Governance fitness standards*
3. Contracts not readily subject to manipulation	*9. Execution of transactions*	*15. Conflicts of interest*
4. Monitoring of trading	*10. Trade information*	*16. Composition of boards of mutually owned markets*
5. Position limits or accountability	*11. Financial integrity of contracts*	*17. Record-keeping*
6. Emergency authority	*12. Protection of market participants*	*18. Antitrust considerations*

See also CFTC Regulation 1.52, 17 C.F.R. 1.52, (SRO adoption and auditing of minimum financial and related reporting requirements).

NFA. Yes. Section 17(b)(1) of the CEA requires that the ongoing RFA demonstrate through the documentation submitted to the CFTC that it is in the public interest, that it will be able to comply with the provisions of Section 17 and the rules and regulations promulgated by the CFTC thereunder, and that it will be able to fulfill the purposes of Section 17. Section 17(b)(8) of the CEA requires that the prospective RFA demonstrate that the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules. Similarly Designation Criteria under core principles for DCMs (Section 5 of the CEA) and application guidance published by the CFTC in Part 38 of its regulations require the demonstration to the CFTC in its application, and on an ongoing oversight and review basis, of a DCM's ability to meet such core principles.

b) Treats all members of the SRO, applicants for membership and similarly situated market participants subject to its rules in a fair and consistent manner?

Yes. DCM Designation Criteria 3—Fair and Equitable Trading, establishes that boards of trade must establish and enforce rules to ensure fair and equitable trading through the facilities of the contract market, and the capacity to detect, investigate, and discipline any person that violates the rules. *See also* response to Principle 7, Question 3(a) on Procedural Fairness. Application Guidance for DCMs under Appendix B to Part 38 of CFTC regulations references "clear and fair standards" with respect to the DCM's authority and ability to discipline, limit or suspend activities of members or terminate membership. In addition, there are specific core principles for DCMs with respect to minimizing conflicts of interest and anti-trust considerations which have bearing on the fairness and consistency with which a DCM interacts with members.

Regarding the NFA, fairness and consistency of treatment of members is established by operation of the following requirements. Section 17(b)(2) of the CEA mandates that the prospective RFA submit rules that provide that any person registered under the CEA, a registered entity, or any other person designated pursuant to the regulations of the CFTC as eligible for membership may become a member of such association. That section also states that the rules of the association may restrict membership in such association on the basis of the type of business conducted by its members. Further, section 17(b)(5) of the CEA requires that the prospective RFA demonstrate that its rules assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs. Consistent with the provisions of the CEA, CFTC Regulation 170.3 provides for the fair and equitable representation of members with respect to the governing board of the association. In particular, the Regulation provides that no single class or group of members may dominate or otherwise exercise disproportionate influence on the governing board.

c) Develops rules that are designed to set standards for its members and to promote investor protection?

Exchanges. Yes. Trade practice, handling of customer funds, reporting, recordkeeping and other business standards for commodity professionals, many of whom constitute the class of exchange membership, are established in the first instance by CEA Sections 5(b) and (d), CFTC regulations (Part 38), DCM rules, and, as explained below, by NFA requirements.

DCMs must initially and on an ongoing basis demonstrate compliance with DCM Core Principle 12 of Section 5(d) of the CEA, and DCM Designation Criterion 3 of Section 5(b) of the CEA. DCM Core Principle 12—Protection of Market Participants, establishes that boards of trade must establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants. DCM Designation Criteria 3—Fair and Equitable Trading, establishes that boards of trade must establish and enforce rules to ensure fair and equitable trading through the facilities of the contract market, and the capacity to detect, investigate, and discipline any person that violates the rules. Core Principle 11 for DCMs provides that the DCM shall establish and enforce rules to ensure the financial integrity of FCMs and IBs and the protection of customer funds.

NFA. Yes. Section 17(b)(3) of the CEA requires the rules of an RFA to provide that membership must be denied to certain firms and individuals, including those subject to an order by the CFTC suspending, denying or revoking registration. Section 17(b)(4) of the CEA requires that the RFA rules provide that applicants for membership conform with specific and appropriate standards with respect to the training, experience and such other qualifications as the RFA deems necessary or desirable, including the financial responsibility of members. Section 17(p) of the CEA further requires each RFA to establish rules that require the association to:

- Establish training standards and proficiency testing for persons involved in the solicitation of transactions, supervisors of such persons and all persons for which it has registration responsibilities, and a program to audit and enforce compliance with such standards;

- Establish minimum capital, segregation, and other financial requirements applicable to its members for which such requirements are imposed by the CFTC and implement a program to audit and enforce compliance with such requirements;

- Establish minimum standards governing sales practices of its members and persons associated therewith for transactions subject to provisions of the CEA; and

- Establish supervisory guidelines to protect the public interest relating to the solicitation of new futures and options accounts and make such guidelines applicable to those members determined to require such guidelines in accordance with standards established by the CFTC.

In addition, the NFA and DCMs must monitor and enforce compliance with CFTC regulations establishing standards for intermediaries, such as CFTC minimum financial and reporting requirements, and requirements for the protection of customer

funds and communications with customers pursuant to CFTC Regulation 1.52 and Financial and Segregation Interpretations 4-1, as amended, and 4-2.

Common to SROs. CFTC Regulation 1.59, 17 C.F.R. 1.59, prohibits certain trading on material, inside information by SRO members and by members of SRO governing boards and committees. *See infra*, response to Principle 7, Question 3(b).

d) Submits to the regulator its rules, and any amendments thereto, for review and/or approval, as the regulator deems appropriate, and ensures that the rules of the SRO are consistent with the public policy directives established by the regulator?

Yes.

Rules and rule amendments by certification. A DCM may implement most new rules and rule amendments by filing with the CFTC a certification that the amended rule complies with the CEA and CFTC regulations and policies. Self-certification of amendments to terms and conditions of contracts based on enumerated agricultural commodities is not permitted when the amendments are material and the contract has any open interest.

The CFTC's requirements and procedures for self-certification filings for listing new products and for implementing rule amendments are set forth in CFTC regulations 40.2 and 40.6, respectively. *See infra*, section entitled *Rule Approval by Self-Certification.*

Section 5c(c) of the CEA sets forth that registered entities including DCMs may approve and implement new rules by providing the CFTC with written certification that such rule complies with the CEA, but may also submit such rules for prior approval and must do so in certain circumstances. Such rules must comply with the CEA, and under Section 5c(d), if the CFTC determines that a DCM is violating core principles, it will provide notice to the entity in writing of such determination and afford the registered entity an opportunity to make appropriate changes to come into compliance, after which the CFTC may take further steps, including suspension/revocation of certification.

Voluntary approval of products and rules. A contract market may request CFTC approval of its futures or option products under the provisions of CFTC Regulation 40.3. Product approval requests may be submitted concurrently with the filing of a contract under self-certification procedures or any time later. A contract market also may request CFTC approval of its rules under the provisions of CFTC Regulation 40.5.

The requirements for approval of a product are contained in the CFTC's "Guideline No. 1" (Appendix A to Part 40). This guideline provides exchanges with more specific information regarding initial and continued compliance with the CEA and the CFTC's regulations and policies for listing contracts.

See infra, response to Principle 25, Question 4(a).

NFA. Yes. Section 17(a)(2) of the CEA requires an applicant for RFA status to provide the CFTC with copies of its constitution, charter or articles of incorporation or association, along with all bylaws. Section 17(j) of the CEA states that an RFA must file with the CFTC copies of any changes or additions to the RFA rules. Section 17(j) further provides that the RFA may make any proposed change or addition effective ten days after the receipt of such a filing by the Commission unless the RFA requests that the Commission review and approve the submission or the Commission informs the RFA of its intention to do so. If the Commission decides that it will review the rules for approval, the Commission must determine whether such change or addition is consistent with the requirements of Section 17 of the CEA and is not in violation of any other provision of the CEA. If the Commission disapproves the change or addition as inconsistent with the CEA, the Commission must provide the RFA with notice and opportunity to be heard. Further, if the Commission does not approve or institute disapproval proceedings with respect to a rule within 180 days after the receipt of such a rule, or if the Commission does not conclude disapproval proceedings within one year after the receipt of such rule, the RFA may implement the submitted rule until the Commission concludes the disapproval process.

e) Cooperates with the regulator and other domestic SROs to investigate and enforce applicable laws, regulations and rules?

Yes. The CEA, CFTC regulations and interpretative advisories establish a general obligation on the SROs to cooperate with the CFTC and with other SROs to investigate and enforce applicable laws and regulations.

CEA Section8(a)(1) provides that for the efficient execution of the provisions of the CEA, and in order to provide information for the use of Congress, the CFTC may make such investigations as it deems necessary to ascertain facts regarding the operations of boards of trade and other persons subject to the CEA. CEA Section 5b authorizes the CFTC to suspend or revoke the designation of any board of trade which fails or refuses to comply with any of the provisions of the CEA or any of the rules, regulations or orders issued by the CFTC thereunder.

The CFTC's rules contemplate cooperation among exchanges. CFTC Regulation 1.52 authorizes any two or more SROs to file with the CFTC a plan for delegating to a designated SRO (including a registered futures association), the responsibility of monitoring and auditing for compliance with the minimum financial and related reporting requirements adopted by such SROs. Among other things, Regulation 1.52(d) authorizes such SROs to establish programs among themselves to provide access to any necessary financial or related information.

Cooperation with other SROs is not required for authorization to act as an SRO, and participation in the Joint Audit Agreement is not mandatory, however, all current SROs do participate. Under Regulation 1.52, SROs with FCM members in common may establish joint audit plans, and, pursuant to such plans, delegate the responsibility to audit

and conduct financial surveillance of an FCM to one of the SROs as the DSRO. With respect to an FCM that is not a member of any exchange, NFA is the FCM's DSRO. The Commission requires that DSROs ensure that each FCM is subject to an on-site examination within nine to 18 months of the "as of" date of the previous examination by the DSRO. The Joint Audit Committee (JAC), which consists of representatives of the DSROs that are signatories to a joint audit plan under Regulation 1.52, has established uniform procedures for such on-site examinations. Cooperation with the CFTC is not a specified Designation Criteria, although it is expected, based on the delegations and authority being provided to the SROs, and can be enforced through the CFTC's ability to monitor and remove the authority of the SROs.

Additionally, DCM Designation Criteria 8—Ability of the Contract Market to Obtain Information, under CEA Section 5(b), requires the board of trade to establish and enforce rules that will allow the board of trade to obtain any necessary information to perform any of the functions described in this subsection, including the capacity to carry out such international information-sharing agreements as the Commission may require.

f) Imposes appropriate sanctions for non-compliance with its own rules?

Exchanges. Yes. DCM Core Principle 2–Compliance with Rules, requires a DCM to monitor and enforce compliance with the rules. *See also* CFTC Regulation 1.52(a), 17 C.F.R. Section 1.52(a).

Also, DCM Designation Criteria 6—Disciplinary Procedures of Section 5(b) of the CEA requires the board of trade to establish and enforce disciplinary proceedings that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties. See (d) and (e) above regarding DCMs. Further, Designation Criteria under the CEA requires that a DCM demonstrate that it shall establish and enforce disciplinary procedures for violations of its rules (Section 5(b)(6) of the CEA) and ongoing core principles for DCMs require monitoring and enforcing compliance with rules.

NFA. Yes. Section 17(b)(8) of the CEA requires that an RFA develop rules that provide for the appropriate discipline of its members, whether by expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules. Section 17(i) provides that the CFTC may review the disciplinary action taken by an RFA. The review would identify the rules of the RFA violated by the person in question and confirm whether such rules were applied in a manner consistent with the purposes of the CEA. Pursuant to this authority, the CFTC also may, having found that a penalty is excessive or oppressive, cancel, reduce or require remission of the penalty. NFA's bylaws and rules provide for the imposition of sanctions on members and associates of members for non-compliance with NFA's rules. *See* NFA's Bylaws and Manual at *http://www.nfa.futures.org/nfamanual/NFAManual.aspx*.

g) Where applicable, e.g., a mutual organization, assures a fair representation of members in selection of its board of directors and administration of its affairs?

Exchanges. Yes. DCM Core Principle 16—Composition of Mutually Owned Contract Markets, under Section 5(d) of the CEA, requires that in the case of a mutually owned contract market, the board of trade shall ensure that the composition of the governing board reflects market participants.

DCM Core Principle 14—Governance Fitness Standards, under Section 5(d) of the CEA, requires boards of trade to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of contract market and any other persons with direct access to the facility.

DCM Core Principle 15—Conflicts of Interest, under Section 5(d) of the CEA, requires the board of trade to establish and enforce rules to minimize conflicts of interest in the decision making process of the contract market and establish a process for resolving such conflicts of interest. The Commissions guidance in Part 38, Appendix B details:

> (a) Application guidance. The means to address conflicts of interest in decision-making of a contract market should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict. In addition, the Commission believes that the contract market should provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by board members, committee members and contract market employees or gained through an ownership interest in the contract market.
>
> (b) Acceptable Practices. All DCMs bear special responsibility to regulate effectively, impartially, and with due consideration of the public interest, as provided for in Section 3 of the CEA. Under DCM Core Principle 15, they are also required to minimize conflicts of interest in their decision-making processes. To comply with this DCM Core Principle, contract markets should be particularly vigilant for such conflicts between and among any of their self-regulatory responsibilities, their commercial interests, and the several interests of their management, members, owners, customers and market participants, other industry participants, and other constituencies. Acceptable Practices for minimizing conflicts of interest shall include the following elements:
>
> (1) Board Composition for Contract Markets
>
> (i) At least thirty-five percent of the directors on a contract market's board of directors shall be public directors; and
>
> (ii) The executive committees (or similarly empowered bodies) shall be at least thirty-five percent public.
>
> (2) Public Director

(i) To qualify as a public director of a contract market, an individual must first be found, by the board of directors, on the record, to have no material relationship with the contract market. A “material relationship” is one that reasonably could affect the independent judgment or decision making of the director.

(ii) In addition, a director shall not be considered “public” if any of the following circumstances exist:

(A) The director is an officer or employee of the contract market or a director, officer or employee of its affiliate. In this context, “affiliate” includes parents or subsidiaries of the contract market or entities that share a common parent with the contract market;

(B) The director is a member of the contract market, or a person employed by or affiliated with a member. “Member” is defined according to Section 1a(24) of the CEA and CFTC Regulation 1.3(q). In this context, a person is “affiliated” with a member if he or she is an officer or director of the member, or if he or she has any other relationship with the member such that his or her impartiality could be called into question in matters concerning the member;

(C) The director, or a firm with which the director is affiliated, as defined above, receives more than $100,000 in combined annual payments from the contract market, any affiliate of the contract market, or from a member or any person or entity affiliated with a member of the contract market. Compensation for services as a director does not count toward the $100,000 payment limit, nor does deferred compensation for services prior to becoming a director, so long as such compensation is in no way contingent, conditioned, or revocable;

(D) Any of the relationships above apply to a member of the director's “immediate family,” i.e., spouse, parents, children, and siblings.

(iii) All of the disqualifying circumstances described in subsection (2)(ii) shall be subject to a one-year look back.

(iv) A contract market's public directors may also serve as directors of the contract market's parent company if they otherwise meet the definition of public in this Section (2).

(v) A contract market shall disclose to the Commission which members of its board are public directors, and the basis for those determinations.

(3) Regulatory Oversight Committee

(i) A board of directors of any contract market shall establish a Regulatory Oversight Committee ("ROC") as a standing committee, consisting of only public directors as defined in Section (2), to assist it in minimizing actual and potential conflicts of interest. The ROC shall oversee the contract market's regulatory program on behalf of the board. The board shall delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the ROC to fulfill its mandate.

(ii) The ROC shall:

(A) Monitor the contract market's regulatory program for sufficiency, effectiveness, and independence;

(B) Oversee all facets of the program, including trade practice and market surveillance; audits, examinations, and other regulatory responsibilities with respect to member firms (including ensuring compliance with financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and the conduct of investigations;

(C) Review the size and allocation of the regulatory budget and resources; and the number, hiring and termination, and compensation of regulatory personnel;

(D) Supervise the contract market's chief regulatory officer, who will report directly to the ROC;

(E) Prepare an annual report assessing the contract market's self-regulatory program for the board of directors and the Commission, which sets forth the regulatory program's expenses, describes its staffing and structure, catalogues disciplinary actions taken during the year, and reviews the performance of disciplinary committees and panels;

(F) Recommend changes that would ensure fair, vigorous, and effective regulation; and

(G) Review regulatory proposals and advise the board as to whether and how such changes may impact regulation.

(4) Disciplinary Panels

All contract markets shall minimize conflicts of interest in their disciplinary processes through disciplinary panel composition rules that preclude any group or class of industry participants from dominating or exercising disproportionate influence on such panels. Contract markets

> can further minimize conflicts of interest by including in all disciplinary panels at least one person who would qualify as a public director, as defined in subsections (2)(ii) and (2)(iii) above, except in cases limited to decorum, attire, or the timely submission of accurate records required for clearing or verifying each day's transactions. If contract market rules provide for appeal to the board of directors, or to a committee of the board, then that appellate body shall also include at least one person who would qualify as a public director as defined in subsections (2)(ii) and (2)(iii) above.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

NFA. Yes. Section 17(b)(5) of the CEA requires that an RFA's rules assure a fair representation of its members in the adoption of any rule of the association, the selection of its officers and directors, and in all other phases of the administration of its affairs. Section 17(b)(11) also requires that an RFA must provide for meaningful representation on the governing board of such an association a diversity of membership interests and provides that no less than 20 percent of the regular voting members of such board be comprised of qualified nonmembers of or persons who are not regulated by such association. Section 17(b)(12) requires that the RFA provide on all major disciplinary committees for a diversity of membership sufficient to ensure fairness and to prevent special treatment or preference for any person in the conduct of disciplinary proceedings and the assessment of penalties. Consistent with the provisions of the CEA, CFTC Regulation 170.3 provides for the fair and equitable representation of members with respect to the governing board of the association. In particular, the Regulation provides that no single class or group of members may dominate or otherwise exercise disproportionate influence on the governing board. Additionally, CFTC Regulation 170.6 mandates a fair and orderly procedure with respect to disciplinary actions brought against association members or persons associated with members.

h) Avoids rules that may create anti-competitive situations as defined in the Explanatory Note?

Yes. DCM Core Principle 18 of Section 5(d) of the CEA provides that:

> Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall endeavor to avoid—(A) adopting any rules or taking any actions that result in any unreasonable restraints of trade; or (B) imposing any material anticompetitive burden on trading on the contract market.

Appendix B to Part 38 of the CFTC's regulations provides the following Commission guidance:

> (a) Application guidance. An entity seeking designation as a contract market may request that the Commission consider under the provisions of Section 15(b) of the

CEA any of the entity's rules, including trading protocols or policies, and including both operational rules and the terms or conditions of products listed for trading, at the time of designation or thereafter. The Commission intends to apply Section 15(b) of the CEA to its consideration of issues under this Core Principle in a manner consistent with that previously applied to contract markets.

(b) Acceptable practices. [Reserved]

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm.*

Additionally, Section 15 of the CEA requires the CFTC to take into consideration the public interest to be protected by the antitrust laws and endeavour to take the least anticompetitive means of achieving the objectives of the CEA in, among other things, issuing any order or in approving any rule of a contract market or a registered futures association. CFTC Regulation 170.9 requires that an applicant to become an RFA must demonstrate, among other things, that the association will promote fair and open competition among its members and will conduct its affairs consistent with the public interest to be protected by the antitrust laws.

i) Avoids using the oversight role to allow any market participant unfairly to gain an advantage in the market?

Yes. *See infra*, response to Principle 7, Question 4.

DCM Designation Criterion 2—Prevention of Market Manipulation, under Section 5(b) of the CEA, provides that the board of trade shall have the capacity to prevent market manipulation through market surveillance, compliance, and enforcement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

DCM Core Principle 4—Monitoring of Trading, under Section 5(d) of the CEA, provides that the board of trade shall monitor trading to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process.

DCM Core Principle 12—Protection of Market Participants, under Section 5(d) of the CEA, provides that the board of trade shall establish and enforce rules to protect market participants from abusive trade practices committed by any party acting as an agent for the participants.

Core Principle 15 for DCMs provides that a DCM shall establish and enforce rules to minimize conflicts of interest in the decision making process of the DCM, and application guidance includes managing such conflicts through the use of a Regulatory Oversight Committee of the Board of Directors, as well as maintaining a certain number of Public (disinterested) directors. Core Principle 12, requiring DCMs to establish rules

to protect market participants from abusive practices, should also apply to prohibit abusive practices by the DCM itself.

2) Does the regulator:

a) Have in place an effective on-going oversight program of the SRO, which may include:

i) Inspection of the SRO;
ii) Periodic reviews;
iii) Reporting requirements;
iv) Review and revocation of SRO governing instruments and rules; and
v) The monitoring of continuing compliance with the conditions of authorization or delegation.

Yes, to all of the above. The CFTC's regulatory scheme is based upon the assumption of self-regulatory responsibilities by the exchanges following their designation under Section 5 of the CEA and by an RFA following registration under Section 17 of the CEA. Essentially, the CFTC's exchange oversight programs attempt to ascertain whether the exchange SROs are in compliance with their self-regulatory responsibilities. DCM Core Principle 4–Monitoring of Trading, requires a DCM to monitor trades to prevent manipulation; DCM Core Principle 12–Protection of Market Participants, requires a DCM to establish and enforce rules to protect markets from abusive practices.

DCMs. Among other things, each contract market is required to adopt and submit for CFTC approval, rules prescribing minimum financial and related reporting requirements for its members.[56] Additionally, DCM Designation Criterion 1—In General—set forth in Section 5(b) of the CEA, requires a board of trade to demonstrate to the Commission that the board of trade meets initially and on an ongoing basis the criteria specified in Section 5(b). Furthermore, DCM Core Principle 1, set forth in Section 5(d) of the CEA, requires a board of trade, in order to maintain designation, to comply with the core principles specified in Section 5(d).

Criteria for Designation as a DCM. The criteria for designation as a contract market are set forth in Section 5(b) of the CEA and Part 38 of the CFTC's regulations. The criteria relate to the following standards:

(1) General Demonstration of Adherence to Designation Criteria;

(2) Prevention of Market Manipulation;

(3) Fair and Equitable Trading;

(4) Enforcement of Rules on the Trade Execution Facility;

[56] 17 C.F.R. Section 1.52.

(5) Financial Integrity of Transactions;

(6) Disciplinary Procedures;

(7) Public Access to Information on the Contract Market; and

(8) Ability of the Contract Market to Obtain Information.

Appendix A to Part 38 provides more specific information on these designation requirements as well as guidance to applicants seeking to become DCMs.

Ongoing compliance with core principles. A DCM must comply, on a continuing basis, with the following 18 core principles. Appendix B to Part 38 provides additional information and guidance to applicants on how DCMs can remain in compliance with these core principles.

1. In general	*7. Availability of general information*	*13. Dispute resolution*
2. Compliance with rules	*8. Daily publication of trading information*	*14. Governance fitness standards*
3. Contracts not readily subject to manipulation	*9. Execution of transactions*	*15. Conflicts of interest*
4. Monitoring of trading	*10. Trade information*	*16. Composition of boards of mutually owned markets*
5. Position limits or accountability	*11. Financial integrity of contracts*	*17. Record-keeping*
6. Emergency authority	*12. Protection of market participants*	*18. Antitrust considerations*

US futures markets' transactions are cleared either through clearing organizations that are a division of the exchange or through separately incorporated organizations. Regardless of the type of organization, all such clearing organizations are required to be registered as DCOs. Relevant DCO operations are subject to review within the context of Staff's overall financial compliance program (discussed below) for DCMs.

CFTC Audit Program. The CFTC's audit and review functions with respect to DCMs fall into two general areas: (1) Reviews of exchange market surveillance, audit trail, trade

practice surveillance and disciplinary action programs; and (2) reviews of exchange financial and sales practice compliance programs.

DCM Core Principle 10—Trade Information requires a DCM to maintain rules and procedures to provide for the recording and safe storage of all identifying information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

In addition, DCM Core Principle 17—Recordkeeping requires a DCM to maintain records of all activities related to the business of the contract market in a form and manner acceptable to the Commission for a period of 5 years.

DMO's Market Compliance Section conducts regular reviews (about every two to three years) of each DCM's ongoing compliance with core principles through the self-regulatory programs operated by the exchange in order to enforce its rules, prevent market manipulation and customer and market abuses, and ensure the recording and safe storage of trade information. These reviews are known as rule enforcement reviews ("RERs").

Periodic RERs normally examine a DCM's audit trail, trade practice surveillance, disciplinary, and dispute resolution programs for compliance with the relevant DCM core principles, which include DCM Core Principle 10—Trade Information, and DCM Core Principle 17—Recordkeeping, with respect to audit trail programs; DCM Core Principle 2—Compliance With Rules, and DCM Core Principle 12—Protection of Market Participants, with respect to trade practice surveillance and disciplinary programs; and DCM Core Principle 13—Dispute Resolution, with respect to dispute resolution programs.

Other periodic RERs usually examine a DCM's market surveillance program for compliance with DCM Core Principle 4—Monitoring of Trading, and DCM Core Principle 5— Position Limitations or Accountability. On some occasions, these two types of RERs may be combined in a single RER. Market Compliance can also conduct horizontal RERs of the compliance of multiple exchanges in regard to particular core principles.

For further information, *see http://www.cftc.gov/industryoversight*.

Rule Enforcement Reviews of Exchange Market Surveillance, Audit Trail, Trade Practice Surveillance and Disciplinary Action Programs. DCM Core Principle 2—Compliance with Rules requires a DCM to monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market.

Objectives. RERs are designed to assess an exchange's overall compliance capabilities for a given "target period" under review. Such reviews do not necessarily cover all elements of an exchange's program, but instead target specific areas for in-depth analysis. Reviews are

tailored to specific exchanges at specific times and evolve over time with changes at the exchanges and in the futures industry. Upon completion of a review, a report is issued and submitted to the CFTC for approval for issuance to the exchange. These reports also are made available to the general public. The published reports are designed to report on all of the staff's findings since the prior published report. Any serious findings that are discovered by the staff during an interim review basis are shared immediately with the SRO.

Review of Exchange Financial and Sales Practice Compliance Programs. DCM Core Principle 11—Financial Integrity of Contracts, requires a DCM to establish and enforce rules providing for the financial integrity of any contracts traded on the contract market, and rules to ensure the financial integrity of any FCMs and IBs and the protection of customer funds.

Objectives. CFTC staff examines the design and implementation of an exchange's financial and sales practice compliance program for a target period. In addition to assessing the overall effectiveness of such programs, Staff's reviews are also intended to identify specific deficiencies or areas that could be improved or enhanced.

"Financial compliance" refers generally to the examination of a contract market for compliance with its obligations to adopt and submit to the CFTC regulations prescribing minimum financial and related reporting requirements for all of its member FCMs[57] (*see* CFTC Regulation 1.52(a)), and to enforce all bylaws, rules, regulations and resolutions made or issued by it or by the governing board thereof or by any committee, which provide minimum financial standards and related reporting requirements for FCMs which are members of such contract market (*see* CFTC Regulation 1.52(b)) and ongoing financial surveillance, including steps taken in connection with "major market moves."

"Sales practice compliance" refers to the examination of the books and records kept by contract market members relating to their business of dealing in commodities, insofar as such business relates to their dealings on such contract market. Such books and records include but are not limited to promotional and advertising materials including information relative to performance representations; disclosure and other account opening documents; records of customers' orders; confirmations and account statements.

The CFTC's Division of Trading and Markets, Financial and Segregation Interpretation No. 4-1 provides the SROs with minimum standards for carrying out their surveillance of compliance by FCMs with applicable financial and related reporting requirements.[58]

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[57] Since many FCMs are members of more than one SRO, the CFTC has allowed the SROs to agree among themselves which of the SROs will be the designated self-regulatory organization ("DSRO") for the purpose of auditing and maintaining ongoing financial and sales practice surveillance over member FCMs. The SROs have entered into such allocation agreements among themselves and have established a Joint Audit Committee ("JAC"), discussed above, to coordinate the activities of the SROs. JAC has designated NFA as the SRO responsible for periodically advising the CFTC of changes in the allocation of DSRO responsibility (*see* Regulation 1.52(c)-(i)).

[58] Comm. Fut. L. Rep. (CCH) Section7114A (July 1985). It does not address the SRO's responsibilities with regard to option sales practice examinations of branch offices, guaranteed introducing brokers and commodity trading advisors.

Addendum A to Interpretation 4-1 sets forth an SRO's responsibilities with respect to sales practice and compliance audits of member FCMs, and Addendum B to Interpretation 4-1 addresses the coordination by commodity and securities industry SROs of audit and financial surveillance activities conducted over FCMs registered with both the CFTC and the SEC. [59] Financial and Segregation Interpretation No. 4-2 amended Interpretation 4-1 and Addendum A to permit risk-based auditing.[60]

Interpretation 4-1 generally requires each designated SRO (DSRO) to conduct, at least once every two years, a full scope financial audit of each member FCM that carries customer accounts. This schedule may, however, be modified under the risk-based auditing procedures set forth in Interpretation 4-2.[61] In those years in which a full scope audit is not performed, a DSRO must make an examination of sufficient scope to satisfy itself that the FCM is in compliance with applicable segregation, recordkeeping, and reporting requirements (a "limited scope" examination). Addendum A requires each DSRO to audit FCMs carrying customer funds routinely for applicable sales practice and compliance matters. The scope of the sales practice/compliance audit is determined by the DSRO after taking into account information available on the FCM, including information related to the number of complaints, results of past audits, adequacy of the systems of internal control, and the general nature of the FCM's business. The sales practice compliance audit is performed by the DSRO in conjunction with the biennial full scope audit.

CFTC staff also may conduct direct examinations of selected registrants to ensure maintenance of high quality work by an SRO.

These formal reviews, which result in a written report submitted to the CFTC, constitute only one aspect of the CFTC's broader on-going oversight program.

The CFTC market surveillance program is structured to detect and prevent price manipulation in futures and option markets. The principal goals of market surveillance are to spot adverse situations in these markets and to pursue appropriate remedial actions, in coordination with the involved exchange, to avoid market disruption. To accomplish these

[59] Addendum to Financial and Segregation Interpretation No. 4-1 (Self Regulatory Organizations Sales Practice Audit and Compliance Responsibilities), and Addendum B to Financial and Segregation Interpretation No. 4-1 (Coordinating Financial Rule Enforcement Programs Conducted by Self-Regulatory Organizations Over Dually-Registered Firms).

[60] Financial and Segregation Interpretation 4-2 permits the frequency and scope of the examination to be determined based upon the DSRO's overall assessment of the financial and operational risks posed by an FCM. The DSRO's assessment would include on-site evaluation and testing of the FCM's systems of internal controls and an assessment of the FCM's financial and compliance history by exchange personnel who, through ongoing oversight activities, are familiar with the FCM's operations.

[61] An SRO that implements risk-based auditing will not be required to perform a biennial full scope financial audit of each of its member FCMs that carry customer funds. Rather, both the frequency and scope of the examination would be determined based upon the DSRO's overall assessment of the financial and operational risks posed by an FCM. However, each financial, sales practice, and compliance area must be covered at least once by the DSRO over a three-examination cycle.

objectives, the market surveillance staff must determine when a trader's position in a futures market becomes so large relative to other market factors that the trader is capable of causing prices to diverge from legitimate supply and demand conditions. The surveillance staff routinely collects and analyzes daily data concerning overall supply and demand conditions in the cash market, cash and future prices and price relationships, and the size of hedgers' and speculators' positions in the futures market.

At the heart of the CFTC's market surveillance system (and also as an important component of its financial surveillance system) is the large-trader reporting system. In order to identify potentially disruptive futures positions, Staff uses its reporting system to collect and analyze data on large trader positions in all commodities. Reportable positions—daily reports of futures positions above specified levels set for reporting purposes—are obtained from FCMs, clearing members and foreign brokers. Exchanges also provide the daily positions that each clearing member is carrying in each futures and options contract on each underlying commodity.

Because traders frequently carry futures positions through more than one FCM and because individuals sometimes control, or have a financial interest in more than one account, the CFTC routinely collects information that enables its surveillance staff to aggregate related accounts. FCMs must file a form which identifies each new account with reportable positions for each futures contract. In addition, if a trader's position reaches a reportable level, the trader may be required to file a more detailed identification report to identify accounts and reveal any relationships that may exist with other accounts or traders.

An additional monitoring mechanism allows surveillance economists to investigate further the positions of large traders by instituting a "special call," which requires a trader to report their futures and option positions with all brokerage firms, or their cash market or OTC positions. The trader is required to give information on their trading and delivery activity. This mechanism may be used when a trader is using too many brokers to be easily monitored through required reports. Special calls also may be used to examine cash market positions and commitments in relation to futures market positions to access the economic rationale of the trader's overall position. The CFTC thus has the authority and techniques to investigate and discover the identities of the true account owners and controllers of large positions, whether domestic or foreign.

On a daily basis, staff in DMO's Market Compliance Section reviews details of transactions at each exchange by using the Commission's automated surveillance system. The Commission is currently in the process of significantly upgrading this system to enhance the Commission's ability to detect trade practice violations, including wash trading and trading ahead. Additionally, DMO staff periodically observes trading activity on the floor of each exchange (for the exchanges that still have open outcry trading) and discusses potential issues of concern with compliance staff at the exchange.

It should be noted that the market surveillance process is not conducted exclusively at the CFTC. Contract markets conduct and maintain their own market surveillance programs as part of their self-regulatory responsibilities.

NFA Oversight. Yes. The CFTC has general oversight responsibility for all NFA functions to ensure compliance with the CEA and rules thereunder. The CFTC also monitors NFA for enforcement of its own rules and bylaws.

As an RFA, NFA is considered an SRO and, as noted above, must, in carrying out its financial audit and surveillance activities, comply with the requirements of CFTC Regulation 1.52 and Financial and Segregation Interpretations 4-1, as amended, and 4-2.

In addition to the FCMs for which it is responsible under the joint audit plan, NFA also is responsible for regulatory compliance matters with respect to its member IBs, except for IBs that are guaranteed by an FCM that does not have NFA as its DSRO. NFA also is responsible for sales practice surveillance over all member CPOs and CTAs. NFA's oversight of CPOs and CTAs also extends to review of annual reports and disclosure documents filed pursuant to Part 4 of the CFTC's regulations consistent with the CFTC's delegation of the same,[62] and the conduct of examinations of such firms on a periodic basis.[63]

The CFTC ensures compliance by NFA with its self-regulatory obligations and DCMs with core principles by conducting periodic reviews of NFA's compliance programs and Core Principle oversight reviews of DCMs. NFA oversight reviews focus on the specific program responsibilities of NFA, including review of the financial and sales practice compliance programs for FCMs, IBs, CPOs and CTAs, as well as review of NFA's programs for arbitration, registration and fitness, and disciplinary actions.

In the implementation of such reviews, Staff conducts on-site inspections, meets with NFA or DCM staff and reviews program materials and databases, evaluates procedures, and performs reviews of samples of NFA's or the DCM's files to determine whether the SRO's procedures are consistent with its regulatory obligations, whether the SRO has properly executed its program, and that the files contain sufficient documentation. The results of these reviews are presented to the CFTC and reported back to NFA or the DCM. Consecutive reviews of the same program may focus on a particular aspect of the program in question, including following up on recommendations made in prior reviews.

As an example of the CFTC's oversight of NFA, the CFTC oversees NFA's registration program through frequent contacts between staff members on specific matters, quarterly meetings of the Registration Working Group, which is comprised of staff from the CFTC and NFA, as well as formal reviews by CFTC staff of the operation of NFA's program. The CFTC conducted a review of the registration program in 1996 and is currently reviewing the program again. These reviews have two general purposes: (1) to determine whether NFA's written program properly addresses all relevant CFTC regulations and guidelines; and (2) to confirm that the execution of the written program is complete and is consistently applied in accordance with NFA's written program. Following the completion of the review, the CFTC generates a report detailing its findings with respect to the reviewed

[62] 62 Fed. Reg. 52,088 (Oct. 6, 1997); 67 Fed. Reg. 77,470 (Dec. 18, 2002).
[63] *See* Article III of NFA's Articles of Incorporation at *http://www.nfa.futures.org/nfamanual/NFAManual.aspx*.

program, including recommendations for correction of problems or improvements. CFTC staff also attends regular meetings of the Joint Audit Committee to deal with examination or supervision issues that arise among the SROs.

Within the past ten years, Staff has conducted reviews of NFA's programs for CPO and CTA compliance, telemarketing supervision, FCM and IB financial reports, disciplinary actions, and arbitration. CFTC staff also has conducted oversight reviews of all the SROs during the same time period.

Section 17(k) of the CEA provides that the CFTC is authorized to abrogate any rule of an RFA if it appears to the CFTC that such abrogation is necessary or appropriate to assure fair dealing by the members of the association, to assure a fair representation of its members in the administration of its affairs, or to effectuate the purposes of the CEA. The CFTC also may alter or supplement RFA rules, after notice and hearing. Section 17(c) of the CEA provides that the CFTC may suspend the registration of an RFA if it finds that the rules thereof do not conform to the requirements of the CFTC. Under Section 5c(d) of the CEA, if the CFTC determines that a DCM (or other registered entity such as a DCO) is violating core principles it will provide notice to the entity in writing of such determination and afford the registered entity an opportunity to make appropriate changes to come into compliance, after which the CFTC may take further steps, including suspension/revocation of certification.

b) Retain full authority to inquire into matters affecting the investors or the market?

Yes. *See supra*, response to Principle 7, Question 2(a).

Section 8 of the CEA allows the Commission to make such investigations as it deems necessary to ascertain the facts regarding the operations of the boards of trade and other persons subject to the provisions of the CEA. This includes the authority to investigate the market conditions of commodities, including the supply and demand for such commodities.

DCM Core Principle 17—Recordkeeping—requires DCMs to maintain records of all activities related to the business of the contract market in a form and manner acceptable to the Commission for a period of 5 years. See also CFTC Regulation 1.31, which requires that all books and records required to be kept by the CEA or the Commission's regulations are open to inspection by the Commission or DOJ.

With regards to NFA, pursuant to Section 17 of the CEA, the CFTC broadly retains full authority over all matters undertaken by an RFA.

c) Take over an SRO's responsibilities where the powers of an SRO are inadequate for inquiring into or addressing particular misconduct or allegations of misconduct or where a conflict of interest necessitates it?

Exchanges. Yes. CEA Section 8a(9) authorizes the CFTC to direct a contract market, whenever it has reason to believe that an emergency exists, to take such action as in the

CFTC's judgment is necessary to maintain or restore orderly trading in or liquidation of any futures contract. CEA Section 8a(7) authorizes the CFTC to alter or supplement the rules of a contract market under certain circumstances. In order for the CFTC to take such action under Section 8a(7), the CFTC must first make the appropriate request to a contract market in writing specifying the desired rule change and, after appropriate notice and hearing, determine that the contract market did not make the requested changes and that such changes are necessary or appropriate for the protection of persons producing, handling, processing, or consuming any commodity traded for future delivery on such contract market, or the product or byproduct thereof, or for the protection of traders or to insure fair dealing in commodities traded on a contract market. Under Section 5c(d), if the CFTC determines that a DCM is violating core principles, it will provide notice to the entity in writing of such determination and afford the registered entity an opportunity to make appropriate changes to come into compliance, after which the CFTC may take further steps, including suspension/revocation of certification.

NFA. Section 17(k) of the CEA provides that the CFTC is authorized to abrogate any rule of an RFA if it appears to the CFTC that such abrogation is necessary or appropriate to assure fair dealing by the members of the association, to assure a fair representation of its members in the administration of its affairs, or to effectuate the purposes of the CEA. The CFTC also may alter or supplement RFA rules, after notice and hearing. Section 17(c) of the CEA provides that the CFTC may suspend the registration of an RFA if it finds that the rules thereof do not conform to the requirements of the CFTC.

3) Does the law or regulator require the SRO to follow similar professional standards of behavior as would be expected of a regulator:

a) On matters relating to confidentiality and procedural fairness?

Confidentiality. Yes. The CEA requires SROs to maintain the confidentiality of material nonpublic information and information obtained from the CFTC in connection with the exercise of their self-regulatory responsibilities:

DCM Core Principle 14—Governance Fitness Standards, requires a DCM to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other persons with direct access to the facility.

In addition, DCM Core Principle 15—Conflicts of Interest, requires a DCM to establish and enforce rules to minimize conflicts of interest in the decision-making processes of the contract market and to establish a process for resolving such conflicts of interest. The means to address conflicts of interest in decision-making of a contract market should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict. In addition, the contract market should provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by board members, committee members and contract market employees or gained through an ownership interest in the contract market.

CEA Section 9(e)(1) makes it a felony for any person who is an employee, member of the governing board, or member of any committee of a board of trade, contract market or RFA, in violation of a regulation issued by the CFTC, willfully and knowingly to disclose for any purpose inconsistent with the performance of such person's official duties any material nonpublic information obtained through special access related to the performance of such duties.

CFTC Regulation 1.59(d)(ii), prohibits any employee, member of the governing board or member of any committee of an SRO from disclosing for any purpose inconsistent with the performance of such person's official duties any material, nonpublic information obtained through special access related to the performance of duties.

An exchange or RFA must maintain the confidentiality of information disclosed to it by the CFTC, except in a proceeding. The CFTC is authorized under CEA Section 8a(6) to communicate to the proper committee or officer of any contract market, RFA or SRO the full facts concerning any transaction or market operation, including the names of parties, that in the judgment of the CFTC disrupts or tends to disrupt any market or is otherwise harmful or against the best interests of producers, consumers, or investors, or which is necessary or appropriate to effectuate the purposes of the CEA. However, Section 8a(6) provides that any information furnished by the CFTC under this authority "shall not be disclosed by such contract market, registered futures association, or SRO except in any self-regulatory action or proceeding." *See also* CFTC Regulation 140.72, delegating such authority to certain Staff.

An exchange must maintain the confidentiality of, and is prohibited from disclosing to third parties, information developed by the exchange in an investigation. A contract market is required by CEA Section 8c (2) to make public its findings in any exchange disciplinary proceeding pursuant to its internal rules (that is, a proceeding to suspend, expel, discipline or deny access to an exchange member), but may not disclose the evidence for its findings except to the person suspended, expelled, disciplined or denied access to the exchange or to the CFTC. The CFTC has clarified that its delegation of registration and disqualification functions to NFA permits exchanges to disclose to NFA all evidence underlying exchange disciplinary actions. [64]

NFA. Section 17(b)(9) of the CEA requires that an RFA have rules that provide for a fair and orderly procedure with respect to the disciplining of members and persons associated with members for the denial of membership. Each person subject to such a proceeding must be given an opportunity to be heard and must be informed of the specific grounds for discipline. Further, a record must be kept and, in the event that disciplinary action is taken, specific grounds supporting such action must be provided to the disciplined entity. In addition, an RFA, pursuant to CFTC Regulation 170.6, must conduct proceedings in a manner consistent with fundamental due process.

[64] *See* CFTC Interpretative Letter No. 00-56 (April 13, 2000).

With respect to confidentiality, CFTC Regulation 1.59 prohibits employees, governing board members, committee members and consultants of SROs, from disclosing material non-public information obtained through their position with the SRO for any purpose that is not consistent with the performance of their duties with respect to the SRO, and requires that SROs and RFAs promulgate rules that prohibit governing board members, committee members and consultants from disclosing material, non-public information obtained as a result of the performance of such person's official duties.

Procedural Fairness. Yes. DCM Designation Criteria 3—Fair and Equitable Trading requires a Board of Trade to establish and enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and the capacity to investigate and discipline any person that violates the rules.

In addition, various CFTC regulations impose standards of procedural fairness on SRO programs.

DCM Core Principle 2—Compliance with Rules, requires DCMs to monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market. A DCM should have arrangements, resources and authority for effective rule enforcement. This should include the authority and ability to discipline and limit, or suspend, the activities of a member or market participant as well as the authority and ability to terminate the activities of a member or market participant pursuant to clear and fair standards.

DCM Core Principle 12—Protection Of Market Participants, requires DCMs to establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants and requires DCMs to establish rules providing for a fair and equitable procedure through arbitration or otherwise for the settlement of customer's claims and grievances against any member or employee of the contract market. DCMs should have rules prohibiting conduct by intermediaries that is fraudulent, noncompetitive, unfair, or an abusive practice in connection with the execution of trades and a program to detect and discipline such behavior. The DCM should have methods and resources appropriate to the nature of the trading system and the structure of the market to detect trade practice abuses.

Similarly, CFTC Regulation 170.8, requires RFAs to demonstrate a capability to promulgate rules and conduct proceedings which provide a fair, equitable and expeditious procedure, through arbitration or otherwise, for the voluntary settlement of customers' claims or grievances brought against any member of the association or any employee thereof.

The CFTC has delegated to NFA responsibility for processing and granting applications for registration of various categories of registrants under the CEA. The various delegation orders have imposed procedural conditions and/or were accompanied by the approval of NFA rules that contained procedural protections. For example, in 1985 the CFTC approved rules adopted by NFA pursuant to which NFA would conduct proceedings to deny, condition, suspend, restrict or revoke the registration of any

applicant for registration or registrant who may be subject to a statutory disqualification under Sections 8a(2) through 8a(4) of the CEA and for whom NFA has been authorized to perform the CFTC's registration functions. The procedures embodied in those NFA rules closely parallel those specified by the CFTC in Subpart C of Part 3 of its regulations. Specifically, NFA adopted the CFTC's standards defining the scope of evidence that may be presented by the applicant or registrant to challenge allegations of statutory disqualification, as well as the standards to be followed by the party reviewing the matter and making determinations. Wherever NFA has modified those procedures, the CFTC's review concluded that the modifications would not adversely affect the rights of applicants and registrants.[65]

b) On the appropriate use of information obtained in the course of the SRO's exercise of its powers and discharge of its responsibilities?

Yes. DCM Core Principle 15—Conflicts of Interest, requires a board of trade to establish and enforce rules to minimize conflicts of interest in the decision making process of the contract market and establish a process for resolving such conflicts of interest. The Commissions guidance in Part 38 Appendix B details:

> (a) *Application guidance.* The means to address conflicts of interest in decision-making of a contract market should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict. In addition, the Commission believes that the contract market should provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by board members, committee members and contract market employees or gained through an ownership interest in the contract market.

Furthermore, CEA Section 9(e)(2) makes it a felony for any person who is an employee, member of the governing board, or member of any committee of a board of trade, contract market or RFA, in violation of a regulation issued by the CFTC, willfully and knowingly to trade for such person's own account, or for or on behalf of any other account, in contracts for future delivery or options thereon on the basis of material nonpublic information that such person knows was obtained in violation of CEA Section 9(e)(1) (*see infra*) from any employee, member of the governing board, or member of any committee of a board of trade, contract market, or RFA.

Moreover, CFTC Regulation 1.59(d)(i), prohibits any employee, member of the governing board or member of any committee of an SRO from trading for such person's own account, or for or on behalf of any other account, in any commodity interest based on any material, nonpublic information obtained through special access related to the performance of such person's official duties. CFTC Regulation 1.59(d)(2) similarly prohibits any person from trading for such person's own account on the basis of any

[65] *See* 50 FR 34885, 34886 (August 28, 1985).

material, nonpublic information that such person knows was obtained in violation of 1.59(d)(i).

Core Principle 15 for DCMs provides that a DCM shall establish and enforce rules to minimize conflicts of interest in the decision making process of the DCM, and application guidance includes managing such conflicts through the use of a Regulatory Oversight Committee of the Board of Directors, as well as maintaining a certain number of Public (disinterested) directors. Core Principle 12 requiring DCMs to establish rules to protect market participants from abusive practices should also apply to prohibit abusive practices by the DCM itself.

4) Does the law or regulator assure that potential conflicts of interest at the SRO are avoided or resolved?

Yes. DCM Core Principle 15—Conflicts of Interest, requires a board of trade to establish and enforce rules to minimize conflicts of interest in the decision making process of the contract market and establish a process for resolving such conflicts of interest. The Commissions guidance in Part 38 Appendix B details:

(a) *Application guidance.* The means to address conflicts of interest in decision-making of a contract market should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict. In addition, the contract market should provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by board members, committee members and contract market employees or gained through an ownership interest in the contract market.

(b) *Acceptable Practices.* All DCMs bear special responsibility to regulate effectively, impartially, and with due consideration of the public interest, as provided for in Section 3 of the CEA. Under DCM Core Principle 15, they are also required to minimize conflicts of interest in their decision-making processes. To comply with this Core Principle, contract markets should be particularly vigilant for such conflicts between and among any of their self-regulatory responsibilities, their commercial interests, and the several interests of their management, members, owners, customers and market participants, other industry participants, and other constituencies. Acceptable Practices for minimizing conflicts of interest shall include the following elements:

(1) *Board Composition for Contract Markets*

(i) At least thirty-five percent of the directors on a contract market's board of directors shall be public directors; and

(ii) The executive committees (or similarly empowered bodies) shall be at least thirty-five percent public.

(2) *Public Director*

(i) To qualify as a public director of a contract market, an individual must first be found, by the board of directors, on the record, to have no material relationship with the contract market. A "material relationship" is one that reasonably could affect the independent judgment or decision making of the director.

(ii) In addition, a director shall not be considered "public" if any of the following circumstances exist:

(A) The director is an officer or employee of the contract market or a director, officer or employee of its affiliate. In this context, "affiliate" includes parents or subsidiaries of the contract market or entities that share a common parent with the contract market;

(B) The director is a member of the contract market, or a person employed by or affiliated with a member. "Member" is defined according to Section 1a(24) of the CEA and Commission Regulation 1.3(q). In this context, a person is "affiliated" with a member if he or she is an officer or director of the member, or if he or she has any other relationship with the member such that his or her impartiality could be called into question in matters concerning the member;

(C) The director, or a firm with which the director is affiliated, as defined above, receives more than $100,000 in combined annual payments from the contract market, any affiliate of the contract market, or from a member or any person or entity affiliated with a member of the contract market. Compensation for services as a director does not count toward the $100,000 payment limit, nor does deferred compensation for services prior to becoming a director, so long as such compensation is in no way contingent, conditioned, or revocable;

(D) Any of the relationships above apply to a member of the director's "immediate family," i.e., spouse, parents, children, and siblings.

(iii) All of the disqualifying circumstances described in subsection (2)(ii) shall be subject to a one-year look back.

(iv) A contract market's public directors may also serve as directors of the contract market's parent company if they otherwise meet the definition of public in this Section (2).

(v) A contract market shall disclose to the Commission which members of its board are public directors, and the basis for those determinations.

(3) Regulatory Oversight Committee

(i) A board of directors of any contract market shall establish a standing committee, consisting of only public directors as defined in Section (2), to assist it in minimizing actual and potential conflicts of interest. The ROC shall oversee the contract market's regulatory program on behalf of the board. The board shall delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the ROC to fulfill its mandate.

(ii) The ROC shall:

(A) Monitor the contract market's regulatory program for sufficiency, effectiveness, and independence;

(B) Oversee all facets of the program, including trade practice and market surveillance; audits, examinations, and other regulatory responsibilities with respect to member firms (including ensuring compliance with financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and the conduct of investigations;

(C) Review the size and allocation of the regulatory budget and resources; and the number, hiring and termination, and compensation of regulatory personnel;

(D) Supervise the contract market's chief regulatory officer, who will report directly to the ROC;

(E) Prepare an annual report assessing the contract market's self-regulatory program for the board of directors and the Commission, which sets forth the regulatory program's expenses, describes its staffing and structure, catalogues disciplinary actions taken during the year, and reviews the performance of disciplinary committees and panels;

(F) Recommend changes that would ensure fair, vigorous, and effective regulation; and

(G) Review regulatory proposals and advise the board as to whether and how such changes may impact regulation.

(4) Disciplinary Panels

All contract markets shall minimize conflicts of interest in their disciplinary processes through disciplinary panel composition rules that preclude any group or class of industry participants from dominating or exercising disproportionate influence on such panels. Contract markets can further minimize conflicts of interest by including in all disciplinary panels at least

> one person who would qualify as a public director, as defined in subsections (2)(ii) and (2)(iii) above, except in cases limited to decorum, attire, or the timely submission of accurate records required for clearing or verifying each day's transactions. If contract market rules provide for appeal to the board of directors, or to a committee of the board, then that appellate body shall also include at least one person who would qualify as a public director as defined in subsections (2)(ii) and (2)(iii) above.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

Core Principle 12 requiring DCMs to establish rules to protect market participants from abusive practices should also apply to prohibit abusive practices by the DCM itself.

NFA. Yes**.** *See supra*, response to Principle 7, Question 2(b) and (g). CFTC Regulation 1.64(b) requires that each SRO and RFA maintain rules that ensure that 20% of its governing board is comprised of knowledgeable individuals who are not members or employees of the SRO or RFA, who are not otherwise performing services for the SRO or RFA, and who are not officers, principals or employees of a firm that is a member of the SRO or RFA. Additionally, the SRO must be able to demonstrate that the board membership fairly represents the diversity of interests at that SRO and is otherwise consistent with the composition requirements of CFTC Regulation 1.64. CFTC Regulation 1.64(c)(1) mandates that each SRO must have in effect rules ensuring that at least one member of each major disciplinary committee or hearing panel is a person who is not a member of the SRO where the disciplinary action is being taken against a member of the SRO, a member of the governing board, or the member of a major disciplinary committee, or if the alleged or adjudicated rule violations involve manipulation or attempted manipulation, or conduct which directly results in financial harm to a non-member of a contract market. With respect to RFA's, CFTC Regulation 1.64(c)(3) requires that RFAs include persons representing membership interests other than that of the subject of the disciplinary proceeding being considered on each major disciplinary committee or hearing panel thereof. Further, Section 17(k) of the CEA provides that the CFTC is authorized to abrogate any rule of an RFA if it appears to the CFTC that such abrogation is necessary or appropriate to assure fair dealing by the members of the association, to assure a fair representation of its members in the administration of its affairs, or effectuate the purposes of the CEA. The CFTC also may alter or supplement RFA rules, after notice and hearing. Section 17(c) of the CEA provides that the CFTC may suspend the registration of an RFA if it finds that the rules thereof do not conform to the requirements of the CFTC.

CFTC Regulation 1.69 requires that a member of an SRO's governing board, disciplinary committee or oversight panel must abstain from voting on any matter and from deliberating on the same where the that member is a named party in interest; is an employer, employee, or fellow employee of a named party in interest; is associated with a named party in interest through a broker association; has significant, ongoing business relationship with a named party in interest; or has a family relationship with the named

party in interest. Moreover, each member of the SRO's governing board, disciplinary committee, or oversight panel must disclose to the appropriate SRO staff whether such relationships exist. The SRO must establish procedures for determining whether such member is subject to a conflict restriction in any matter involving a named party in interest based on information provided by the member and any other source of information reasonably available to the SRO. Under CFTC Regulation 1.69(2), if a member of an SRO's governing board, disciplinary board or oversight board has a direct and substantial financial interest in the result of the vote based upon either exchange or non-exchange position that could reasonably be affected by the action, such member must abstain from deliberations and voting regarding the same. Pursuant to that regulation, the member must also disclose such interest to SRO staff and the SRO must have appropriate procedures in place to evaluate the conflict.

Core Principle 15 for DCMs provides that a DCM shall establish and enforce rules to minimize conflicts of interest in the decision making process of the DCM, and application guidance includes managing such conflicts through the use of a Regulatory Oversight Committee of the Board of Directors, as well as maintaining a certain number of Public (disinterested) directors. Core Principle 12 requiring DCMs to establish rules to protect market participants from abusive practices should also apply to prohibit abusive practices by the DCM itself.

Among other requirements enumerated in Section 17 of the CEA and Part 170, an RFA must:

- Assure fair and equitable representation of the views and interests of all association members;

- Impose dues equitably among all members, and may not be structured in a manner constituting a barrier to entry of any person seeking to engage in commodity-related business;

- Establish and maintain a program for the protection of customers, including the adoption of rules to protect customers and customer funds and to promote fair dealing with the public;

- Provide a fair and orderly procedure with respect to disciplinary actions brought against association members or persons associated with members;

- Provide a fair and orderly procedure for processing membership applications and for affording any person to be denied membership an opportunity to submit evidence in response to the grounds for denial; and

- Demonstrate its capacity to promulgate rules and to conduct proceedings that provide a fair, equitable and expeditious procedure, through arbitration or otherwise, for the voluntary settlement of a customer's claim or grievance brought against any member or any employee of a member.

Section 17(a) of the CEA requires that an applicant to become an RFA, as part of the application process, must submit to the CFTC a registration statement consistent with CFTC Regulation 170.11. CFTC Regulation 170.11 provides that the applicant must file with the CFTC a letter requesting registration as an RFA, as well as, the constitution, charter or articles of incorporation of the association, the bylaws of the association, any other rules, resolutions, or regulations of the association corresponding to the aforementioned documents, a detailed description of the association's organization, membership, and rules of procedure, and a detailed statement of the association's capability to comply with the provisions of Section 17 of the CEA and Part 170 of the CFTC regulations. Pursuant to CFTC Regulation 170.12, the review of such registration statement has been delegated by the Commission to the Director of DCIO. Following such review, the Commission may by order grant the registration if the requirements are satisfied or, after appropriate notice and opportunity to be heard, deny such registration if the application is deficient.

ENFORCEMENT

PRINCIPLES 8-10

Principle 8. The regulator should have comprehensive inspection, investigation and surveillance powers

Assessment: Fully Implemented

1) Can the regulator inspect a regulated entity's business operations, including its books and records, without giving prior notice?

Yes. Registrants are required to make certain filings with and disclose certain information to the Commission, and keep a variety of books, records, and other information on their futures and options related activities open to inspection by Commission representatives, as set forth below. These filings, disclosures, books and records are required to be readily available to the Commission and DOJ without compulsory process or notice.

All books and records required to be kept, by either the CEA or the Commission's regulations, must be retained for five years and must be "readily accessible" during the first two years of that period. *See* CFTC Regulation 1.31(a), 17 C.F.R. 1.31(a). A copy of any such book or record must be furnished to any authorized representative of the Commission, upon request and at the expense of the person who is required to keep it. In lieu of furnishing a copy, the person may give the representative the original book or record for reproduction by the Commission. In either event, the copies or originals must be provided promptly.[66]

The record-keeping obligations of various Commission registrants and other market participants can be found in the following provisions of the CEA and the CFTC's regulations:

- FCMs, IBs, floor brokers and floor traders - Sections 4f and 4g of the CEA, 7 U.S.C. 6f, 6g, as well as in a number of separate provisions in the Commission's regulations, including but not limited to 1.32 (segregated account, daily computation and record), 1.33 (monthly and confirmation statements), 1.34 (monthly point balance), 1.35 (records of cash commodity, futures and option transactions), 1.36 (record of securities and property received from customers and options customers), 1.37 (customer's account identification record), 1.40 (crop, market information letters, reports).

[66] CFTC Regulation 1.31(a), 17 C.F.R. 1.31(a).

- CTAs and CPOs - Section 4n of the CEA, 7 U.S.C. 6n and Commission Regulations 4.23 and 4.33.
- DCMs - Section 5(d)(17) of the CEA, 7 U.S.C. 7(d)(17); and Part 16 of Commission Regulations.
- DTEFs - Section 5a(d)(8), 7 U.S.C. 7a(d)(18).
- DCOs - Section 5b(c)(2)(J), 7 U.S.C. 7a-1(c)(2)(J).
- options dealers - Commission Regulation 32.7, 17 C.F.R. 32.7
- traders holding reportable futures or options positions on Commission-DCMs - Section 4i of the CEA, 7 U.S.C. 6i, and Commission Regulations found in Parts 17, 18 and 19
- electronic trading facilities – Section 2(h), 7 U.S.C. 2(h)

The CFTC's access to records includes nonpublic and public information held by individuals and entities regulated by the CFTC (FCMs, floor brokers, floor traders, IBs, CTAs, CPOs, associated persons, leverage transaction merchants, agricultural trade option merchants and exchanges) including customer information and to information about persons that do business with such regulated individuals and entities.

2) Can the regulator obtain books and records and request data or information from regulated entities without judicial action, even in the absence of suspected misconduct, in response to:

a) A particular inquiry?

Yes, pursuant to the Commission's inspection powers, the Commission can obtain information from registered individuals and entities without judicial action, as set forth in Sections 5, 5a, 5b, 4g and 4n and Regulations 1.31 and 1.35 and described in response to Principle 8, Question 1. In addition, the Commission can obtain information from certain exempt commercial markets, as set forth in Section 2(h)(5).

b) On a routine basis?

Yes. The CFTC carries out periodic, routine inspections and audits of SROs to ensure that those SROs are carrying out their obligations under the Act. The CFTC imposes a duty in the first instance on DCMs to establish a continuing affirmative action program to secure compliance with, among other things, the CEA and with exchange rules and by-laws. CFTC staff has issued guidance as to how an SRO should conduct its financial and sales practice programs. As part of that process, individual firms are inspected.

Under this system of self regulations, the CFTC does not carry out periodic routine inspections of the business operations of intermediaries. Rather, the CFTC conducts audits of the sufficiency of the SRO's compliance programs.

The CFTC does inspect individual intermediaries on a "for cause" basis and on a sampling basis as part of its audits of SRO compliance programs.

3) Does the regulator have the power to supervise its authorized exchanges and regulated trading systems through surveillance?

Yes, CFTC staff carries out periodic routine inspections and audits of authorized exchanges and regulated trading systems to ensure that they are carrying out their obligations under the CEA. The CFTC imposes on authorized exchanges an obligation to establish an affirmative action program to secure compliance with, among other things, the CEA and with exchange rules and bylaws. The CFTC staff has issued guidance on how an exchange should conduct its financial and sales practice program. As a part of that program, individual firms are inspected.

Under this system of self regulation, the CFTC does not carry out periodic routine inspections of the business operations of intermediaries. Instead, the CFTC conducts audits of the sufficiency of the exchanges' compliance programs.

The CFTC does inspect individual intermediaries on a for-cause basis and on a sampling basis as part of its examinations of exchange compliance programs.

4) Does the regulator have record-keeping and record retention requirements for regulated entities?

Yes. *See supra*, response to Principle 8, Question 1.

5) Are regulated entities required:

a) To maintain records concerning client identity?

Yes. FCMs, IBs and members of a contract market must keep a record which shows for each commodity futures or options account the true name and address of the person for whom such account is carried or introduced and the principal occupation or business of such person. They also must keep a record showing the name of any other person guaranteeing such account or exercising any trading control over the account.[67]

The Patriot Act also requires that certain registrants verify the true identity of their customers. *See infra*, response to Principle 8, Question 5(c).

b) To maintain records that permit tracing of funds and securities in and out of brokerage and bank accounts related to securities transactions?

Yes. Commission regulations require that there be a complete record, or audit trail, of the entry and execution of all orders for transactions in commodity futures and options. For example, each FCM, IB, and member of a contract market must keep all records, data, and memoranda, including copies of statements of purchase and sale, which have been prepared in the course of its business of dealing in commodity futures and options. Additionally, an FCM or IB receiving an oral order from a customer must immediately prepare a written record of the order including account identification and an order

[67] CFTC Regulation 1.37(a)(1), 17 C.F.R. 1.37(a)(1).

number, and the order must be time-stamped within one minute of its receipt.[68] A member of a DCM receiving an oral order must do the same, and must also time-stamp the order when the report of its execution is made.[69]

In addition, an FCM must maintain records for each commodity and option customer and foreign futures or options customer showing any customer funds carried with the FCM and a detailed accounting of all charges and credits to the customer account.[70] These comprehensive record creation, retention and reporting requirements ensure that all transactions in futures and options can be reliably documented and reconstructed, and are readily available to investigating authorities. The Commission's authority to obtain all the foregoing records is the same as set forth in response to Principle 8, Question 1.

c) To put in place measures to minimize potential money laundering?

Yes. At present, in the futures industry, most of the anti-money laundering ("AML") requirements (i.e., anti-money laundering program, suspicious activity reporting, customer identification program, and due diligence for foreign correspondent and private banking accounts) apply to CFTC-registered FCMs and IBs. FCMs are equivalent to brokers and dealers in the securities industry. IBs are similar to FCMs in that they both solicit and accept orders for the purchase or sale of any commodity for future delivery on U.S. futures exchanges. They are distinguishable from FCMs in that, unlike FCMs, IBs are not permitted to accept money or other property to margin, guarantee, or secure any trades or contracts.

U.S. financial institutions, including FCMs and IBs, are required to establish AML programs. 31 U.S.C. 5318(h)(1). A financial institution regulated by an SRO shall be deemed to satisfy the requirements of 31 U.S.C. 5318(h)(1) if it implements and maintains an AML program that complies with the rules of its SRO. 31 C.F.R. 103.120(c). FCMs and IBs are supervised by their applicable SROs, including the NFA.

NFA's AML rule is set forth in NFA Compliance Rule 2-9(c). The Rule requires FCMs and IBs to establish written AML programs. An AML Program must be in writing and must include: the development of internal policies, procedures, and controls; the designation of a compliance officer; an ongoing employee training program; and an independent audit function to test programs. NFA also has issued an Interpretive Notice, which provides guidance for FCMs and IBs in complying with the AML rule. All of NFA's Compliance rules, including NFA's AML rule, can be found at the following link: *http://www.nfa.futures.org/nfaManual/complianceRules.asp*.

CFTC Regulation 42.2, 7 U.S.C. 42.2, sets forth the CFTC's AML requirements. Regulation 42.2 requires FCMs and IBs to comply with applicable provisions of the Bank Secrecy Act ("BSA"), including, the customer identification program ("CIP") rule that was jointly issued by the CFTC and Treasury (*see* 31 C.F.R. 103.123). FCMs and IBs

[68] CFTC Regulation 1.35(a-1)(1), 17 C.F.R. 1.35(a-1)(1).
[69] CFTC Regulations 1.35(a-1)(2) and (4), 17 C.F.R. 1.35(a-1)(2) and (4).
[70] CFTC Regulations 1.33, 1.35(a), and (b), 17 C.F.R. 1.35(a) and (b).

are required to implement a written CIP as part of their required AML programs. The objective of the CIP procedures is to enable each FCM and IB to form a reasonable belief that it knows the true identity of each customer.

Treasury requires covered financial institutions, including FCMs and IBs, to establish due diligence programs that include appropriate, specific, risk-based and, where necessary, enhanced policies, procedures and controls that are reasonably designed to detect and report, on an ongoing basis, any known or suspected money laundering activity conducted through or involving any correspondent account established, maintained, administered, or managed by such covered financial institution in the United States for a foreign financial institution.[71]

Treasury also requires covered financial institutions, including FCMs and IBs, to maintain due diligence programs that are reasonably designed to detect and report known or suspected money laundering or suspicious activity conducted through or involving any private banking account that is established, maintained, administered, or managed in the United States by such financial institution for a non-U.S. person.[72] Further, FCMs and IBs are required to file suspicious activity reports.[73] FCMs and IBs are also required to file a report concerning a transaction (or series of related transactions) in excess of $10,000 in currency.[74]

FCMs and IBs are also subject to CFTC and NFA customer identification rules that have the effect of minimizing potential money laundering.

CFTC Regulation 1.37 requires every FCM and IB to obtain the true name and address of the person for whom an account is carried by the FCM or introduced by the IB. The FCM and IB additionally must obtain the principal occupation or business of such person and the name of any person that guarantees or exercises any trading control with regard to such account. If an account becomes reportable, certain additional information is required to be obtained and filed with the Commission. *See, e.g.*, CFTC Regulation 17.01 (requires the reporting of the identity of the owner of the account and its registration; the legal organization, and principal business/occupation of the owner of the account; the name and location of all persons having a ten percent or more financial interest in the account; and the names and addresses of all persons with trading authority, if there are five or fewer such persons). *See also* CFTC Regulation 18.04 (the Commission may require the reporting of the name, address, registration and principal business and occupation of the reporting trader; the name and address of each person whose trading is controlled by the reporting trader; the name, address and business phone of each person who controls the trading of the reporting trader; and the names and locations of guarantors and persons with a financial interest of 10 percent or more in the reporting trader or its accounts).

[71] 31 C.F.R. 103.176.
[72] 31 C.F.R. 103.178.
[73] 31 C.F.R. 103.17.
[74] 31 C.F.R. 103.22.

NFA has also adopted AML and know-your-customer ("KYC") rules that apply to members. NFA's KYC requirements are set forth in NFA Compliance Rule 2-30. This Rule requires NFA members to obtain the true name, address, and principal occupation or business of each customer that is a natural person; the customer's current estimated annual income and net worth; age; and an indication of the customer's previous investment and futures trading experience.

Finally, as discussed in response to Principle 8, Question 4, the CEA, CFTC regulations and NFA rules also impose comprehensive record creation, retention and reporting requirements to ensure that all transactions in futures and options can be reliably documented and reconstructed, and are readily available to investigating authorities.

6) Does the regulator have the authority to determine or have access to the identity of all customers of regulated entities?

Yes. As indicated in response to Principle 8, Question 5(a), registrants must keep a record of the identity of the owners, controllers and principles of accounts carried by or introduced to or by them. Principals of registered intermediaries, defined as each person who is a holder or beneficial owner of ten percent or more of the outstanding shares of any class of stock or has contributed ten percent or more of the capital of the entity, must provide the Commission with identifying information.[75] Moreover, CTAs and CPOs must provide the Commission with names and addresses of all partners, officers, directors, and persons performing similar functions.[76] The Commission's authority to obtain all the foregoing records is the same as set forth in the response to Principle 8, Question 1.

The Patriot Act requires Treasury to issue rules setting forth minimum standards for financial institutions (including futures industry registrants) to identify and verify the identity of customers. Treasury and the CFTC have jointly issued final rules that require FCMs and IBs to have customer identification programs (CIPs) for identifying and verifying the identity of customers. An FCM's or IB's procedures must enable it to form a reasonable belief that it knows the true identity of each customer.

The CIP rules permit FCMs and IBs to rely on other financial institutions to perform identification/verification functions. However, the reliance must be reasonable under the circumstances, the relied-upon financial institution must be subject to an AML program rule under the BSA and be regulated by a Federal functional regulator, and the financial institution must enter into a contract requiring it to certify annually to the FCM or IB that it has implemented an AML program and that it will perform specified requirements of the CIP. Pursuant to a staff No-Action Letter issued on March 14, 2005, FCMs and IBs may rely upon certain CTAs to perform procedures of the FCM's or IB's CIP even though such CTAs are not yet subject to an AML program rule.

[75] Commission Regulation 3.10, 17 C.F.R. 3.10.
[76] Section 4n of the CEA, 7 U.S.C. 6n.

7) Where a regulator out-sources inspection or other regulatory enforcement authority to an SRO or a third party:

a) Does the regulator supervise the outsourced functions of third parties?

Yes. The CFTC's supervisory approach to outsourcing is addressed in the context of (1) reviews of an exchange's application for initial designation as a "contract market" and (2) ongoing supervision, including rule enforcement reviews, which assess a designated market's ongoing compliance with the initial Designation Criteria and "core principles" that govern the operation and conduct of such a regulated market.

Whether the matter involves a delegation of core functions or a contracting for services (outsourcing), the staff inquiry focuses on determining whether the delegated functions or contracted services will enable the exchange to remain in compliance with the CEA's requirements.

Moreover, the registered entity must have a sufficient degree of control over the persons under contract because it remains the registered entity's responsibility to ensure that its obligations under the Act are met.

The location of the service provider, affiliate status, use of subcontractors and registered status of the service provider are all material considerations. As each "delegation" or "outsourcing" presents issues of fact finding, no single aspect is determinative. Staff inquiry would be guided by the factors outlined in 1.1. Note in particular that with regard to use of affiliates, among others, "the person under contract must have no conflict of interest."

Background Note. As an initial matter, it is important to understand the distinction drawn by the CFTC between "outsourcing" and a "delegation of functions."

The CFTC distinguishes between "outsourcing" and a "delegation" of functions.

Section 5c (b) of the CEA provides that:

> (1) In general - a contract market or derivatives execution facility may comply with any applicable Core Principle through delegation of any relevant function to a registered futures association or another registered entity.
>
> (2) Responsibility – a contract market or DTEF that delegates a function under paragraph (1) shall remain responsible for carrying out the function."

In the context of a 2001 rulemaking, the NFA asked the CFTC to clarify a contract market's ability to delegate functions under the CEA's core principles and to limit entities acceptable for outsourcing of functions to registered futures associations and registered entities. The CFTC's response outlined its approach to the performance of

exchange functions by third parties by distinguishing between a delegation of function and outsourcing:[77]

Section 5c(b) of the CEA, however, limits only "delegations" of functions to RFAs and to registered entities; it does not restrict "outsourcing" of specified activities on a contract basis.

The Commission has long-recognized the ability of contact markets to meet their self-regulatory obligations by using persons under contract to perform specified duties. The Commission has conditioned the use of outside contractors to perform duties in connection with self-regulatory functions upon the contract market "maintaining a sufficient degree of control over the persons under contract" and the person under contract having no conflict of interest." The Commission has further provided that, when using contractors to fulfill a self-regulatory function, it is the exchange's responsibility to ensure that its obligations under the CEA are met.[78] Accordingly, DCMs have contracted for the performance of various services related to their operations and self-regulatory responsibilities, including compliance with various core principles. For example, contract markets or DTEFs reasonably may be expected to outsource to various contractors functions relating to operating their trading platforms or to disseminating information required to be made public.

"In contrast to such contracting arrangements, a delegation confers upon another the authority to act in the delegating entity's name**.** The distinction between delegation of authority and contracting for services is particularly well-illustrated in matters related to member discipline and market surveillance. A market that delegates these functions empowers the delegatee to take appropriate remedial actions, including the sanctioning of members or market participants for rule violations. In contrast, a market may contract with an entity to conduct trading surveillance and to investigate the facts surrounding rule infractions."

"Unlike a delegatee, a contractor would not have the authority to decide on behalf of the delegating entity whether an infraction had occurred or to impose remedial sanctions. These decisional functions can be exercised only by delegation of that authority to registered entities or a registered futures association, as Congress has provided."

Further, although section 5c(b)(2) of the CEA provides that the Commission would have oversight authority over a delegatee because it is a registered entity, the contract market or DTEF that delegates responsibilities under the CEA "also "shall remain responsible for carrying out the function."

"Therefore, regardless of whether a registered entity has delegated functions or contracted for services, the entity must assure itself that the delegated functions or contracted services will enable it to remain in compliance with the [CEA]'s requirements."

[77] 66 Federal Register 42256, 42266 (August 10, 2001).
[78] Comm. Fut. L. Rep. (CCH) ¶6430, CFTC (May 13, 1975)

"Moreover, the registered entity must have a sufficient degree of control over the persons under contract because it remains the registered entity's responsibility to ensure that its obligations under the [CEA] are met."

b) Does the regulator have full access to information maintained or obtained by the third parties?

Yes. The CFTC would have access whether the function is characterized as a "delegation" or "outsourcing." If an SRO "delegated" a function, the CFTC would have regulatory power with respect to both the SRO and the "registered entity" to whom the SRO delegated a function. If an SRO "outsourced" a function, the CFTC would have power over the SRO.

c) Can the regulator cause changes/improvements to be made in the third parties' processes?

Yes, through exercise of its powers over the registered entities. CFTC staff conducts ongoing supervision that addresses the continuing compliance of DCMs and DTEFs with core principles.

Note that whether there may be a concern with respect to access to information or a need to "cause changes or improvements" in the third parties' processes CFTC staff requires a written regulatory services agreement "for purposes of determining compliance with Designation Criteria and core principles." *See* Staff Memorandum dated February 10, 2004, recommending designation of HedgeStreet, at p. 36. Among other things, Staff inquires into the ability of the exchange to monitor and supervise the service provider (as required by the CFTC) and as part of this process would raise any issues arising from such services agreement.

d) Are these third parties subject to disclosure and confidentiality requirements that are no less stringent than those applicable to the regulator?

Yes. Any delegation can only be made to another registered entity. An SRO that "outsourced" a function remains responsible for the exercise of all SRO responsibilities and, to the extent the matter involves a confidential matter, would be required to ensure that the entity carrying out the outsourced function maintains any required confidentiality.

Principle 9. The regulator should have comprehensive enforcement powers

Assessment: Fully Implemented

1) Does the regulator or other competent authority within the jurisdiction have the investigative and enforcement power to enforce compliance with the laws and regulations relating to securities activities?

Yes. The CFTC has comprehensive investigative and enforcement powers. The CFTC enforces compliance with the laws and regulations relating to the futures industry by conducting investigations and bringing enforcement actions where appropriate. The CFTC has broad authority to investigate actual or potential violations of the federal commodities laws and to determine the scope of its investigations and the persons and entities subject to investigation.

Section 8(a)(1) authorizes the Commission to make such investigations as it deems necessary to ascertain the facts regarding the operations of boards of trade and other persons subject to the provisions of this chapter. 7 U.S.C. 2. Further, Section 6(c) of the CEA, 7 U.S.C. 15, provides:

> For the purpose of securing effective enforcement of the provisions of this chapter, for the purpose of any investigation or proceeding under this chapter, … any member of the Commission or any Administrative Law Judge or other officer designated by the Commission … may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records that the Commission deems relevant or material to the inquiry.

Finally, Part 11 of the Commission's Rules Relating to Investigations set forth the rules applicable to investigatory proceedings conducted by the Commission to determine whether there have been violations of the CEA or the Commission's regulations. Regulation 11.2 sets out the authority of the DOE to carry out Section 6(c) and conduct the investigations, which includes obtaining evidence through voluntary statements and submissions, through exercise of inspection powers over registrants, and through the issuance of subpoenas.[79] In addition, Part 11 provides witnesses certain procedural protections, such as the right to have a lawyer present when testifying and to review the Commission's formal order of investigation. A witness can also assert his or her Fifth Amendment protection against self-incrimination. CFTC investigations are non-public.

[79] 17 U.S.C. 11.2.

Where the investigation indicates such a violation, the Director of DOE shall recommend an appropriate civil enforcement action, either administrative or in federal court. *See infra*, response to Principle 9, Question 2.

2) Does the regulator or other competent authority within the jurisdiction have the following powers:

a) Power to seek orders, to refer matters for civil proceedings or to take other action to ensure compliance with regulatory, administrative, and investigative powers?

b) Power to impose administrative sanctions?

c) Power to initiate or to refer matters for criminal prosecution?

d) Power to order the suspension of trading in securities or to take other appropriate actions?

Yes, to all of the above. Under Sections 6c, 6(c) and 6(d) of the CEA, the CFTC has the authority to file a civil enforcement action in federal district court or an administrative enforcement proceeding in an administrative tribunal to ensure compliance with the CEA.

The relief available in federal district court is composed of the remedies that Congress expressly authorized federal courts to grant under Section 6c of the CEA and the federal courts' general equitable powers. Thus, the Commission's federal court enforcement actions may seek any or all of the following types of relief when appropriate:

- Preliminary and permanent injunctions barring future violations of the CEA and CFTC regulations and enforcing compliance with the CEA and regulations;
- An ex parte order (i) prohibiting any person from destroying, altering or disposing of, or refusing to permit authorized representatives of the Commission to inspect, when and as requested, any books and records or other documents, (ii) prohibiting any person from withdrawing, transferring, removing, dissipating, or disposing of any funds, assets, or other property, or (iii) appointing a temporary receiver to administer such restraining order;
- Imposition of civil monetary penalties;
- Appointment of a permanent receiver to administer a defendant's estate;
- An order directing that a defendant disgorge ill-gotten gains;
- An order directing that a defendant make restitution to customers;
- An order rescinding all contracts entered into by a defendant with any customer;
- An order directing that the defendant make an accounting (in a form and by an individual or firm approved by the Commission and the Court) of the defendant's estate; and
- An award of pre-judgment interest on any sums to be disgorged or paid in restitution.

All complaints initiating an administrative action pursuant to Sections 6(c) and 6(d) of the CEA are conducted under the Commission's Rules of Practice contained in Part 10 of the Commission's regulations. The following sanctions are available in administrative actions and all administrative complaints notify respondents of these possible sanctions that can be imposed if liability is found:

- An order prohibiting a respondent from trading on or subject to the rules of any contract market and requiring all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order;
- An order suspending (for a period of not more than six months), revoking or restricting a respondent's registration with the Commission;
- An order assessing civil monetary penalties against a respondent, not to exceed $140,000 per violation ($1 million for manipulation;
- An order directing that a respondent make restitution to customers of damages proximately caused by the respondent's violations; and
- An order directing a respondent to cease and desist from violating the CEA or CFTC regulations in an administrative action brought pursuant to Section 6(d).

In addition to other substantive violations of the CEA, as set forth in Section 6(c), if an individual or firm named in a subpoena refuses to comply with its terms, the Commission may apply to a federal district court to enforce the subpoena. The Commission has delegated its authority to file a subpoena enforcement action to the Director of DOE.

In pertinent part, Section 6(c) of the CEA provides as follows:[80]

> In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction in which the investigation . . . is conducted, or where such person resides or transacts business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. Such court may issue an order requiring such person to appear before the . . . officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question.

If the subpoenaed party refuses to comply with the district court's order enforcing the subpoena, the court can punish the party for contempt.

The CFTC has the power to refer matters for criminal prosecution to DOJ, but cannot independently initiate such actions. Alleged criminal violations of the CEA pursuant to Section 9 of the CEA or violations of other federal laws that involve commodity futures trading are frequently referred to DOJ for prosecution.

[80] 7 U.S.C.A. 15.

3) Does the regulator or other competent authority have the investigative and enforcement power to require from any persons involved in relevant conduct or who may have information relevant to a regulatory or enforcement inquiry/investigation:

a) Data?

b) Information?

c) Documents?

d) Records?

e) Statements or testimony?

Yes, to all of the above. Through its inspection power, the CFTC can obtain information from registered individuals and entities, large traders and market members, without judicial action. Sections 4g and 4n of the CEA provide the CFTC with the authority to examine all the books and records of registered individuals and entities. Pursuant to section 5(2) of the CEA, all records required to be maintained by futures exchanges are open at all times to inspection by any representative of the CFTC or DOJ. *See* response to Principle 8, Question 1.

The CFTC's access to records includes nonpublic and public information held by individuals and entities regulated by the CFTC (FCMs, floor brokers, floor traders, IBs, CTAs, CPOs, associated persons, leverage transaction merchants, agricultural trade option merchants and exchanges) including customer information and to information about persons that do business with such regulated individuals and entities.

In addition to its inspection powers, the CFTC has broad subpoena powers and may obtain information from any individual or entity, whether registered or not, in connection with possible violations of futures laws. Section 6(c) of the CEA authorizes the CFTC to subpoena the production of documentary and testimonial evidence "from any place in the United States, any State, or any foreign country or jurisdiction."

4) Can private persons seek their own remedies for misconduct relating to the securities laws?

Yes. Section 22 of the CEA, 7 U.S.C. 25, permits private rights of action under certain circumstances. Section 22(a) permits, under certain circumstances, private damage actions against anyone other than a SRO who violates, or wilfully aids and abets a violation, of the CEA. Section 22(b) establishes, under certain circumstances, a private damage remedy against SROs and their officials, which in bad faith refuse to enforce their own rules, or enforce their own rules in violation of the CEA, and cause monetary loss to the plaintiff.

Section 14 of the CEA, 7 U.S.C. 18, permits anyone complaining of a violation of the CEA or the CFTC's rules to apply to the CFTC for an order awarding damages caused by the violation. These so-called reparations procedures offer a variety of methods to

resolve claims, including a voluntary procedure based on the submission of written documents, a summary procedure for claims of less than $30,000 where evidence is submitted in writing and an oral hearing may be held by telephone and a formal procedure before an administrative law judge. *See* CFTC regulations relating to Reparations procedures in 17 C.F.R. 12.

The CFTC also requires each DCM to adopt rules which provide for the fair and equitable procedure through arbitration or otherwise for the settlement of customer's claims and grievances against any member or employee of the contract market.[81] The use by customers of the dispute resolution mechanism established by contract markets is voluntary.[82]

Section 17(a)(10) of the CEA requires that any RFA provide a fair, equitable, and expeditious procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof.

5) Where an authority other than the regulator must take enforcement or other corrective action, can the regulator share information obtained through its regulatory or investigation activities with that authority?

Yes. Sections 8(a)(2) and 12(a), 7 U.S.C. 12, 16, specifically authorize the Commission to request the assistance of and cooperate with other state and federal agencies, including DOJ, in the conduct of its investigations.

6) Where the regulator is unable to obtain information in its jurisdiction necessary to an investigation, is there another authority that can obtain the information?

To the extent the information is available from another federal or state agency, such as a state securities regulator, the SEC or FERC, the CFTC may obtain this information by seeking access to the public and non public information in that agency's files. The CFTC cooperates with other domestic enforcement authorities through explicit statutory authorization, formal MOUs and other informal arrangements to combat fraud and other illegal practices that could harm customers or threaten market integrity.

7) If yes, can that authority share the information with the regulator for the regulator's use in investigations and proceedings?

The only limitation on the sharing of information is in the context of information that is obtained by DOJ in a criminal investigation through the grand jury process. Under the Federal Rules of Criminal Procedure, DOJ cannot share this information with the CFTC, though it can share any information obtained through means other than the grand jury.

[81] 17 C.F.R. 180.
[82] 17 C.F.R. 180.3.

Principle 10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program

Assessment: Fully Implemented

1) Is there an effective system of inspection in place whereby the regulator carries out inspections:

a) On a routine periodic basis?

Yes.

Market Surveillance Program. The CFTC conducts a market surveillance program to detect and prevent price manipulation in futures and option markets. The principal goals of market surveillance are to spot adverse situations in these markets and to pursue appropriate remedial actions, in coordination with the involved exchange, to avoid market disruption. To accomplish these objectives, the market surveillance staff must determine when a trader's position in a futures market becomes so large relative to other market factors that the trader is capable of causing prices to diverge from legitimate supply and demand conditions. The surveillance staff routinely collects and analyzes daily data concerning overall supply and demand conditions in the cash market, cash and future prices and price relationships, and the sizes of hedgers' and speculators' positions in the futures market.

At the heart of the CFTC's market surveillance system (and also as an important component of its financial surveillance system) is the large-trader reporting system. In order to identify potentially disruptive futures positions, Staff uses its reporting system to collect and analyze data on large trader positions in all commodities. Reportable positions—daily reports of futures positions above specified levels set for reporting purposes—are obtained from FCMs, clearing members and foreign brokers. Exchanges also provide the daily positions that each clearing member is carrying in each futures and options contract on each underlying commodity.

Since traders frequently carry futures positions through more than one FCM and since individuals sometimes control, or have a financial interest in, more than one account, the CFTC routinely collects information that enables its surveillance staff to aggregate related accounts. FCMs must file a form which identifies each new account with reportable positions for each futures contract. In addition, if a trader's position reaches a reportable level, the trader may be required to file a more detailed identification report to identify accounts and reveal any relationships that may exist with other accounts or traders.

An additional monitoring mechanism allows surveillance economists to investigate further the positions of large traders by instituting a "special call," which requires a trader to report its futures and option positions with all brokerage firms, or its cash market or OTC positions. The trader is required to give information on its trading and delivery activity. This mechanism may be used when a trader is using too many brokers to be easily monitored through required reports. Special calls also may be used to examine cash market positions and commitments in relation to futures market positions to access the economic rationale of the trader's overall position. The CFTC thus has the authority and techniques to investigate and discover the identities of the true account owners and controllers of large positions, whether domestic or foreign. A salient example of the use of special call authority is the September 2008 Staff Report on Commodity Swap Dealers and Index Traders with Commission Recommendations, available on the CFTC's Web site. CFTC staff undertook a survey of swap dealers and commodity index funds to better characterize their activity and understand their potential to influence the futures markets. This type of a compelled survey relating to off-exchange activity is unprecedented, but the growth and evolution in futures market participation and growing public concern regarding off-exchange activity supported the need for this extraordinary regulatory inquiry. Special call authority was also invoked in early 2008 to start receiving daily information on large positions and transactions from the Henry Hub Natural Gas Swap traded on the ICE ECM as "NG Fin, FP for LD1". This action was taken since this contract appears to be part of a single market with the NYMEX-traded Henry Hub Natural Gas Futures Contracts. Needless to say, the vast majority of the special calls are much more targeted to particular traders and time periods.

It should be noted that the market surveillance process is not conducted exclusively at the CFTC. Contract markets conduct and maintain their own market surveillance programs as part of their self-regulatory responsibilities.

Rule Enforcement Reviews of DCMs. The Commission's regulatory scheme is based upon the assumption of self-regulatory responsibilities by the DCMs and continuing oversight by the Commission of the exercise of those responsibilities.

In addition to monitoring exchange operations on an ongoing basis through compliance reporting and ad hoc "for cause" inquiries, the Commission's staff periodically reviews the programs and procedures adopted by each DCM to ensure compliance with the relevant core principles and to assess the effectiveness of those rules and procedures.

The operational integrity of exchanges is addressed through the CFTC's periodic RERs that broadly address market surveillance, trade practice surveillance and disciplinary programs. The DMO's Market Compliance Section conducts regular reviews of each DCM's ongoing compliance with core principles through the self-regulatory programs operated by the exchange in order to enforce its rules, prevent market manipulation and customer and market abuses, and ensure the recording and safe storage of trade information.

Periodic RERs (about every two to three years) normally examine a DCM's market surveillance program for compliance with Core Principle 4, Monitoring of Trading, and

Core Principle 5, Position Limitations or Accountability. On some occasions, these two types of RERs may be combined in a single RER. Market Compliance can also conduct horizontal RERs of the compliance of multiple exchanges in regard to particular core principles.

In conducting an RER, Staff examines trading and compliance activities at the exchange in question over an extended time period selected by DMO, typically the twelve months immediately preceding the start of the review. Staff conducts extensive review and analysis of documents and systems used by the exchange in carrying out its self-regulatory responsibilities; interview compliance officials and staff of the exchange; and prepare a detailed written report of their findings. In nearly all cases, the RER report is made available to the public and posted on *http://www.cftc.gov*.

On a daily basis, staff in DMO's Market Compliance Section reviews details of transactions at each exchange by using the Commission's automated surveillance system. The Commission is currently in the process of significantly upgrading this system to enhance the Commission's ability to detect trade practice violations, including wash trading and trading ahead. Additionally, DMO staff periodically observes trading activity on the floor of each exchange (for the exchanges that still have open outcry trading) and discusses potential issues of concern with compliance staff at the exchange.

b) Based upon a risk assessment?

See below.

c) Based upon a complaint associated with an inspected entity?

With respect to (a)-(c), the Commission itself does not conduct routine on-site direct inspections of intermediaries, but it does conduct such examinations for cause or to test the quality of the DSRO's work. With respect to testing the work performed by DSROs, Staff conducts risk-based reviews that focus on five areas of an SRO's supervisory program: financial stability, customer protection, risk management, market moves and operational capabilities.

Under the CEA, SROs also are required to develop programs to assess whether FCMs and IBs are in compliance with exchange and Commission minimum financial and related reporting requirements. Financial and Segregation Interpretations No. 4-1 and 4-2, issued by Commission staff, establish minimum components for a DSRO's financial surveillance program. These interpretations provide that a DSRO should conduct an examination of each FCM on a basis no less frequently than once every 9 to 15 months. Each examination must assess the FCM's compliance with minimum capital and customer funds protection requirements.

Under Regulation 1.52, SROs with FCM members in common may establish joint audit plans, and pursuant to such plans delegate the responsibility to audit and conduct financial surveillance of an FCM to one of the SROs as the DSRO. With respect to an FCM that is not a member of any exchange, NFA is the FCM's DSRO. The Commission requires DSROs to ensure that each FCM is subject to an on-site examination within nine

to 18 months of the "as of" date of the previous examination by the DSRO. The Joint Audit Committee (JAC), which consists of representatives of the DSROs that are signatories to a joint audit plan under Regulation 1.52, has established uniform procedures for such on-site examinations.

The Commission has issued guidance that emphasizes DSRO examination of the internal controls of FCMs, noting that the DSRO's assessment of such internal controls must include a review and evaluation of the procedures followed by an FCM in evaluating and minimizing the financial risk to the FCM and its customers. Such assessments must take into account the types, size and concentration of customer, non-customer and proprietary transactions, positions and commitments the FCM carries, on exchange and off-exchange, both domestic and foreign. *See* Interpretative Release 4-2 (August 20, 1999).

2) Is there an automatic system which identifies unusual transactions on authorized exchanges and regulated trading systems?

Yes.

Core Principle 2 of Section 5(d) of the CEA requires a DCM to monitor and enforce compliance with rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market.

Core Principle 4 of Section 5(d) of the CEA requires the DCM to monitor trading to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process.

Core Principle 5 of Section 5(d) of the CEA requires the DCM to reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month. The board of trade shall adopt position limitations or position accountability levels for speculators, where necessary and appropriate.

Core Principle 12 of Section 5(d) of the CEA requires a DCM to establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants.

Pursuant to the acceptable practices set forth in Appendix B to Part 38 of the Commission's regulations, an acceptable market surveillance program should provide for the regular collection and evaluation of market data to determine whether markets are responding to the forces of supply and demand. An exchange also should have routine access to the positions and trading of its market participants. To diminish potential problems that may arise from excessively large speculative positions, an exchange may need to establish speculative limits for some commodities. Rules establishing such limits may provide for hedge or other exemptions, and the limits may be set differently for each contract, delivery month, or period when in effect. Spot month limits should be adopted for markets based on commodities having limited deliverable supplies or where necessary to minimize a market's susceptibility to manipulation or price distortion.

Position limits may not be necessary for markets where the threat of excessive speculation or manipulation is very low. For such contracts, such as financial instruments, an exchange may provide for position accountability in lieu of position limits. An exchange should have an automated large trader reporting system that is used daily to enforce compliance with position limit rules.

Pursuant to Appendix B to Part 38 of the Commission's regulations, a contract market's trade practice surveillance program should have the arrangements, resources, and authority necessary to perform effective rule enforcement. The arrangements and resources attendant to the program should facilitate the direct supervision of the contract market, including analysis of relevant data.

An acceptable trade practice surveillance program should have systems that maintain all data reflecting the details of each transaction executed on the contract month. In this regard, the program should include routine electronic analysis of these data to detect potential trading violations. The program also should provide for appropriate and thorough investigation of all potential trading violations brought to the contract market's attention, including member and Commission referrals and customer complaints. In addition, the program should have the authority to discipline, suspend, or terminate the activities of members or market participants pursuant to clear and fair standards.

All exchanges have a trade practice surveillance system that is designed to detect potential trade practice violations.

3) Can the regulator demonstrate adequate mechanisms and procedures to detect and investigate:

a) Market and/or price manipulation?

Yes. The exchanges are obliged to detect and deter unlawful conduct and use a combination of direct surveillance, inspection, reporting, product design requirements, position limits, settlement price rules or market halts complemented by vigorous enforcement of their rules. The CFTC conducts oversight of the exchanges' programs to ensure effectiveness. In addition to the exchange surveillance program, the CFTC independently conducts an extensive market surveillance program, utilizing large trader reports. DOE also aggressively pursues leads to detect and deter violations, including manipulation. *See infra*, response to Principle 26, Question 1.

With respect to a specific inquiry, the CFTC has power to investigate possible violations of the CEA, as discussed in Response to Principle 9 Question 1. In particular, the Division of Enforcement employs its full panoply of investigative powers to examine conduct that affects the integrity of the commodity futures markets, including price manipulation, cornering, communication of false information that tend to affect commodity prices (Sections 6(c), 6(d) and 9(a)(2) of the CEA): position limit violations (Section 4a(e) of the CEA); and enumerated trade practice violations, such as wash trades, accommodation trades and fictitious sales (Section 4c(a) of the CEA). To the

extent the investigation indicates a violation of the CEA, the Commission takes appropriate enforcement action as described in response to Question 2 in Principle 9. In addition, the Division is empowered to investigate violations of "core principles" relating to registered entities (e.g. exchanges and clearing organizations).

b) Insider trading?

The CEA does not generally prohibit insider trading in the commodity futures and options markets. The premise has been that insider trading has limited applicability to futures trading because it would defeat the market's basic economic function of allowing traders to hedge the risks of their commercial enterprises.[83] The price discovery function of futures markets depends on traders bringing information to the market through their trading. From an economic perspective, regulation has not focused on the source or quality of the information; rather, rational traders have been presumed to trade in their best economic interests. However, the knowing communication of false or misleading information that tends to affect commodity prices is a violation of the CEA. (7 U.S.C. 13(a)(2)). The exception is for information obtained by employees of the CFTC and registered entities. Section 9(e) of the CEA provides an explicit prohibition against insider trading for certain persons, making it a felony: (1) for any person who is an employee, member of the governing board, or member of any committee of a board of trade, registered entity, or registered futures association, in violation of a regulation issued by the Commission, willfully and knowingly to trade for such person's own account, or for or on behalf of any other account, in contracts for future delivery or options thereon on the basis of, or willfully and knowingly disclose for any purpose inconsistent with the performance of such person's official duties as an employee or member, any material nonpublic information obtained through special access related to the performance of such duties, and (2) willfully and knowingly to trade for such person's own account, or for or on behalf of any other account, in contracts for future delivery or options thereon on the basis of material, nonpublic information that such person knows was obtained in violation of paragraph (1) from an employee, member of the governing board, or member of any committee of a board of trade, registered entity, or registered futures association.

It should be noted that the CEA's prohibition of insider trading applies to Commission employees (7 U.S.C. 13(c) and (d)) and employees of self regulatory organizations, as well as the SRO's board and committee members (7 U.S.C. 13(e); Reg. 1.59). There is no explicit insider trading prohibition that applies to others in the futures industry, though some situations might allow for charges under the CEA's general fraud authority (*e.g.*, a broker trading ahead of an executable customer order).

[83] Testimony of Commission Chairman Phillip McBride before the SEC/CFTC Jurisdictional Issues and Oversight: Hearings on H.R. 5447, H.R. 5515 and H.R. 6156 Before the Subcommittee on Telecommunications, Consumer Protection and Finance of the House Committee on Energy and Commerce, 97th Cong., 2nd Sess,. Part 1 at 21 (1982); *A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material Non-Public Information* (Sept. 1986). *See also*, Markham, Jerry W., *"Front-Running" – Insider Trading Under the CEA,*" 38 Cath. U. L. rev. 69 (Fall 1988).

To the extent an investigation indicates a violation of the CEA, the Commission takes appropriate enforcement action as described in response to Principle 9, Question 2.

c) Failure of compliance with other regulatory requirements, for example: conduct of business, capital adequacy, disclosure or segregation of client assets?

Yes. FCMs must segregate customer funds and cannot commingle firm assets with customer funds. Clearing organizations and depositories also must treat such funds as customer assets (Section 4d of the CEA); DCM Core Principle 11 requires DCMs to have and enforce rules to provide for the financial integrity of contracts traded on the DCM (including clearing and settlement through a DCO); Capital, accounting, internal controls, and segregation requirements for FCMs and IBs are enumerated in Regulations 1.16 - 1.34.

All of the investigative tools available to the DOE are employed in the investigation of these types of matters. These tools include:

- Ability to obtain records and information via inspection powers and subpoena powers;
- Ability to obtain voluntary statements and sworn testimony;
- Trade analysis; and
- Financial analysis.

To the extent the investigation indicates a violation of the CEA, the Commission takes appropriate enforcement action as described in response to Question 2 in Principle 9.

4) Does the regulator have an adequate system to receive and respond to investor complaints?

Yes. The CFTC has authority to collect information and evidence pertinent to the effective enforcement of the CEA, 7 U.S.C. 2, 5, 9, 12(a), 13a-1, 15, and the CFTC's rules, and may also collect information and evidence relating to futures and options matters on behalf of foreign authorities, 7 U.S.C. 16(f)(1). This includes information provided by the public.

The CFTC's DOE investigates and prosecutes alleged violations of the CEA and Commission regulations, which often emanate from customer complaints. And, while the Commission does not represent any particular customer or claimant, the Commission relies on the public as an important source of information in carrying out its regulatory and enforcement responsibilities. The public may contact the Division to report suspicious activities or transactions which may involve the trading of commodity futures contracts or commodity options by calling the CFTC toll-free (866-366-2382), submitting a form on the CFTC's Web site

(*http://www.cftc.gov/customerprotection/redressandreparations/index.htm*) or e-mailing the Commission (Questions@cftc.gov).

The information provided by the public is used in the routine operation of the Commission, which includes law enforcement, review of legislative and regulatory proposals, regulation of the commodity futures markets, and review of reports and documents filed with the Commission. Specifically, the Commission's DOE will review the complaint and, if warranted, conduct an investigation into the activity. In the event the investigation results in an enforcement action alleging violations of the CEA, the Commission may use the information provided by the public in any administrative or civil proceeding in which it is a party, or in which any member of the Commission or its staff participates as a party. The CFTC may also provide the information to other state and federal agencies, and foreign authorities.

As indicated in response to Principle 9, Question 4, the Commission may also direct customers to the Commission's reparations program as a mechanism for resolving appropriate complaints.

5) Is there evidence, such as inspection reports and follow up action, which indicates that the regulator is competently discharging inspection responsibilities?

As stated in response to Principle 10, Question 1, the CFTC does not conduct routine direct inspections of intermediaries, but it does conduct such examinations for cause or to test the quality of the DSRO's work. Routine examinations are handled by an intermediary's DSRO. A DSRO should conduct an examination of each FCM on a basis no less frequently than once every nine to 18 months pursuant to Commission guidance. Examination reports and workpapers from such inspections are retained by DSROs but may be reviewed by DCIO and sampled for testing in the Commission's oversight reviews of SRO's compliance with core principles. Final reports of such oversight reviews of SROs by DCIO are maintained but are considered confidential supervision reports.

DMO's Market Compliance Section conducts regular reviews of each DCM's ongoing compliance with core principles through the self-regulatory programs operated by the exchange in order to enforce its rules, prevent market manipulation and customer and market abuses, and ensure the recording and safe storage of trade information. These reviews are known as rule enforcement reviews (RERs).

Periodic RERs normally examine a DCM's audit trail, trade practice surveillance, disciplinary, and dispute resolution programs for compliance with the relevant core principles, which include Core Principle 10, Trade Information, and Core Principle 17, Recordkeeping with respect to audit trail programs; Core Principle 2, Compliance With Rules, and Core Principle 12, Protection of Market Participants with respect to trade practice surveillance and disciplinary programs; and Core Principle 13, Dispute Resolution, with respect to dispute resolution programs. Other periodic RERs normally examine a DCM's market surveillance program for compliance with Core Principle 4, Monitoring of Trading, and Core Principle 5, Position Limitations or Accountability. In

conducting an RER, DMO) staff examine trading and compliance activities at the exchange in question over an extended time period selected by DMO, typically the twelve months immediately preceding the start of the review. Staff conduct extensive review of documents and systems used by the exchange in carrying out its self-regulatory responsibilities; interview compliance officials and staff of the exchange; and prepare a detailed written report of their findings. RER reports are available to the public.

6) Is there evidence that the regulator is adequately addressing unusual market activity?

The Commission routinely monitors activity in all markets under its jurisdiction for unusual activity in the markets. The Commission's market surveillance program's primary mission is to identify situations that could pose a threat of manipulation and to initiate appropriate preventive actions. Each day, for all active futures and option contract markets, the CFTC's market surveillance staff monitors the daily activities of large traders, key price relationships, and relevant supply and demand factors in a continuous review for potential market problems.

Surveillance economists prepare weekly summary reports of futures and option contracts for regional surveillance supervisors, who immediately review these reports. Surveillance staff informs Commission and senior staff of potential problems and significant market developments at weekly surveillance meetings so that they will be prepared to take prompt action when necessary.

The market surveillance process is not conducted exclusively at the CFTC. Surveillance issues are usually handled jointly by the CFTC and the appropriate exchange. Relevant surveillance information is shared and corrective actions are taken, when appropriate. Potential problem situations are jointly monitored and, if necessary, verbal contacts are made with the participants in question. These contacts may be for the purpose of understanding their trading, confirming reported positions, alerting the brokers or traders as to the regulatory concern for the situation, or warning them to trade responsibly. This "jawboning" activity by the Commission and the exchanges has been effective in resolving most potential problems at an early stage.

The Commission customarily gives the exchange the first opportunity to resolve problems in its markets, either informally or through emergency action. If an exchange fails to take actions that the Commission deems appropriate, the Commission has broad emergency powers under which it can order the exchange to take actions specified by the Commission. Such actions could include imposing or reducing limits on positions, requiring the liquidation of positions, extending a delivery period, or closing a market.

7) Does the regulator require regulated entities to have in place supervisory and compliance procedures reasonably designed to prevent securities laws violations?

Yes. As noted in the Rule Enforcement Review section of the response to Principle 10, Question 1, DMO staff conducts a review of the DCM for compliance with Core Principle 2 of Section 5(d) of the CEA to ensure that the Exchange is enforcing the rules

of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market.

Core Principle 4 of Section 5(d) of the CEA requires the DCM to monitor trading to prevent market manipulation, price distortion, and disruptions of the delivery or cash-settlement process.

Core Principle 5 of Section 5(d) of the CEA requires the DCM to reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month. A DCM must adopt position limitations or position accountability for speculators, where necessary and appropriate.

Core Principle 9 of Section 5(d) of the CEA requires the DCM to provide a competitive, open, and efficient market and mechanism for executing transactions.

Core Principle 10 of Section 5(d) of the CEA requires the DCM to maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

Core Principle 11 of Section 5(d) of the CEA requires the DCM to establish and enforce rules providing for the financial integrity of any contracts traded on the contract market (including the clearance and settlement of the transactions with a DCO), and rules to ensure the financial integrity of any FCMs and IBs and the protection of customer funds.

Core Principle 12 of Section 5(d) of the CEA requires the DCM to establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants.

For information on intermediaries, *see supra*, response to Principle 10, Question 6.

8) Does the regulator monitor how compliance procedures are executed and communicated to employees of such entities?

Yes. During RERs conducted by DMO, Staff reviews the DCM's compliance program to ensure, among other things, that the exchange is adhering to the procedures prescribed in the exchange's Compliance Manual. DMO staff also conducts a review of the DCM to ensure that the exchange has adequate staff to fulfill its self-regulatory responsibilities.

To help ensure compliance by registrants with the operational conduct requirements, Commission Regulation 166.3 requires each registrant (except APs with no supervisory duties), to "diligently supervise" the handling by its partners, officers, employees and agents of all activities relating to its business as a CFTC registrant. Also, the review of FCM internal procedures falls within the scope of SRO audit and surveillance obligations under Regulation 1.52. SRO obligations under this regulation include monitoring and auditing compliance by FCMs with their minimum financial and related reporting requirements, and also receiving the financial reports that all FCMs are required to file.

In the context of an enforcement investigation, DOE will review and investigate the supervisory and compliance procedures of Commission registrants. As set forth more fully in response to Principle 10, Question 9, below, failure to supervise is a violation of the Commission's Regulations.

9) Can the regulator take measures against or discipline or sanction intermediaries for failure to supervise reasonably subordinate personnel whose activities violate the securities laws?

Yes. Commission Regulation 166.3 requires each Commission registrant to "diligently supervise the handling … of all commodity interest accounts" by its partners, officers, employees and agents. Thus, any violation of the CEA by a supervised person creates a liability on the supervisor for failure to supervise. Independently, Section 2(a)(1)(B) of the CEA imposes *respondeat superior* liability on the principal for the acts of its agents. "The act, omission, or failure of any official, agent or other person acting for any individual, association, partnership, corporation or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent or other person." The full panoply of remedies is available in an enforcement proceeding alleging these violations. *See* Response to Principle 8, Question 2.

10) Does the regulator require market surveillance mechanisms that permit an audit of the execution and trading of all transactions on authorized exchanges and regulated trading systems?

Yes. The Commission interprets this question to mean an exchange's compliance with the audit trail requirements under the CEA.

Core Principle 10 of Section 5(d) of the CEA requires the DCM to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

Core Principle 17 of Section 5(d) of the CEA requires the DCM to maintain records of all activities related to the business of the contract market in a form and manner acceptable to the Commission for a period of five years.

Pursuant to the acceptable practices set forth in Appendix B to Part 38 of the Commission's regulations, an effective contract market audit trail should capture and retain sufficient trade-related information to permit contract market staff to detect trading abuses and to reconstruct transactions within a reasonable period of time. In addition, the contract market must create and maintain an electronic transaction history database that contains information with respect to transactions executed on the DCM. An acceptable audit trail also must be able to track a customer order from time of receipt through fill allocation or other disposition. Further, an acceptable audit trail should include original

source documents, transaction history, electronic analysis capability, and safe storage capability.

Original source documents include unalterable, sequentially identified records on which trade execution information is originally recorded, whether manually or electronically. A transaction history consists of an electronic history of each transaction, including all data that are input into the trade entry or matching system for the transaction to match and clear. These data should include the categories of participants for whom such trades are executed; timing and sequencing data adequate to reconstruct trading; and the identification of each account to which fills are allocated. An electronic analysis capability permits sorting and presenting data included in the transaction history so as to reconstruct trading and to identify possible trading violations, while safe storage capability provides for a method of storing the data included in the transaction history in a manner that protects the data from unauthorized alteration, accidental erasure, or other loss.

CFTC Regulation 1.31 governs the manner in which an exchange is required to maintain trade-related records. The Regulation mandates that all records required to be kept under the CEA or CFTC regulations be maintained for five years and be readily accessible during the first two years. However, trading cards, documents on which trade information is originally recorded in writing, and order tickets must be retained in hard copy for five years.

11) Does the regulator or other competent authority have an effective enforcement program in place to enforce regulatory requirements?

Yes.

The CFTC has over 95 attorneys and 18 investigators on board in the Enforcement Division who are charged with investigating and prosecuting violations of the CEA. As part of the Commission's aggressive efforts to bolster staffing levels, an additional 14 professional staff are scheduled to come on board in the next few weeks. Currently, there are more than 200 pending investigations in Enforcement. Moreover, 97% of Enforcement cases were successfully resolved in fiscal year 2008.

When an investigation indicates that there is reason to believe that violative conduct has occurred, the CFTC files either an administrative or civil injunctive enforcement action against the alleged wrongdoers. In an administrative action, wrongdoers who are found to have violated the CEA or CFTC regulations or orders can be prohibited from trading on U.S. futures markets and, if registered, have their registrations suspended or revoked. Violators also can be ordered to cease and desist from further violations, to pay civil monetary penalties of $140,000[84] per violation ($1 million for manipulation) or triple

[84] CFTC Regulation 143.8, 17 C.F.R. 143.8, provides an inflation adjustment for civil monetary penalties assessed under CEA 6(c) and 6b pursuant to the authority Debt Collection Improvement Act of 1996 at least once every four years. The inflation adjustment applies only to violations of the CEA, CFTC regulations or orders that occur after November 27, 1996 or the date when the inflation adjustment becomes effective.

their monetary gain, and to pay restitution to those persons harmed by the misconduct. *See* 7 U.S.C. 6(c) and 6(d). In civil injunctive actions, defendants can be enjoined from further violations, their assets can be frozen and their books and records impounded. Defendants also can be ordered to disgorge all illegally obtained funds, to make full restitution to customers, and to pay civil monetary penalties. *See* 7 U.S.C. 6(c).

Each year, the CFTC brings between 40 and 50 enforcement actions. In fiscal year 2008, the Commission brought 40 enforcement cases. The Division is on track to exceed that number for FY2009. These cases target certain program areas, for example: 1) allegations of manipulation, attempted manipulation, trade practice violations, and false reporting; 2) misconduct by commodity pools, hedge funds, CPOs, and CTAs; and 3) financial, supervision, recordkeeping and other violations committed by registered entities. In addition, the Enforcement program continues to battle pervasive fraud involving retail forex futures, forex options, and/or off-exchange retail forex transactions.

By way of example, the following summary of recent enforcement matters provides some measure of the effectiveness of the Commission's enforcement program.

Overall Civil Monetary Penalties. During FY 2008, a total of $234,835,121.55 in civil monetary penalties ("CMPs") was imposed in the Commission's enforcement actions, which included both administrative and federal district court cases. Of that amount, the Commission collected $140,745,252, or 60% of the amount imposed.

Commodity Pools and Hedge Funds. From October 2000 through September 2008, the Commission filed a total of 73 enforcement actions alleging misconduct in connection with commodity pools and hedge funds, and the Commission has obtained penalties of $564,127,597 in these actions. The majority of the Commission's commodity pool/hedge fund fraud cases are brought against unregistered CPOs and/or CTAs (40 of 73 cases filed).

Cooperative Enforcement. During FY 2008, cooperative efforts resulted in 31 cases being filed by other domestic criminal and civil law enforcement authorities that included cooperative assistance from the Commission.

Forex. Since enactment of the CFMA in December 2001 through December 2008, the Commission has filed a total of 98 enforcement actions against 181 firms and 193 individuals selling illegal foreign currency futures and option contracts. To date, the Commission has obtained in these enforcement actions approximate monetary sanctions of $562 million in civil monetary penalties and $453 million in restitution.

International Enforcement. The Commission has entered into bilateral cooperative enforcement/information sharing arrangements with more than twenty-five foreign authorities. In 2002, the Commission entered into a multilateral information sharing arrangement established by IOSCO which has become the international benchmark for such international MOUs. In FY 2008, DOE made 105 requests for assistance to 35 foreign authorities and received 32 requests from 16 different foreign authorities.

Energy Market Manipulation. From December 2002 to date, the CFTC has filed a total of 43 enforcement actions charging a total of 73 respondents/defendants (42 companies and 31 individuals) with misconduct in the energy markets. The CFTC has obtained $445,940,000 in civil monetary penalties in settlement of these enforcement actions. Copies of the complaints and dispositive orders issued in cases filed by the Commission are found on the Commission's Web site at *http://www.cftc.gov/lawandregulation/enforcementactions/index.htm*.

COOPERATION
PRINCIPLES 11-13

Principle 11. The regulator should have the authority to share both public and non-public information with domestic and foreign counterparts

Assessment: Fully Implemented

1) For each of the regulators identified, does the regulator have authority to share with other *domestic* regulators and authorities information on:

a) Matters of investigation and enforcement?

b) Determinations in connection with authorization, licensing or approvals?

c) Surveillance?

d) Market conditions and events?

e) Client identification?

f) Regulated entities?

g) Listed companies and companies that go public?

Yes, to all of the above. The CFTC may communicate public information without restriction. Section 8(e) of the CEA provides the parameters under which the CFTC may share non-public information, including, for example, to any department or agency of any State or any political subdivision thereof, acting within the scope of its jurisdiction.

The CFTC has the authority to share any registration information maintained by the Commission upon reasonable request by any domestic department or agency. Whenever the Commission determines that the information is appropriate to be used by the domestic agency, the Commission may provide it without request.[85]

In addition, Section 8a(3) of the CEA requires that the Commission provide the SEC with notice of the commencement of any proceeding and a copy of any order entered by the Commission against any FCM or IB registered pursuant to section 6f (a)(2) of the CEA, any floor broker or floor trader exempt from registration pursuant to section 6f (a)(3) of the CEA, any associated person exempt from registration pursuant to section 6k(6)[1] of the CEA, or any board of trade designated as a contract market pursuant to section 7b–1 of the CEA.

[85] 7 U.S.C. 12(g).

More broadly, Section 12(a) of the CEA directs: "The Commission may cooperate with any department or agency of the government, any state or territory, department, agency or political subdivision thereof." Thus, the Commission has the authority to share all of the information enumerated in (a)-(g) above which is obtained in the course of its administration of the CEA or pursuant to the exercise of its subpoena powers under Section 6(c) of the CEA, 7 U.S.C. 15, subject to the restrictions set forth in Section 8(e). That is, no information furnished to any domestic regulator, department or agency shall be disclosed by such department or agency *except* in any action or proceeding under the laws of the United States to which it, the Commission, or the United States is a party. In order to grant such access, the CFTC asks that, in the absence of a request submitted pursuant to a formal MOU between the CFTC and the requesting authority, the domestic authority provide a written access request setting forth its need for the requested information, providing confidentiality undertakings and agreeing to the restrictions in Section 8(e) of the CEA.

To the extent the non-public files contain bank records that are subject to the Right to Financial Privacy Act or electronic communications subject to the Electronic Communications Privacy Act, the Commission must ascertain, before sharing the records, that the material is relevant to a legitimate law enforcement inquiry of the requesting agency and ensure that there is a valid Access Request granted to that agency that includes RFPA and/or ECPA materials.

2) Can the regulator share the information described in Key Question 1 with other *domestic* authorities without the need for external approval such as from a relevant government minister or attorney?

Yes. The CFTC has the authority to share such information with domestic authorities, subject to the conditions set forth in Section 8(e) of the CEA and discussed in response to Principle 11, Question 1, above, without the need for external approval.

3) Does the regulator have the authority to share information with *foreign* counterparts with respect to each of the matters listed in Key Question 1, specifically:

a) Matters of investigation and enforcement?

b) Determinations in connection with authorization, licensing or approvals?

c) Surveillance?

d) Market conditions and events?

e) Client identification?

f) Regulated entities?

g) Listed companies and companies that go public?

Yes, to all of the above. The CFTC has the authority to share the information enumerated in (a)-(g) above with foreign futures authorities and certain other foreign authorities, subject to certain conditions. The CFTC may communicate public information without restriction.

Section 8(e) of the CEA places certain restrictions on the ability of the CFTC to provide access to its existing non-public files to foreign futures authorities and certain other foreign authorities, described below.

- **Status of the requesting authority.** Section 8(e) of the CEA authorizes the CFTC to provide information in the possession of the CFTC obtained in connection with the administration of the CEA to a "foreign futures authority" or any department or agency of a foreign government or any political subdivision thereof acting within the scope of its authority." Section 1a (10) defines a "foreign futures authority" as "any foreign government, or any department, agency, governmental body or regulatory organization empowered by a foreign government to administer or enforce a law, rule or regulation as it relates to a futures or option matter."

- **Confidentiality.** The confidentiality restrictions placed on information provided by the CFTC relate to the nature of the specific information provided. With respect to nonpublic information generally, Section 8(e) of the CEA requires that nonpublic information provided to a requesting authority not be disclosed except in connection with an adjudicatory action or proceeding in the jurisdiction of the requesting authority to which the authority or its government is a party. In order to grant such access, the CFTC asks that, in the absence of a request submitted pursuant to a formal MOU between the CFTC and the requesting authority, the foreign authority provide a written access request setting forth its need for the requested information and providing confidentiality undertakings.

- **Restricted uses.** In granting requests for assistance, the CFTC generally will permit information it provides to be used for the purposes stated within the request with respect to ensuring compliance with, or enforcement of, the laws and regulations of the requesting authority and for the purposes stated within the general framework of the use stated in the request including conducting a civil or administrative enforcement proceeding, assisting in a criminal prosecution, or conducting any investigation related thereto for any general charge applicable to the violation of the provisions specified in the request.

- **Reciprocity.** Because the CFTC's approach is to seek to maximize the amount of available assistance, it has not imposed an inflexible reciprocity requirement on requests for assistance. Rather, in deciding whether to grant assistance, the CFTC is directed by Section 12(f)(2) of the CEA statute to "consider whether . . . the requesting authority has agreed to provide reciprocal assistance to the CFTC in futures and options matters" and whether "compliance with the request would prejudice the public interest of the United States."

- **MOU.** The CFTC has entered into numerous information-sharing arrangements with non-US regulatory authorities. In addition, the CFTC is a signatory to the Boca Declaration and IOSCO MMOU. *See http://www.cftc.gov*. *See infra*, response to Principle 12, Question 3.

No secrecy or blocking laws are imposed in the United States on information sharing with foreign futures authorities.

4) Can the regulator share the information for enforcement and regulatory purposes with *foreign* counterparts without the need for external approval, such as from a relevant government minister or attorney?

Yes.

5) Can the regulator provide information to other *domestic* and *foreign* authorities on an unsolicited basis?

Yes. To the extent the conditions set forth in response to Principle 11, Questions 1 and 3 above are met.

6) Can the regulator share information with *foreign* counterparts even if the alleged conduct is not such that it would constitute a breach of the laws of the regulator's jurisdiction if conducted within that jurisdiction?

Yes. The CFTC does not impose a dual illegality requirement. Section 12(f)(1) of the CEA expressly states that the CFTC may provide investigative assistance to a foreign futures authority (including information) "without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States."

7) Where the regulator can obtain information and records identifying the person or persons beneficially owning or controlling bank accounts related to securities and derivatives transactions and brokerage accounts, can the regulator share that information with *domestic* and *foreign* counterparts?

Yes, subject to the conditions discussed in response to Principle 11, Questions 1 and 3.

Principle 12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts

Assessment: Fully Implemented

1) Does the regulator have the power, by legislation, rules or as a matter of administrative practice, to enter into information-sharing agreements (whether formal or informal) with other *domestic* authorities?

Yes. As a matter of practice, the CFTC can enter into information-sharing arrangements, generally known as MOUs, to facilitate consultation, cooperation and the exchange of information, public or non-public, with other domestic authorities. MOUs are statements of intent to consult, cooperate and exchange information, which are approved by the Commission and signed by the Chairman or his/her designee. MOUs facilitate cooperation by establishing clear mechanisms for the exchange of information, including setting forth the terms and conditions for sharing and protecting the confidentiality of non-public information.

It is important to note that such arrangements are not a prerequisite for the CFTC to cooperate with domestic authorities. As discussed in the response to Principle 11, Question 1, the CFTC can cooperate and share non-public information with domestic authorities, whether on an ad hoc basis or under an MOU, pursuant to Sections 8(e) and 12(a) provided, among other things, that the CFTC has received assurances of confidentiality regarding the use of non-public information. Assurances of confidentiality are typically incorporated in the terms of the MOUs.

2) Does the regulator have the power, by legislation, rules or as a matter of administrative practice, to enter into information-sharing agreements (whether formal or informal) with *foreign* counterparts?

Yes. Section 12(a) of the CEA grants the CFTC the power to cooperate with any foreign futures authority or any department, agency or political subdivision thereof. The CEA permits the Commission to furnish to foreign authorities information in its files, both public and non-public, that the Commission has obtained in connection with its administration of the CEA. Moreover, Section 12(f) authorizes the Commission to conduct an investigation, including the use of inspection and compulsory process, in response to a request from a foreign futures authority. In addition, implicit in the Commission's authority to share information with foreign futures authorities under Section 8(e) and the reference to MOUs in Section 8(a), is the authority to enter into information sharing agreements with such authorities.

Furthermore, in the CFMA, Congress included the following:

Sense of the Congress – It is the sense of the Congress that, consistent with its responsibilities under the CEA, the CFTC should, as part of its international activities, continue to coordinate with foreign regulatory authorities, to participate in international regulatory organizations and forums, and to provide technical assistance to foreign government authorities, in order to encourage–

(1) The facilitation of cross-border transactions through the removal or lessening of any unnecessary legal or practical obstacles;
(2) The development of internationally accepted regulatory standards of best practice;
(3) The enhancement of international supervisory cooperation and emergency procedures;
(4) The strengthening of international cooperation for customer and market protection; and
(5) Improvements in the quality and timeliness of international information sharing.

See also section 8(a)(1)(B)(ii) of the CEA.

3) Has the relevant regulator developed information-sharing mechanisms to:

a) Facilitate the detection and deterrence of cross-border misconduct?

b) Assist in the discharge of licensing and surveillance responsibilities?

Yes, to all of the above. The CFTC cooperates with foreign regulatory and enforcement authorities through formal MOUs and other arrangements to combat cross-border fraud and other illegal practices that could harm customers or threaten market integrity.

Cross-border information sharing among market authorities plays an integral role in the effective surveillance of global markets that are linked by products, participants, and technology. Information sharing arrangements can be critical in combating cross-border fraud and manipulation, addressing the financial risks of market participants, and sharing regulatory expertise on market oversight and supervision. The CFTC makes and receives a significant number of requests for assistance and information to and from foreign authorities in connection with various surveillance and enforcement issues. In FY 2008, the CFTC made 120 requests for assistance to 39 different foreign authorities. Likewise, the CFTC has received and responded to 47 requests in FY 2008 from 18 different authorities.

The CFTC has entered into MOUs and cooperative arrangements with many jurisdictions, including cooperative enforcement arrangements, arrangements relating to sharing financial and other types of fitness information, and arrangements for sharing information on matters related to the implementation of the CFTC's Part 30 regulations, which grant foreign firms an exemption from certain CFTC requirements.

These arrangements are public documents and copies may be obtained from the Office of the Secretariat at the CFTC or by viewing the CFTC's Web site at *http://www.cftc.gov/international/memorandaofunderstanding/index.htm.* The CFTC also is negotiating arrangements and side letters designed to enhance and streamline the supervision of entities regulated by a non-US regulatory authority.

The CFTC has entered into bilateral arrangements for cooperative enforcement with authorities in more than 20 jurisdictions. MOUs typically provide for access to non-public documents and information already in the possession of the authorities and often include undertakings to obtain documents and to take testimony of, or statements from, witnesses on behalf of a requesting authority. In addition, the CFTC is a signatory to the MOU Concerning Consultation, Cooperation and the Exchange of Information of IOSCO, October 16, 2002, the first worldwide multilateral enforcement cooperation arrangement among securities and derivatives regulators. The IOSCO MOU provides for the exchange of essential information to investigate cross-border securities and derivatives violations, including the most serious offenses, such as manipulation, insider trading and customer fraud. The MOU enables regulators to share critical information, including bank, brokerage, and client identification records and to use that information in civil and criminal prosecutions.

4) Where warranted by the scope of cross-border activity and the ability to provide reciprocal assistance, does the regulator actively try to establish information-sharing arrangements with *foreign* regulators?

Yes. As indicated, where a foreign regulator is not a signatory to the IOSCO MMOU, the Commission has entered into bilateral MOUs and other cooperative arrangements to facilitate information sharing. In addition, as noted above, the CFTC is actively working on entering into MOUs and side letters in a supervisory context.

5) Are these arrangements documented in writing?

Yes. *See http://www.cftc.gov/international/memorandaofunderstanding/index.htm.*

6) Does the regulator take steps to assure safeguards are in place to protect the confidentiality of information transmitted consistent with its uses?

Yes, as required by the various confidentiality provisions of the CEA. The CEA only permits the Commission to disclose to foreign authorities information in the Commission's possession when it is satisfied that the information will not be publicly disclosed except in an adjudicatory action or proceeding.[86] Thus, the information shared may be disclosed in a civil or administrative enforcement proceeding or a criminal prosecution to which the foreign authority is a party. The disclosed information also could be utilized by a foreign authority for the purpose of ensuring compliance with (and in investigations of) matters, and in surveillance and enforcement activities, provided that the information is not publicly disclosed except in an adjudicatory action or proceeding to

[86] Section 8(e) of the CEA, 7 U.S.C. 12(e).

which the foreign authority is a party. The information may be disclosed to an SRO for surveillance or enforcement activities if the SRO is a foreign futures authority. *See* Section 8(e) of the CEA, 7 U.S.C. 12(e). The Commission seeks these assurances from an authorized representative of the foreign authority before it shares non-public information.

7) Can the regulator demonstrate that it shares information, where appropriate safeguards are in place, when it is requested by another domestic authority or foreign counterpart?

Domestic. During FY 2008, cooperative efforts resulted in 31 cases being filed by other domestic criminal and civil law enforcement authorities that included cooperative assistance from the Commission.

Foreign. Yes. In FY 2008, the CFTC made 120 requests for assistance to 38 different foreign authorities. Likewise, the CFTC has received and responded to 47 requests from 18 different jurisdictions in FY 2008.

Principle 13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers

Assessment: Fully Implemented

1) Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in obtaining:

a) Contemporaneous records sufficient to reconstruct all securities and derivatives transactions, including records of all funds and assets transferred into and out of bank and brokerage accounts relating to those transactions?

b) Records for securities and derivatives transactions that identify:

i) The client:

1) Name of the account holder?

2) Person authorized to transact business?

ii) The amount purchased or sold?

iii) The time of the transaction?

iv) The price of the transaction?

v) The individual and the bank or broker and brokerage house that handled the transaction?

c) Information located in its jurisdiction identifying persons who beneficially own or control non-natural persons organized in its jurisdiction?

Yes, to all of the above. Under Section 12(f) of the CEA, the CFTC has the authority to conduct an investigation, including the use of compulsory powers, on behalf of a foreign futures authority. This includes compelling (a) the production of documents (including, but not limited to, bank records, trading records, records identifying the beneficial owners that are critical to such investigations) and (b) the taking of statements. In exercising its statutory authority to provide such assistance, the CFTC is directed by Congress to consider whether (1) the requesting authority has agreed to provide reciprocal assistance in futures matters to the CFTC, and (2) compliance with the request would prejudice the public interest of the United States. Information provided is generally subject to

confidentiality and use restrictions.[87] Banking and other financial records may, under certain circumstances, be subject to the Right to Financial Privacy Act, which provides a procedure for obtaining bank records that includes notice to the account holder and an opportunity to be heard. However, it should be noted that, in certain circumstances, such notice can be delayed. Certain electronic communications may be subject to the Electronic Communications Privacy Act protections.

2) Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in securing compliance with laws and regulations related to:

a) Insider dealing, market manipulation, misrepresentation of material information and other fraudulent or manipulative practices relating to securities and derivatives, including solicitation practices, handling of investor funds and customer orders?

b) The registration, issuance, offer, or sale of securities and derivatives, and reporting requirements related thereto?

c) Market intermediaries, including investment and trading advisers who are required to be licensed or registered, collective investment schemes, brokers, dealers and transfer agents?

d) Markets, exchanges and clearing and settlement entities?

Yes, to all of the above. The Commission is authorized to conduct an investigation, including the use of compulsory process, in response to a request from a foreign futures authority. The Commission may render assistance to a foreign authority even if the matter would not constitute a violation of the laws of the United States. *See* Sections 6(c) and 12(f) of the CEA, 7 U.S.C. 15, 16(f). In other words, the CFTC does not need an independent interest in the alleged violations.

3) Is the *domestic* regulator able, according to its domestic laws and regulations, to provide effective and timely assistance to *foreign* regulators regardless of whether the *domestic* regulator has an independent interest in the matter?

Yes. *See* Sections 6(c) and 12(f) of the CEA, 7 U.S.C. 15, 16(f).

4) Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in obtaining information on the regulatory processes[88] in its jurisdiction?

Yes. *See* Sections 6(c) and 12(f) of the CEA, 7 U.S.C. 15, 16(f).

5) Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in requiring or requesting:

a) The production of documents?

[87] Section 12(f)(2) of the CEA.

[88] "Regulatory processes" refer to formal processes, such as licensing procedures or audit procedures which could be relevant to enforcement.

b) Taking a person's statement or, where permissible, testimony under oath?

Yes, to all of the above. *See supra*, response to Principle 13, Question 1.

6) Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in obtaining court orders, if permitted, for example, urgent injunctions?

Yes. The CFTC has the authority to assist a foreign authority in obtaining a court order, including in urgent circumstances. Using its full investigatory powers, the CFTC can obtain information for a foreign authority that can be used in proceedings to obtain a court order.

7) Is the *domestic* regulator able to provide effective and timely assistance to *foreign* regulators regarding information about financial conglomerates subject to its supervision and more precisely assistance in relation, for example, to:

a) The structure of financial conglomerates?

b) The capital requirements in conglomerate groups?

c) Investments in companies within the same group?

d) Intra-group exposures and group-wide exposures?

e) Relationships with shareholders?

f) Management responsibility and the control of regulated entities?

Yes. *See supra*, response to Principle 11, Question 3.

To the extent the requirements of Section 8(e) and 12(f) of the CEA are met, the Commission can share both confidential and non-confidential information in its files.[89] For FCMs, this would include:[90]

- an organizational chart depicting the various entities with which the FCM is affiliated (including subsidiaries) and specifically identifying the FCM's material affiliates, as determined by the criteria identified in CFTC Regulation 1.14(a);[91]
- capital requirements of an FCM or its affiliate(s) required by the Commission or the SEC;
- financing and capital adequacy, including sources of funding, management of liquidity of material assets of the FCM, the structure of debt capital and sources of alternative funding;

[89] For purposes of this question, we have interpreted financial conglomerates to include FCMs, DCMs and DCOs.
[90] For other registrant categories, the Commission could seek such information by way of an inspection request and/or a subpoena.
[91] Note that all non-material entities or affiliates in large organizational groups may not necessarily be included. Information relating to other related entities are only reported if it impacts whether an affiliate is deemed to be material.

- direct ownership of 10% or more of the FCM (available through the NFA registration database); and
- risk management policies and procedures that describe the methods followed to mitigate exposures resulting from related party transactions.

See generally, CFTC Regulations 1.12, 1.14, 1.15 and 1.17. In addition, to the extent the Commission becomes concerned about the financial condition of an FCM, Section 4(c)(3) of the CEA empowers the Commission to require an FCM to make reports concerning the financial activities of affiliated persons whose business activities are reasonably likely to have a material impact on the financial or operational condition of the FCM.

In its designation application, and on an ongoing basis, DCOs must demonstrate to the Commission that it has adequate financial, operational, and managerial resources to discharge the responsibilities of a DCO. (Section 5b(2): Core Principle (B) Financial Resources). In addition, DCOs must provide to the Commission all information necessary for the Commission to conduct the oversight function of the applicant with respect to the activities of the DCO. (Section 5b(2) Core Principle (J) Reporting). Thus, to the extent the information regarding financial conglomerates is related to a DCOs ability to comply with the Designation Criteria and core principles and the CEA in general, the Commission may have such information in its files.

To the extent the information and/or documents identified are not in its files, the Commission can request such documents from its registrants on behalf of a foreign authority or obtain such information from the SEC (or any other federal agency), if the subject is required to report it.

ISSUERS

PRINCIPLES 14-16

The "issuer" Principles do not explicitly apply to the CFTC. However, as requested by the IMF staff in July, Staff have described the relevant accounting and auditing standards under the CFTC's regulations.

Principle 14. There should be full, timely and accurate disclosure of financial results and other information that is material to investors' decisions

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1) Does the regulatory framework have clear, reasonably timely, comprehensive and specific disclosure requirements that apply to:

a) Public offerings, including the conditions applicable to an offering of securities for public sale, the content and distribution of prospectuses and other offering documents (and, where relevant, short form profile or introductory documents) and supplementary documents prepared in the offering?

b) Annual reports?

c) Other periodic reports?

d) Shareholder voting decisions?

2) Does the regulatory framework have sufficiently clear, comprehensive and specific requirements that apply to:

a) Timely disclosure of events that are material to the price or value of listed securities?

b) Listing of securities?

c) Advertising of public offerings outside of the prospectus?

3) If there are derivative markets, is there disclosure of the terms of the contracts traded, the mechanics of trading and the risks related to gearing or leverage by market operators or intermediaries?

4) Does the regulatory framework require:

a) Financial information and other required disclosure in prospectuses, listing documents, annual and other periodic reports, and, where applicable, in connection with shareholder voting decisions, to be of sufficient timeliness to be useful to investors?

b) Periodic information about financial position and results of operations (which may be in summary form) to be made publicly available to investors?

c) Appropriate measures to be taken (for example, provision of more recent unaudited financial information) when the audited financial statements included in a prospectus for public offerings are stale?

5) In addition to specific disclosure requirements, is there a general requirement to disclose either all material information or all information necessary to keep the disclosures made from being misleading?

6) Are there measures available to the regulator (e.g., review, certification, supporting documentation, sanctions) to help assure the sufficiency, accuracy and timeliness of the required disclosures?

7) Does regulation ensure that proper responsibility is taken for the content of information in disclosure documents and the timeliness of disclosure by providing for sanctions or liability of the issuer and those responsible persons who fail to exercise due diligence in the gathering and provision of information? (Depending upon the circumstances, these persons may include the issuer, underwriters, directors, authorizing officers, promoters, and experts and advisers consenting to be named as such.)

8) Are the circumstances where disclosures may be omitted or delayed limited to trade secrets, similar proprietary information or other valid business purposes, such as incomplete negotiations?

9) Where there are derogations from the objective of full and timely disclosure, is regulation sufficient to provide for:

a) Temporary suspensions of trading?

b) Restrictions on, or sanctions regarding, the trading activities of persons with superior information?

10) If public offerings or listings by foreign issuers are significant within the jurisdiction, are the jurisdiction's disclosure requirements for such offerings or listings of equity securities by foreign issuers consistent with IOSCO's International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers?

Principle 15. Holders of securities in a company should be treated in a fair and equitable manner

1) Does the regulatory framework and legal infrastructure address the rights and equitable treatment of shareholders in connection with the following:

a) Voting:

i) For election of directors?

ii) On corporate changes affecting the terms and conditions of their securities?

iii On other fundamental corporate changes?

b) Timely notice of shareholder meetings?

c) Procedures that enable beneficial owners to give proxies or voting instructions efficiently?

d) Ownership registration (in the case of registered shares) and transfer of their shares?

e) Receipt of dividends and other distributions, when, as, and if declared?

f) Transactions involving:

i) A takeover bid?

ii) Other change of control transactions?

g) Holding the company, its directors and senior management accountable for their involvement or oversight resulting in violations of law?

h) Bankruptcy or insolvency of the company?

2) Is full disclosure of all information material to an investment or voting decision required in connection with shareholder voting decisions generally and the transactions referred to in Questions 1(f)(i) and 1(f)(ii) specifically?

3) With respect to transactions referred to in Question 1(f)(i) and 1(f)(ii), are shareholders of the class or classes of securities affected by the proposal:

a) Given a reasonable time in which to consider the proposal?

b) Supplied with adequate information to enable them to assess the merits of the proposal?

c) As far as practicable, given reasonable and equal opportunities to participate in any benefits accruing to the shareholders under the proposal?

d) Given fair and equal treatment (in particular, minority security holders) in relation to the proposal?

e) Not unfairly disadvantaged by the treatment and conduct of directors of any party to the transaction or by the failure of the directors to act in good faith in responding to or making recommendations with respect to the proposal?

4) With respect to substantial holdings of voting securities:

a) Is information about the identity and holdings of persons who hold a substantial (well below controlling) beneficial ownership interest in a company required to be timely disclosed:

i) In public offering and listing particulars documents?

ii) Once the ownership threshold requiring disclosure has been reached?

iii) At least annually (e.g., in the issuer's annual report)?

b) Are material changes in such ownership and other required information required to be timely disclosed?

c) Are these disclosure requirements applicable to two or more persons acting in concert even though their individual beneficial ownership might not have to be disclosed?

d) Is the legal infrastructure sufficient to assure enforcement of, and compliance with, the applicable requirements?

5) With respect to holdings of voting securities by directors and senior management:

a) Is information about the beneficial ownership interest and material changes in beneficial ownership in a company required to be timely disclosed?

b) Is such information available:

i) In public offering and listing particulars documents?

ii) At least annually (e.g., in the issuer's annual report)?

c) Is the legal infrastructure sufficient to ensure enforcement of and compliance with these requirements?

6) If public offerings or listings by foreign issuers are significant within the jurisdiction, does the jurisdiction require disclosure in foreign issuers' offering and listing particulars documents of any governance provisions or information relating to the foreign issuer's jurisdiction that may materially affect the fair and equitable treatment of shareholders?

Principle 16. Accounting and auditing standards should be of a high and internationally acceptable quality

1) **Are public companies required to include audited financial statements in:**

   a) Public offering and listing particulars documents?

   b) Publicly available annual reports?

2) Do the required audited financial statements include:

   a) A balance sheet or statement of financial position?

   b) A statement of the results of operations?

   c) A statement of cash flow?

   d) A statement of changes in ownership equity or comparable information included elsewhere in the audited financial statements or footnotes?

3) With respect to the financial statements required in public offering and listing particulars documents and publicly available annual reports:

   a) Are these required to be prepared and presented in accordance with a comprehensive body of accounting standards?

   b) Are these accounting standards of a high and internationally acceptable quality?

4) Are the financial statements presented under circumstances so that they:

   a) Are comprehensive?

   b) Are understandable by investors?

   c) Reflect consistent application of accounting standards?

   d) Are comparable if more than one accounting period is presented?

5) With respect to the audited financial statements included in public offering and listing particulars documents and publicly available annual reports:

   a) Are these required to be audited in accordance with a comprehensive body of auditing standards?

b) Are these auditing standards of a high and internationally acceptable quality?

6) Are there standards or requirements sufficient to ensure that the external auditor is independent?

7) Where unaudited financial statements are used, for example, in interim reports, and interim period financial statements in public offering and listing particulars documents, in full or summary format, is the financial information presented in accordance with accounting standards that are of a high and internationally acceptable quality?

8) In regard to oversight, interpretation and independence:

a) With respect to accounting standards:

i) Does the regulatory framework provide for an organization responsible for the establishment and timely interpretation of accounting standards?

ii) If yes, are the organization's processes open and transparent, and, if the organization is independent, is the interpretation process undertaken in cooperation with, or subject to oversight by, the regulator or another body that acts in the public interest?

b) With respect to auditing standards:

i) Does the regulatory framework provide for an organization responsible for the establishment and timely interpretation of auditing standards?

ii) If yes, are the organization's processes open and transparent, and, if the organization is independent, is the interpretation process undertaken in cooperation with, or subject to oversight by, the regulator or another body that acts in the public interest?

c) With respect to the external auditor, in the case of listed companies:

i) Is the external auditor required to be independent in both fact and appearance of the company being audited?

ii) Is there a governance body independent in both fact and appearance of the management of the company (e.g., shareholders or a statutory or corporate audit oversight body) that oversees the process of selection and appointment of the external auditor?

iii) Is prompt disclosure of information about the resignation, removal or replacement of an external auditor required?

9) Is there an adequate mechanism in place for:

a) Enforcing compliance with accounting standards such as requiring restatements of financial statements that deviate from accepted standards?

b) Enforcing compliance with auditing and auditor independence standards, such as refusal to accept, or requiring revision of, audit reports that deviate from required standards as to the opinion expressed or scope of the audit, or for lack of independence?

10) If public offerings or listings by foreign issuers are significant within the jurisdiction, does the regulator permit the use of high quality, internationally acceptable accounting standards by foreign companies that wish to list or offer securities in the country?

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ADDENDUM

Issuer Principles relate to "securities" and are beyond the scope of the CFTC's jurisdiction. However, as requested by the IMF staff in July, Staff has written the following brief overview of relevant accounting and auditing standards under the CFTC's regulations.

The CFTC does not regulate public stock offerings. The Commission, however, is providing a response to Principle 16 for the purpose of providing a framework for the accounting and auditing requirements imposed upon financial statements required to be submitted by FCMs.

Commission regulations require each FCM to file with the Commission, and with the FCM's DSRO, monthly financial statements (the "Form 1-FR-FCM"). The Form 1-FR-FCM is a regulatory financial statement filing which is used by the Commission and the FCM's DSRO to assess the FCM's compliance with Commission regulatory capital requirements and customer funds protection requirements.

The monthly Form 1-FR-FCM is required to include a statement of financial condition, a statement of changes in ownership equity, a statement of changes in liabilities subordinated to the claims of general creditors, a statement of computation of the minimum capital requirement, a statement of segregation requirements and funds in segregation for customers trading on U.S commodity exchanges, a statement of funds held for customers trading on non-U.S. markets. In addition to the information and statements expressly required, an FCM is required to include further information as may be necessary to make the financial statements not misleading.

FCMs also are required to file with the Commission, and with the FCM's DSRO, an annual Form 1-FR-FCM that has been audited by a certified public accountant. The audited Form 1-FR-FCM must contain a statement of financial condition, a statement of income, a statement of cash flows, a statement of changes in ownership equity, a statement of changes in liabilities subordinated to the claims of general creditors, a statement of computation of the minimum capital requirement, a statement of segregation requirements and funds in segregation for customers trading on U.S commodity exchanges, a statement of funds held for customers trading on non-U.S. markets, and appropriate footnote disclosures. In addition to the information

expressly required, an FCM is required to include further information as may be necessary to make the audited Form 1-FR-FCM not misleading.

FCM audited and unaudited financial statements submitted on Forms 1-FR-FCM are required to be prepared and presented in accordance with United States generally accepted accounting principles, applied upon a consistent basis. Since the financial statements are contained in a CFTC prescribed form, the financial information is uniformly received from FCM registrants, which allows Commission and SRO staff the ability to immediately identify whether an FCM is failing to meet its minimum capital requirements or is not in compliance with regulations designed to protect the holding of customer funds. The prescribed format further provides an easy means of assessing changes in the financial condition of an FCM between reporting periods, and provides staff with the ability to compare the financial condition of a firm relative to other FCMs.

The Commission also establishes qualifications for the certified public accountants that conduct the audits of the annual Form 1-FR-FCM. In order to be recognized as an authorized certified public accountant, the auditor must be properly registered and in good standing under the laws of the state of the auditor's residence or principal office.

The auditor also must be independent from the FCM that is the subject of the audit engagement. The Commission gives appropriate consideration to all relevant circumstances in determining whether an auditor is, in fact, independent from the FCM. Commission regulations specify that the auditor, his firm, or a member of the firm, may not have, or commit to acquiring, a direct financial interest, or any material indirect financial interest in the FCM. The auditor also may not perform bookkeeping services or assume responsibility for maintaining the accounting records of the FCM or any of its affiliates.

Commission regulations further provide that the audit must be conducted by the auditor in accordance with U.S. generally accepted auditing standards. The audit must include a review and appropriate tests of the accounting systems, the internal accounting control, and the procedures for the safeguarding of customer and firm assets. The audit must include all of the procedures necessary under the circumstances for the certified public accountant to express an opinion on the financial statements in the Form 1-FR-FCM.

An FCM is required to provide notice to the Commission and to the FCM's DSRO if the FCM dismisses a public accountant, or if the public accountant resigns, within 15 business days of the dismissal or resignation. The FCM's notice must state the date of the dismissal or resignation, and whether there was any disagreement with the former accountant on any matter of accounting principles or practices, financial statements disclosure, auditing scope or procedures, or compliance with CFTC regulations that, if not resolved to the satisfaction of the former accountant, would have caused him to make reference in his audit report. The FCM also is required to request that the former public accountant provide the FCM with a letter addressed to the Commission stating whether he agrees with the representations contained in the FCM's notice.

CFTC staff reviews FCM financial statements on a monthly basis. The Commission does not accept financial statements that do not comply with the above requirements. In this regard, the Commission has denied requests for relief from the regulations requiring that FCM financial statements be prepared in accordance with U.S. GAAP. The Commission also has directed FCMs to resubmit financial statements that do not comply with CFTC regulations.

COLLECTIVE INVESTMENT SCHEMES

PRINCIPLES 17-20

Principle 17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme

Assessment: Fully Implemented

1) Does the regulatory framework set standards for the eligibility and the regulation for those who wish to:

a) Market a CIS?

b) Operate a CIS?

Under Section 4m of the CEA, all individuals and firms, with certain exceptions, that intend to do business as a CPO must register with the CFTC. Section 1a(5) of the CEA defines a CPO as any person engaged in a business of the nature of an investment trust or syndicate who solicits, accepts or receives from others funds, securities or property for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market or DTEF.

In 1984, the CFTC delegated to NFA the registration of CPOs. NFA reviews applications for registration to determine, among other things, whether an application is subject to statutory disqualification under Sections 8a(2-3) of the CEA. NFA performs an extensive background check, which includes fingerprinting of natural person principals and related FBI clearances, to determine whether a statutory disqualification exists. For foreign applicants, NFA may perform additional background checks such as checks with foreign regulatory and self-regulatory bodies and Interpol. NFA also imposes proficiency testing requirements upon all individual applicants.

The fitness requirements for all market intermediaries are incorporated into the basic registration application form, Form 7R. Form 7R requires disclosure of the applicant's name, address, branch offices, and principals, as well as detailed information about the disciplinary and criminal history of the firm. A Form 8R, which requires similar information to the 7R, is required for each natural person principal and AP applicant. Additionally, applicants for registration as a CPO who have previously operated a CIS under an exemption from registration pursuant to CFTC Regulation 4.13 must accompany their Form 7R with financial statements consistent with the applicable provisions of Part 4 of the CFTC's regulations.

Part 4 of the CFTC's regulations mandate the filing with NFA, as a delegate of the CFTC, of disclosure documents for review prior to a CPO's use in its solicitation of

participants in the CIS, as well as annual financial statements for the CIS to determine compliance with the provisions of that Part.

2) Do the eligibility criteria for CIS include the following:

a) Honesty and integrity of the operator?

b) Competence to carry out the functions and duties of the operator (i.e. human and technical resources)?

c) Financial capacity?

d) Operator specific powers and duties?

e) Adequacy of internal management procedures?

Yes, to all of the above. The CEA specifies certain disqualifications from registration, including many that are based on prior proceedings in which the applicant was found to have violated the law or in which the applicant was formally enjoined from engaging in certain activities. The Commission has authorized NFA to receive and review registration applications and grant or deny registrations, subject to appeal to the Commission and the courts. NFA performs an extensive background check to determine whether a disqualification exists. Three essential elements of the background check are the Disciplinary Information questions on the application forms that require the applicant to disclose and supply detailed information concerning possible disqualifications, a check against the Financial Industry Regulatory Authority's (FINRA's) Central Registration Depository (CRD) database, and the fingerprint cards provided by individuals.

Although Form 7R is only required of entities applying for registration, Form 8R is required of each natural person who is a principal of the applicant, as well as for individuals seeking registration as an associated person (AP). Persons filing a Form 8R also must provide fingerprints on a card provided by NFA. In addition, Form 8R requires disclosure of information on the employment, residential, educational, disciplinary and criminal history of the individual principal or applicant. A "principal" is defined under CFTC Regulation 3.1 as a sole proprietor, general partner, director, officer, manager or managing member, or person who is in charge of a principal business unit, division or function subject to Commission regulation, or any person occupying a similar position who exercises a controlling influence over the regulated activities of the firm. In addition, any holder or beneficial owner of 10% or more of the outstanding shares of stock in the firm, or any person who has contributed 10% or more of the firm's capital, is a principal. It is through this requirement that the CFTC and NFA can consider the knowledge, resources, skills and ethical attitude of senior management, directors and substantial owners/shareholders. However, it should be noted that the CFTC uses an objective approach to assessing ethical attitude, based, in part, on past conduct that could indicate a potential lack of appropriate ethical standards. No subjective inquiry is performed with respect to the business model or management capabilities of the applicant for registration.

CPOs are not required to comply with any minimum financial requirements.

3) Does the approval of schemes take into account the possible need for international cooperation in the case of CIS marketed across jurisdictions or where promoters, managers or custodians are located in several different jurisdictions?

Yes. In certain cases, NFA, as the CFTC's delegate, consults with foreign regulatory authorities to assess the "fitness" of applicants for registration whose applications disclose prior employment with a non-U.S. firm, or where the U.S. registrant has foreign principals.

4) Are there:

a) Effective, proportionate and dissuasive sanctions for unlicensed operation of a CIS and/or for violation of CIS operator obligations?

Yes. The Commission has an arsenal of sanctions available to address wrongdoing by market participants. Section 6(c) of the CEA authorizes CFTC to undertake administrative proceedings against CPOs, including the imposition of conditions, suspension or revocation of registration, the imposition of civil penalties and restitution to customers, and the imposition of cease and desist orders. Moreover, the CFTC has the ability to obtain court orders to freeze pool and/or CPO assets and have receivers appointed to operate the commodity pool for the benefit of participants. *See supra*, response to Principle 9, Question 2. The CFTC also can refer actions for criminal prosecution. Section 9(a) sets forth applicable criminal penalties, which include a fine of not more than $1 million and/or imprisonment for not more than 10 years, together with the costs of prosecution.

b) Are these sanctions consistently applied?

Yes. As set forth above, the Commission has a myriad of tools at its disposal to deter and remediate violations of the CEA by a CIS operator. The interplay of many factors influences the particular mix of sanctions imposed in any given matter. The Commission bases its analysis of an appropriate sanction in a matter on the gravity of the offense, the specific circumstances of each violation and violator, the deterrent and remedial effect of each package of sanctions and penalties imposed in analogous cases. The Commission has identified a variety of factors relevant to ascertaining the gravity of an offense, including whether the violation involves core provisions of the Act, like fraud and manipulation, and whether the violator acted willfully. The Commission may also consider the impact of the case on Commission resources as a result of cooperation or settlement. In 1994, as part of a review of the Commission's sanctioning authority (*See* A Study of CFTC and Futures Self-Regulatory Organization Penalties, Nov. 8, 1994), the Commission reiterated this list of factors that have influenced the Commission in its civil penalty assessments. These factors provide guidance for all parties in the Commission's adjudicatory process.

5) Is the regulator responsible for ensuring compliance with the eligibility standard? In particular, does the regulatory framework provide for attribution to the regulatory authority of responsibilities and clear powers with respect to:

a) Registration or authorization of a CIS?

b) Inspections to ensure compliance by CIS operators?

c) Investigation of suspected breaches?

d) Remedial action in the event of breach or default?

Yes, to all of the above. The CFTC and NFA are responsible for oversight of CPOs. As discussed in the response to Question 2, the CFTC has delegated to NFA responsibility for registration, including registration of CPOs.

NFA, as a registered futures association, has oversight responsibility for CPOs and has instituted a program that seeks to monitor compliance by CPOs with all applicable CFTC and NFA rules and regulations.

Pursuant to Section 17 of the CEA, as a registered futures association, NFA must:

- Establish training standards and proficiency testing for persons involved in the solicitation of transactions, supervisors of such persons and all persons for which it has registration responsibilities, and a program to audit and enforce compliance with such standards; and

- Establish minimum standards governing sales practices of its members and persons associated therewith for transactions subject to provisions of the CEA.

Additionally, when an entity seeks to be registered as a CPO, it must submit a disclosure document to NFA, as the CFTC's delegate, for review to determine compliance with CFTC regulations as well as NFA rules prior to holding itself out to be a duly registered CPO and soliciting participants. CFTC staff regularly reviews NFA's review of disclosure documents as part of the CFTC's oversight of NFA.

NFA also conducts examinations of registered CPOs generally within the first year after becoming active and then every 3 to 4 years thereafter to ensure compliance with the CFTC's regulations and NFA's rules. NFA conducts a risk-based analysis to determine the frequency with which it conducts examinations of CPOs. This analysis considers many different business factors, as well as information such as customer complaints or concerns that arise during NFA's review of a firm's disclosure document, financial statement or promotional material.

In the event that a registered CPO fails to comply with its regulatory obligations, NFA's Business Conduct Committee (BCC) is empowered to take action against the entity and impose sanctions, including expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules. Similarly, the CFTC, through its DOE, may impose

civil penalties for violations of CFTC regulations ranging from a ban from registration to a monetary penalty, as well as seek criminal penalties.

6) Is there ongoing monitoring of the conduct of CIS operators throughout the life of a scheme, including continued compliance with eligibility, licensing, registration, or authorization requirements?

Yes. Pursuant to Part 4 of the CFTC's regulations, registered CPOs are required to file disclosure documents and annual financial statements with NFA for review to determine whether such documents comply with the mandates of the applicable CFTC regulations. As part of the CFTC's oversight of NFA, CFTC staff regularly reviews a sample of disclosure documents on a quarterly basis to determine the efficacy of NFA's review. Additionally, CFTC staff is in regular communication with NFA staff regarding discrete issues in both disclosure documents and annual financial statements as they arise.

7) Does the ongoing monitoring involve review of reports to the regulator submitted by CIS (CIS operators, custodians, etc.) on a routine basis?

Yes. NFA regularly reviews annual financial statements and disclosure documents filed by registered CPOs, and CFTC staff conducts ongoing oversight of NFA with respect to these responsibilities.

8) Does the ongoing monitoring normally involve performance of on-site inspections of entities involved in operating CIS (CIS operators, custodians, etc.)?

Yes. NFA conducts regular on-site inspections of registered CPOs as part of its ongoing monitoring of their operations. Additionally, as stated previously, NFA conducts a risk-based analysis to determine the frequency with which it conducts examinations of CPOs. This analysis considers many different business factors, as well as information such as customer complaints or concerns that arise during NFA's review of a firm's disclosure document, financial statement or promotional material. NFA generally conducts examinations of registered CPOs within the first year after becoming active and then every 3 to 4 years thereafter.

9) Do the regulatory authorities proactively perform investigative activities in order to identify suspected breaches with respect to entities involved in the operation of a CIS?

Yes. Although the CFTC retains authority to conduct inspections, NFA has primary responsibility for inspections of CPOs, and performs periodic examinations as discussed above.

10) Is the operator of a CIS subject to a general and continuing obligation to report to the regulatory authority or investors, either prior to or after the event, any information relating to material changes in its management, organization or by-laws?

Yes. CFTC Regulation 4.26 requires each CPO to correct any defect in its Disclosure Document that it knows to be materially inaccurate or incomplete in any respect. The correction must be made to all existing participants within 21 days of the date upon

which the CPO first knows or has reason to know of the defect. Any amendments to the Disclosure Document must be filed electronically with NFA. In addition, CFTC Regulation 4.22(a) requires that the periodic account statement distributed for the pool disclose any material business dealings involving the CPO and any other persons providing services to the pool if they have not previously been disclosed to the pool's participants. NFA also requires CPOs to provide annual updates regarding their registration information and business operations.

11) Does the regulatory system assign clear responsibilities for maintaining records of the operations of the scheme?

Yes. CFTC Regulation 4.23 states that each CPO must make and keep books and records relating to the pool as well as to its operation as a CPO in an accurate, current and orderly manner in its main business office and in accordance with CFTC Regulation 1.31. According to these regulations, records must be made available to the CFTC and DOJ.

12) Are there provisions to prohibit, restrict or disclose certain conduct likely to give rise to conflicts of interest between a CIS and its operators or their associates or connected parties?

CFTC Regulation 4.24(j) requires a CPO to include in its Disclosure Document a full description of any actual or potential conflicts of interest regarding any aspect of the pool on the part of the CPO, the trading manager (if any), any major CTA, the CPO of any major investee pool, any principal of the foregoing entities, and any other persons providing services to the commodity pool. The CPO also must describe any other material conflict of interest with respect to the pool.

13) Are there regulatory provisions aiming at minimizing conflict of interest situations, to ensure that any conflicts that do arise do not adversely affect the interests of investors?

CFTC regulations do not mandate that a CPO take any actions to minimize conflicts of interest; rather, CFTC Regulation 4.24(j) requires the disclosure of a full description of any actual or potential conflicts of interest regarding any aspect of the pool on the part of the CPO, the trading manager (if any), any major CTA, the CPO of any major investee pool, any principal of the foregoing entities, and any other persons providing services to the commodity pool.

14) Is the CIS required to comply with rules related to:

a) Best execution?

b) Appropriate trading and timely allocation of transactions?

c) Churning?

d) Related party transactions?

e) Underwriting arrangements?

Yes. Within the CFTC's disclosure-based regime, CPOs are responsible for adhering to trading strategies and other information set forth in the Disclosure Document and other documents governing the operation of the pool, and are required under CFTC Regulation 4.24(h)(2) to disclose any material restrictions or limitations on trading.

With respect to CPOs, CFTC Regulation 4.24(k) requires that, if there are any material transactions or arrangements for which there is no publicly disseminated price between the pool and any person affiliated with a person providing services to the pool, the CPO must disclose a full description of such arrangements, including a discussion of the costs associated therewith.

Additionally, CFTC Regulation 1.35(a-1)(5) specifically governs post-execution allocation of bunched orders and provides that specific account identifiers for accounts included in bunched orders need not be recorded at the time of order placement or upon report of execution if: (1) the person placing and directing the allocation of an order eligible for post-execution allocation has been granted written investment discretion with respect to the customer account; (2) eligible account managers must make certain information available to customers, including the general nature of the allocation methodology to be used, whether accounts in which the manager has an interest have been included in the bunched order, and a summary of data sufficient to compare one customer's results with another customer's or the manager's; (3) the orders eligible for post-execution allocation must be allocated by an eligible account manager as soon as practicable after the entire transaction is executed or not later than the end of the day on which the order is executed, be allocated in a fair and equitable manner, and be in accordance with an allocation methodology that is objective and specific to permit independent verification of its fairness; and (4) eligible account managers must make available upon request of any representative of the CFTC, DOJ, or other appropriate regulatory agency records sufficient to demonstrate that all allocations meet the standards articulated in CFTC Regulation 1.35(a-1)(5) and to permit reconstruction of the handling of the order from the time of placement to the allocation.

Further, CFTC Regulation 1.46 governs the application and closing out of offsetting and short positions by FCMs and provides that where an FCM purchases any commodity for future delivery for a customer when the account of such customer at the time of such purchase has a short position in the same future of the same commodity on the same market or sells any commodity for future delivery for a customer when the account of such customer at the time of such sale has a long position in the same future of the same commodity on the same market, the FCM must apply such purchase or sale against such previously held short or long futures position and promptly furnish the customer with a statement showing the financial result of the transactions involved. The FCM is required to perform the same function with respect to the purchase or sale of puts and calls with respect to options, with the exception of providing a statement to the customer. Under CFTC Regulation 1.46(b), where the short or long futures or option position in such customer's or option customer's account immediately prior to such offsetting purchase or sale is greater than the quantity purchased or sold, the FCM must apply such offsetting purchase or sale to the oldest portion of the previously held short or long position, absent specific instructions from the customer to the contrary. CFTC Regulation 4.24(h)(2)

requires the CPO to disclose the manner in which the FCMs holding the pool's accounts will treat offsetting positions pursuant to Regulation 1.46, if the method is other than to close out all offsetting positions, or to close out offsetting positions other than on a first-in, first-out basis.

15) Does the regulatory system provide for clear indication of circumstances under which delegation is allowed and is there prohibition of systematic and complete delegation of core functions of the CIS operator to the extent that there is a transformation, gradual or otherwise, into an empty box?

Neither the CEA nor CFTC regulations prohibit a CPO from delegating functions to another person or entity. The CPO remains primarily responsible for its obligations under the CEA and CFTC regulations despite any delegations to any other parties.

16) If delegation is permitted, is the delegation done in such as way so as not to deprive the investor of the means of identifying the company legally responsible for the delegated functions? In particular:

a) Is the CIS operator responsible for the actions or omissions, as though they were its own, of any party to whom it delegates a function?

b) Does the regulatory system require the CIS operator to retain adequate capacity and resources and have in place suitable processes to monitor the activity of the delegate and evaluate the performance of the delegate?

c) Can the CIS operator terminate the delegation and make alternative arrangements for the performance of the delegated function where appropriate?

d) Are there requirements for disclosure to investors in relation to the delegation arrangements and the identity of the delegates?

e) Does the regulatory system address delegations which may give rise to a conflict of interest between the delegate and the investors?

As set forth above, CPOs are not prohibited from delegating functions to another person or entity. A CPO, however, remains primarily responsible for its obligations under the CEA and CFTC regulations. Regulatory oversight is maintained through periodic audits of CPOs by NFA, with oversight of reviews of NFA by the CFTC. Moreover, the CPO is required under CFTC Regulation 4.24 to disclose information about entities and individuals who provide services to the commodity pool as well as any conflicts of interest that may arise.

Principle 18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets

Assessment: Fully Implemented

1) Does the regulatory framework provide for requirements as to the legal form and structure of CIS that delineate the interests of participants and their related rights?

Yes. CFTC Regulation 4.20 generally provides that a CPO must operate its pool as an entity cognizable as a legal entity separate from that of the CPO. The CFTC may exempt a CPO from this requirement if it sets up a corporation that: (1) represents in writing that each participant will be issued stock or other evidence of ownership in the corporation for all property received from participants; (2) demonstrates that it has adequate procedures in place to ensure that all property from participants is received in the corporation's name and that no property of the pool is commingled with any other person; and (3) is not found by the CFTC to be organized contrary to the public interest. The creation of any legal entity does, of necessity, require the preparation of an organizational document, which delineates the structure of the entity and the rights and obligations associated with holding an ownership interest therein.

2) Does the regulatory framework provide that the legal form and structure of a CIS, as well as the implications thereof for the nature of risks associated with the scheme, be disclosed to investors in such a way that they are not dependent upon the discretion of the CIS operator?

Yes. CFTC Regulation 4.24(d) requires that a CPO disclose the form of organization of the pool in the Disclosure Document of the pool that is distributed to prospective participants. As a matter of course, the offering of an interest in the pool generally involves the provision of the organizational documents for the pool in conjunction with the Disclosure Document. Further, pursuant to CFTC Regulation 4.24(g), the CPO is required to disclose the principal risk factors relating to participation in the pool, including, but not limited to, risks relating to volatility, leverage, liquidity, and counterparty creditworthiness with respect to the trading structures employed and investment activity expected to be engaged in by the pool.

3) Is there a regulatory authority responsible for ensuring that the form and structure requirements are observed and evidence that the above requirements are enforced in the assessed jurisdiction?

Yes. When an entity seeks to be registered as a CPO, it must submit a disclosure document to NFA, as the CFTC's delegate, for review to determine compliance with the CFTC's regulations as well as NFA's rules prior to holding itself out to be a duly

registered CPO and soliciting participants. CFTC staff regularly reviews NFA's review of disclosure documents as part of the CFTC's oversight of NFA. NFA also conducts periodic examinations of CPOs, as discussed above.

In the event that a registered CPO fails to comply with its regulatory obligations, NFA's BCC is empowered to take action against the entity and impose sanctions, including expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules. Similarly, the CFTC, through its DOE may impose civil penalties for violations of CFTC regulations ranging from a ban from registration to a monetary penalty as well as seek criminal penalties.

4) Does the regulatory framework provide that where changes are made to investor rights that do not require prior approval from investors, notice is given to them before the changes take effect?

Yes. CFTC Regulation 4.26(a)(1) requires that all information contained in the Disclosure Document must be current as of the date of the document, including information relating to rights of participants. CFTC Regulation 4.26 states that a CPO must provide participants with disclosure of changes to the information in the Disclosure Document within 21 days of the date on which the CPO knows or has reason to know about such changes. Additionally, CFTC Regulation 4.24(w) requires that a CPO must disclose all material information to existing or prospective pool participants even if the information is not specifically required by CFTC regulations.

5) Does the regulatory framework provide that where changes are made to investor rights, notice is given to the relevant regulatory authority?

Yes. CFTC Regulation 4.26 provides that a CPO must file with NFA any amendments to the Disclosure Document, including those changes made to the rights of commodity pool participants.

6) Does the regulatory framework require the separation and segregation of CIS assets from the assets of the CIS operator and its managers?

Yes. CFTC Regulation 4.20(b) states that all funds, securities and property received by a CPO must be received in the name of the commodity pool. CFTC Regulation 4.20(c) states that no CPO may commingle the property of any commodity pool with the property of any other person.

CFTC Regulation 4.24(h)(iii)(A) requires that the Disclosure Document disclose the identity of the custodian or other entity (e.g., bank or broker-dealer) which will hold the pool's assets.

7) Does the regulatory framework provide for requirements governing the safekeeping of CIS assets such as:

a) The obligation to entrust the assets to an independent third party; or

b) Special legal or regulatory safeguards in cases where custodial functions are performed by the same legal entity responsible for investment functions (or related entities)?

Yes, to all of the above. CFTC Regulation 4.20(b) states that all funds, securities and property received by a CPO must be received in the name of the commodity pool. CFTC Regulation 4.20(c) states that no CPO may commingle the property of any commodity pool with the property of any other person.

CFTC Regulation 4.24(h)(iii)(A) requires that the Disclosure Document disclose the identity of the custodian or other entity (i.e., bank or broker-dealer) which will hold the pool's assets.

8) Does the regulatory framework provide for the keeping of books and records in relation to transactions involving CIS assets and all transactions in CIS shares or units or interests?

Yes. CFTC Regulation 4.23 generally describes all of the recordkeeping requirements applicable to CPOs. Among other things, a CPO must maintain: (1) an itemized daily record of all commodity interest transactions of the pool; (2) a subsidiary ledger or other equivalent record for each participant in the pool showing all of the funds, securities and other property received from and distributed to each participant; (3) a Statement of Financial Condition; and (4) a Statement of Income (Loss) for the appropriate periods.

9) Does the regulatory framework adequately provide for audit requirements (internal or external) in relation to the assets of a CIS?

Yes. NFA's periodic examinations of CPOs include testing on a sample basis of the reporting of assets in a pool's financial statements.

CFTC Regulation 4.22 requires that financial statements in the periodic and annual reports of a commodity pool be presented in accordance with U.S. GAAP, and that the annual report be certified by an independent public accountant in accordance with the applicable provisions of CFTC Regulation 1.16.

10) Does the regulatory framework adequately provide for an orderly winding up of CIS business, if needed?

Yes. CFTC Regulation 4.22(c) requires the filing of a final Annual Report containing financial statements within 90 days of the pool's permanent cessation of trading or the return of funds to participants. If necessary, Section 6c of the CEA provides the CFTC with the ability to obtain court orders to freeze pool and/or CPO assets and have receivers appointed to operate the commodity pool for the benefit of participants.

Principle 19. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme

Assessment: Fully Implemented

1) Does the regulatory framework require that all matters material to an evaluation of a CIS and the value of an investor's interest are disclosed to investors, and potential investors, in an easy to understand format?

Yes. The CFTC regime for oversight of commodity pools and CPOs is disclosure-based. CFTC regulations require that a CPO provide a detailed Disclosure Document to prospective pool participants before accepting their subscriptions for interests in a commodity pool. CFTC regulations require that prescribed cautionary statements and risk disclosures be presented on the cover and the first page of the Disclosure Document. Further, specified information must be presented in the initial pages of the Disclosure Document. This information includes: the name, address, phone number, and form of organization of the commodity pool and the CPO; whether the commodity pool is privately offered, continuously offered, traded by multiple advisors, or has a principal-protection feature; the date when the Disclosure Document may be used; and the break-even point per unit of initial investment. The document also must disclose the business background of the operator and advisors of the pool as well as their respective principals; all fees and expenses of the pool; conflicts of interest relating to the operation of the pool; relevant material actions against persons managing, trading, or maintaining accounts for the pool; risks of futures trading and specific risks of the pool; information on the pool's investment program and use of proceeds; and provisions relating to redemption. In addition, performance information must be in a prescribed capsule format, the performance of the offered pool must be presented prior to any other performance disclosures, and any information that is not specifically required to be disclosed generally must appear after required information.

Rules of the NFA require that the Disclosure Document be written using plain English principles, including:

(i) Avoiding legal jargon;
(ii) Using short sentences and paragraphs;
(iii) Using words that are definite and part of everyday language;
(iv) Using glossaries to define technical terms that cannot be avoided; and
(v) Using table and bullet lists, where appropriate

2) Does the regulatory framework include a general disclosure obligation to allow investors, and potential investors, to evaluate the suitability of the CIS for that investor or potential investor?

Yes. As discussed in the response to Question 1, the CFTC's disclosure-based regime requires that a CPO provide a Disclosure Document to prospective participants in each pool that it offers, and to inform existing participants with respect to material changes regarding the operation of the pool. The Disclosure Document includes information, such as the minimum subscription amount required to participate, the risks of the investments to be undertaken, and the costs associated with the investment, that would allow the investor or potential investor to evaluate the suitability of the investment.

3) Does the regulatory framework specifically require that the offering documents, or other publicly available information, include the following:

a) The date of issuance of the offering document?

b) Information concerning the legal constitution of the CIS?

c) The rights of investors in the CIS?

d) Information on the operator and its principals?

e) Information on the methodology of asset valuation?

f) Procedures for purchase, redemption and pricing of units?

g) Relevant, audited financial information concerning the CIS?

h) Information on the custodian (if any)?

i) The investment policy(ies) of the CIS?

j) Information on the risks involved in achieving the investment objectives?

k) The appointment of any external administrator or investment managers or advisers who have a significant and independent role in relation to the CIS (including delegates)?

l) Fees and charges in relation to the CIS?

Yes, to all of the above. In response to questions (a)-(l), the Disclosure Document must include:

- The date on which the CPO first intends to use the Disclosure Document;
- The form of organization of the pool;
- Whether or not a participant's liability is limited and restrictions on the transferability of a participant's interest;

- Identity, business background, and past performance of the CPO, CTAs, and their principals;
- The net asset value included in the pool's past performance and financial reports is required to be calculated in accordance with generally accepted accounting principles (U.S GAAP);
- The minimum and maximum subscriptions that may be contributed to the pool, where funds will be held prior to trading, the value at which a participant's interest may be redeemed, conditions or restrictions on redemption, any fees associated with redemption, and liquidity risks relative to the pool's redemption capabilities;
- The most recent account statement and audited annual report for the pool must be attached to the Disclosure Document;
- The custodian that will hold the pool's assets;
- A description of the trading and investment programs and policies that will be followed by the pool, including an explanation of how the pool's advisors, investee funds, and types of investments are selected;
- The general risks of investing in a commodity pool, including the financial risks presented by futures contracts and options on futures contracts, and the fact that the commodity pool may be subject substantial charges for management, advisory, and brokerage fees which will require the pool to make substantial trading profit in order to cover the fees; also, the particular risks of the pool, including risks related to volatility, leverage, liquidity, and counterparty creditworthiness, as applicable to the types of trading and investing strategies expected to be employed;
- Information on external administrators or any other person providing services to the pool, such as disclosure of fees paid by the pool or potential conflicts of interest relating to such arrangements; and
- A complete description of each fee and expense incurred or expected to be incurred by the pool, and the "break-even" point where profits exceed fees and expenses.

4) Does the regulatory authority have the power to hold back, or intervene, in an offering? For example, are there regulatory actions available in the event that the information is inaccurate, misleading or false, or does not satisfy the filing/approval requirements?

Yes. Pursuant to authority delegated from the CFTC, NFA is responsible for reviewing all Disclosure Documents. Prior to using a Disclosure Document, a CPO must submit the Document to NFA and receive an acceptance letter confirming that the Document can be used to solicit. If the Document does not meet regulatory requirements, NFA will provide notice of deficiencies and state that the Document may not be used until all issues are addressed. All Disclosure Documents are filed through the NFA's Electronic Disclosure Document Filing System.

5) Does the regulatory framework cover advertising material outside of the offering documents, in particular does it prohibit false or misleading advertising?

Yes. Pursuant to CFTC Regulation 4.41, no CPO may advertise in a manner which:

- Employs any device, scheme or artifice to defraud any participant or prospective participant;
- Involves any transaction, practice or course of business which operates as a fraud or deceit on any participant or prospective participant; and
- Refers to any testimonial unless the advertisement or sales literature providing the testimonial prominently discloses that the testimonial may not be representative of all participants, the testimonial is no guarantee of future performance, and, if applicable, a non-nominal sum was paid for the testimonial.

In addition, CPOs are subject to NFA rules that prohibit any false or misleading communications with the public, and also provide specific guidance regarding the content and use of promotional material.

6) Does the regulatory framework require that the offering documents be kept up to date to take account of any material changes affecting the CIS?

CFTC Regulation 4.26 requires that all information contained in a Disclosure Document must be current as of the date of the document, provided, however, that performance information may be current as of a date not more than three months prior to the date of the document. No CPO may use a Disclosure Document dated more than nine months prior to the date of its use. If a CPO knows or should know that the Disclosure Document is materially inaccurate or incomplete, it must correct that defect and distribute the correction within 21 calendar days.

7) Does the regulatory framework require a report to be prepared in respect of a CIS's activities either on an annual, semi-annual or other periodic basis?

Yes. CFTC regulations require both periodic and annual reports. Regulation 4.22(a) requires each CPO to distribute a periodic report (either monthly for pools with assets greater than $500,000, otherwise quarterly) within 30 calendar days of the end of each reporting period. The periodic report must contain a statement of operations and a statement of changes in net assets. Regulation 4.22(c) requires each CPO to distribute an Annual Report to each participant within 90 calendar days after the end of the pool's fiscal year. The Annual Report, which also must be filed with NFA, must contain certain information, including, but not limited to: the pool's Net Asset Value and Statements of Financial Condition, Operations, and Changes in Net Assets.

8) Does the regulatory framework require the timely distribution of periodic reports?

Yes. As described in the response to Question 7, CFTC Regulation 4.22(a) requires each CPO to distribute an account statement to each pool participant in each pool that it operates within 30 calendar days after the last date of the reporting period.

9) Does the regulatory framework require that the accounts of a CIS be prepared in accordance with high quality, internationally acceptable accounting standards?

Yes. CFTC Regulation 4.22 requires that the financial statements in the periodic and annual reports must be presented and computed in accordance with generally accepted accounting principles consistently applied. In addition, the pool's annual report must be certified by an independent public accountant.

Principle 20. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme

Assessment: Fully Implemented

1) Are there specific regulatory requirements in respect of the valuation of CIS assets?

Yes. CFTC Regulations 4.10(b), 4.22 and 4.25 specifically require the use of generally accepted accounting principles in calculating the net asset value of a pool.

2) Are there regulatory requirements that the net asset value of assets be calculated:

a) On a regular basis?

b) In accordance with high-quality, accepted accounting standards used on a consistent basis?

Yes, to all of the above. CFTC Regulation 4.22 requires that valuations are to be reported in the Statement of Changes in Net Assets included in the periodic and annual reports of the pool. As noted above, net asset value is required to be computed in accordance with generally accepted accounting principles consistently applied.

3) Are there specific regulatory requirements in respect of the fair valuation of assets where market prices are not available?

Yes. Because CFTC regulations require the use of generally accepted accounting principles in calculating pool valuations, CPOs are subject to FAS 157, Fair Value Measurements, issued by the Financial Accounting Standards Board. This statement defines fair value for commodity pools, establishes a framework for measuring fair value under U.S. GAAP, and expands disclosure about fair value measurements.

4) Are independent auditors required to check the valuations of CIS assets?

Yes. Annual financial reports of commodity pools are required to be audited by an independent public accountant.

5) Are there specific regulatory requirements in respect of the pricing upon redemption or subscription of interests in a CIS?

Yes. CFTC Regulation 4.24(p) requires a CPO to provide in its Disclosure Document a complete description of any restrictions upon the transferability of a participant's interest in the pool, and a complete description of the frequency, timing and manner in which a participant may redeem interests in the pool. Specifically, the description regarding redemption must specify how the redemption value of a participant's interest will be calculated, the conditions under which redemption will be made (including time between request for redemption and payment) and any restrictions on redemption.

6) Does regulation ensure that the valuations made are fair and reliable?

Yes. *See supra*, response to Principle 20, Questions 2-4.

7) Does regulation require the price of the CIS be disclosed or published on a regular basis to investors or prospective investors?

Yes. CFTC Regulation 4.22 requires CPOs to distribute account statements to participants on at least a quarterly basis (and monthly if the pool has at least $500,000 in assets). These reports include all material information relevant to the net asset value per participation of the pool. Similar information must be included in the Disclosure Document provided to any prospective participant.

8) Are there regulatory requirements, rules of practice, and/or rules addressing pricing errors? Are the relevant regulatory authorities able to enforce these rules?

Yes. *See supra*, response to Principle 20, Questions 2, 4 and 7.

9) Does the regulatory framework address the general or specific circumstances in which there may be suspension or deferral of routine valuation and pricing or of regular redemption?

Yes. *See supra*, response to Principle 20, Question 5.

10) Does the regulatory authority have the power to ensure compliance with the rules applicable to asset valuation and pricing? Is there evidence as to actions taken by the relevant regulatory authority in this area?

Yes. Section 4n of the CEA states that each CPO must regularly furnish statements of account to each participant. Such statements must include all the information contained in the relevant CFTC regulations. Violations of the CEA and CFTC regulations subject a person to a wide variety of sanctions, including, but not limited to, suspension or revocation of registration, monetary penalties and restitution.

The CFTC also takes a proactive approach to ensuring compliance by CPOs with respect to pool operations. For example, each year, DCIO issues a CPO guidance letter to assist CPOs and their public accountants with the preparation and filing of annual reports. Each CPO guidance letter highlights regulatory and accounting changes affecting CPOs with respect to financial filing and provides reminders of requirements in response to common deficiencies observed in prior years' annual reports. CPO guidance letters are

available on the CFTC's Web site at *http://www.cftc.gov/industryoversight/intermediaries/guidancecporeports.html*.

11) Does the regulatory framework require that the regulator:

a) Be kept informed of any suspension or deferral of redemption rights?

b) Have the power to take action, to demand, delay or stop the suspension or deferral of redemption rights?

CFTC Regulation 4.26 requires a CPO to provide NFA with a copy of any amendments to its Disclosure Document, including notice of any suspension or deferral of redemption rights. The CFTC and NFA have the power to take action where a CPO has violated either CFTC or NFA rules with respect to valuation and redemption.

MARKET INTERMEDIARIES

PRINCIPLES 21-24

Principle 21. Regulation should provide for minimum entry standards for market intermediaries

Assessment: Fully Implemented

1) Does the jurisdiction require that, as a condition of operating a securities business, the market intermediaries (as defined above) be licensed?

Yes. The CFTC divides market intermediaries into distinct categories according to function, and each of these categories is generally subject to licensing requirements as a condition to operating as an intermediary in the regulated futures markets. The CFTC's "licensing" regime is implemented through a general registration requirement. Specifically, Section 8a of the CEA, requires all individuals and firms, with certain exceptions, that intend to do business as futures professionals to be registered with the CFTC. The primary purposes of registration are to screen an applicant's fitness to engage in business as a futures professional and to identify those individuals and organizations whose activities are subject to federal regulation. In addition, all individuals and firms that wish to conduct futures-related business with the public must apply for NFA membership or Associate status.

Registration of market intermediaries is performed by the NFA pursuant to delegation from the CFTC, and the requirements for registration vary depending on the category of market intermediary. For an FCM, IB, CPO, or CTA, registration requires the completion of a Form 7-R, which requires:

- Disclosure of business information, including information concerning any holding company and/or branch offices;
- Disclosure of criminal or regulatory actions, as well as financial information; and
- Nomination of contact persons for membership, accounting arbitration, compliance and enforcement issues.

Additionally, FCMs and IBs may be required to submit for approval their procedures and/or materials concerning: (a) anti-money laundering; (b) business continuity; (c) electronic order routing systems (for FCMs) or automated order routing systems (for IBs); (d) promotional materials; (e) supervision of associated persons; (f) handling of customer complaints; (g) margins and/or segregation procedures (for FCMs). FCMs and IBs may also be required to provide copies of their Source of Assets letters and any subordinated loan agreements.

For principals or associated persons of an FCM, IB, CPO or CTA, or for floor traders or floor brokers, registration requires the completion of a Form 8-R, which requires:

- Criminal, civil, regulatory, financial, professional, educational and residential background disclosures;

- Evidence of the satisfaction of proficiency examination requirements; and

- Completion of a fingerprint card (to be used by the FBI in conducting a background check on the applicant).

As is discussed in further detail below, in addition to the CFTC's registration requirement, certain categories of market intermediaries are subject to minimum capital requirements as a condition to operating as an intermediary in the regulated futures markets.

2) Are there minimum standards or criteria that all applicants for licensing must meet before a license is granted (or denied) and that are clear and publicly available which:

a) Are fair and equitable for similarly situated intermediaries?

Yes. As explained in the answer to question #1 of this Principle, the CFTC and the NFA both impose minimum standards and criteria that all applicants for licensing (registration) must meet as a condition to becoming registered as an intermediary in the regulated futures markets. The minimum standards concerning registration of intermediaries are published on the Commission and NFA Web sites. The CFTC's rules concerning registration are set forth in Part 3 of its rules (17 C.F.R. 3.1-3.75), which is publicly accessible through the CFTC's Web site at *http://www.cftc.gov/lawandregulation/index.htm*. Each of the NFA's requirements relevant to intermediaries is clearly explained and publicly available on the NFA's Web site at *http://www.nfa.futures.org/NFA-registration/index.html*. In particular, part 200 et seq. of the NFA's rules, each of which is fully set forth on the NFA's Web site at *http://www.nfa.futures.org/nfamanual/NFAManual.aspx*, provides extensive guidance with respect to the NFA's requirements for the registration of intermediaries.

The CFTC's and NFA's registration requirements are applied fairly and equitably to all similarly situated intermediaries.

b) Are consistently applied?

Yes. The CFTC's and NFA's minimum standards and criteria for registration of intermediaries are consistently applied. As explained in the answer to question #1 of this Principle, all similarly situated entities of the same category of registrant (i.e., all similarly situated FCMs, all similarly situated IBs, etc.) are subjected to identical registration requirements.

c) Include an initial capital requirement, as applicable?

Yes. CFTC Regulation 1.17 prescribes the minimum levels of "adjusted net capital" that FCM and IB applicants must possess.

d) Include a comprehensive assessment of the applicant and all those in a position to control or materially influence the applicant that addresses "ethical attitude," including past conduct, and appropriate proficiency requirements,[92] such as, industry knowledge, skill and experience?

Yes. As explained in the answer to question #1 of this Principle, the NFA's registration process does include an examination of an applicant's past conduct and proficiency requirements. Specifically, the NFA requires the completion of a Form 8-R by any individual serving as a principal or an AP of the applicant-entity. A "principal" is defined under CFTC Regulation 3.1 as a sole proprietor, general partner, director, officer, manager or managing member, or person who is in charge of a principal business unit, division or function subject to Commission regulation, or any person occupying a similar position who exercises a controlling influence over the regulated activities of the firm. In addition, any holder or beneficial owner of 10% or more of the outstanding shares of stock in the firm, or any person who has contributed 10% or more of the firm's capital, is a principal. It is through this requirement that the CFTC and NFA can consider the knowledge, resources, skills and ethical attitude of senior management, directors and substantial owners/shareholders.

Form 8-R examines an individual's background as concerns any criminal, civil or regulatory issues, any financial issues, professional work experience, and education. Additionally, Form 8-R requires evidence of the satisfaction of any necessary proficiency examination requirements. The individual applicant also is required to complete a fingerprint card, which is used by the FBI in conducting a background check on the applicant.

It should be noted that the CFTC uses the information gained during the registration process as part of an objective approach to assessing ethical attitude, based, in part, on past conduct that could indicate a potential lack of appropriate ethical standards. No subjective inquiry is performed.

e) Include an assessment of the sufficiency of internal controls and risk management and supervisory systems in place, including relevant written policies and procedures?

Yes. As explained in the answer to question #1 of this Principle, FCMs and IBs may be required to submit for approval their procedures and/or materials concerning: (a) anti-money laundering; (b) business continuity; (c) electronic order routing systems (for FCMs) or automated order routing systems (for IBs); (d) promotional materials; (e) supervision of associated persons; (f) handling of customer complaints; and, (g) margins and/or segregation procedures (for FCMs). FCMs and IBs may also be required to provide copies of their Source of Assets letters and any subordinated loan agreements. However, the NFA is not required to conduct a specific assessment of the sufficiency of

[92] Such requirements would not be applied to shareholders for example.

an applicant's internal controls and risk management prior to granting an FCM or IB registration. Nonetheless, it should be noted that certified financial statements are required for such entities prior to registration and, should material inadequacies in the accounting system, internal accounting control or in the procedures for safeguarding customer funds or firm assets, exist, the certified accountant must notify the applicant/registrant, who must notify NFA, the DSRO, and the CFTC.

3) Does the relevant authority have the power to:

a) Refuse licensing, subject only to administrative or judicial review, if authorization requirements have not been met?

Yes. Sections 8a(2), 8a(3) and 8a(4) of the CEA provide the Commission with authority to statutorily disqualify a person's or an entity's registration in limited, enumerated situations. Pursuant to this authority, the Commission has enacted Regulations 3.60 through 3.64, which establish the procedures by which the Commission may deny, condition, suspend, revoke or place restrictions upon registration.

b) Withdraw, suspend or condition a license where a change in control or other change results in a failure to meet relevant requirements on an ongoing basis?

Yes. Paragraph (a)(3) of Regulation 3.31 requires a registrant to file a Form 8-R on behalf of each new natural person principal who was not listed on the registrant's Form 7-R promptly after the change occurs. (NFA Rule 208 prescribes a 20-day period after the inclusion of a new natural principal in which the Form 8-R must be filed.) As discussed above, a "principal" is defined under regulation 3.1 as a sole proprietor, general partner, director, officer, manager or managing member, or person who is in charge of a principal business unit, division or function subject to Commission regulation, or any person occupying a similar position who exercises a controlling influence over the regulated activities of the firm, any holder or beneficial owner of 10% or more of the outstanding shares of stock in the firm, or any person who has contributed 10% or more of the firm's capital. CFTC Regulation 1.17 provides that, should an FCM not be in compliance with its net capital requirements, it must transfer all customer accounts and immediately cease doing business as an FCM, subject to a 10-business day period during which the CFTC may have discretion to permit it to continue operation pursuant to a demonstration that it will be able to achieve compliance. CFTC regulations 3.55, 3.56 and 3.60 provide the adjudicatory steps to be taken for the CFTC to deny, condition, suspend, revoke or place restrictions on registration subject to Section 8a(4) of the CEA.

c) Take effective steps to prevent the employment of persons (or seek the removal of persons) who have committed securities violations or who are otherwise unsuitable from continuing to engage in intermediary activities, even if these persons are not separately licensed intermediaries if they can have a material influence on the firm?

Yes. Section 8a(4) of the CEA permits the CFTC to suspend, revoke or place restrictions upon the registration of any registrant based on certain criteria, which are set forth in section 8a(3) of the CEA. These include, but are not limited to, violations of the CEA or

rules thereunder, any wilful material misstatement or omission on the application, as well as for "other good cause." Section 8a(2) empowers the Commission to refuse to register any person whose prior registration is under suspension or has been revoked.

Additionally, Commission regulation 3.51 provides that, when information comes to the attention of the Commission that an applicant for initial registration in any capacity under the CEA is subject to statutory disqualification, the Commission may take steps to have the application withdrawn on a voluntary basis, or through the institution of legal proceedings.

4) Where licensing is the responsibility of a SRO, is the process subject to appropriate oversight by the regulator?

Yes. The Commission has authorized the NFA, a SRO and currently the only registered futures association, to receive and review registration applications and grant or deny registrations, subject to appeal to the Commission and the courts. The CFTC oversees the operations of the NFA, which may be subject to CFTC enforcement action for failure to comply with the CEA and CFTC rules.

5) Are market intermediaries required to update periodically relevant information with respect to their license and to report immediately to the regulator (or licensing authority) material changes in the circumstances affecting the conditions of the license?

Yes. Pursuant to CFTC Regulation 3.31, each firm registrant or applicant for registration must promptly correct any deficiency or inaccuracy in its registration information, including information about its principals and APs.

6) Is the following relevant information about licensed intermediaries available to the public:

a) The existence of a license, its category and status?

b) The scope of permitted activities or identity of senior management and names of other individuals authorized to act in the name of the intermediary?

Yes, to all of the above. In response to both (a) and (b), the NFA's Background Affiliation Status Information Center (BASIC), which can be accessed from the NFA's Web site, includes information on each registrant, the category of license held by the firm or individual, the main office, its listed principals, and membership/registration history. Disciplinary actions against the firm or individual are also included.

7) Does the regulator routinely monitor, investigate and enforce securities laws and regulations affecting intermediary activities?

Yes. The CFTC's regulatory scheme is based upon the allocation of self-regulatory responsibilities to the DCMs and NFA to ensure compliance by their members with all relevant rules (*i.e.*, CFTC, NFA and exchange rules), with continuing oversight by the CFTC on a periodic basis.

Section 5(d) of the CEA requires DCMs to monitor and enforce compliance with all applicable rules, which include ensuring fair and equitable trading and the financial integrity of transactions. Similarly, CEA section 17(a) requires a registered futures association to have rules that are designed to prevent fraudulent and manipulative practices, promote just and equitable principles of trade, and protect the public. CEA section 17(q) requires the association to adopt a comprehensive program that fully implements the rules promulgated by the CFTC.

In addition, CFTC Regulation 166.3 and NFA compliance Rule 2-9 establish a general duty upon registered persons to "diligently supervise" their employees in all aspects of their commodity futures activities. Other CFTC, exchange and NFA rules, as well as official NFA compliance publications and exchange notifications, impose more specific supervisory duties.

As part of its overall program, the CFTC's DOE routinely investigates and enforces the provisions of the CEA and the Commission's regulations that apply to intermediaries. These include, in particular, CTA, CPO and hedge fund fraud or other misconduct, unlicensed activity, and FCM liability for failure to supervise and/or vicarious liability for the acts of its agents. DOE's investigative tools are described in more detail in response to Principle 10, Question 3. DOE's enforcement tools are described in more detail in response to Principle 10, Question 11.

8) Does the regulatory scheme for investment advisers require that:

a) If an investment adviser deals on behalf of customers, the capital and other operational controls applicable to other market intermediaries also should apply to the adviser?

N/A. A CTA is any person who, for compensation or profit, is engaged in the business of providing commodity interest advisory services to others. CTAs are not permitted to deal on behalf of customers under this license. If a CTA engages in other activities requiring separate registration, then it must comply with the applicable requirements.

b) If the adviser does not deal, but is permitted to have custody of client assets, regulation provides for the protection of client assets, including segregation and periodic or risk-based inspections (either by the regulator or an independent third party)?

N/A. CTAs are not permitted to have custody of client assets.

c) In the case of both (a) and (b), as well as advisers who manage client portfolios without dealing on behalf of clients or holding client assets, does regulation include:

i) Record-keeping requirements?

Yes. CFTC Regulation 4.33 requires CTAs to keep accurate, current and orderly books and records concerning the clients and subscribers of the CTA and of the activities of the CTA itself.

ii) Clear and detailed requirements setting out the disclosures to be made by the adviser to potential clients, including: descriptions of the adviser's educational qualifications, relevant industry experience, disciplinary history (if any), investment strategies, fee structure and other client charges, potential conflicts of interest, and past investment performance (if relevant)?

Yes. CFTC Regulations 4.34 and 4.35 require that a CTA disclose specific information, including the business background of the CTA and its principals that will make trading or operational decisions, any material actions against the CTA and principals, a description of the trading program and related risk factors, fees, any actual or potential conflicts of interest, and past performance of its client accounts.

iii) Rules and procedures designed to prevent guarantees of future investment performance, misuse of client assets, and potential conflicts of interest?[93]

Yes. CFTC Regulation 4.35(a)(9) requires the prominent disclosure of the following statement with past performance information presented in CTA Disclosure Documents: "PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS."

CFTC Regulation 4.34(j) requires a CTA to provide a full description of any actual or potential conflicts of interest regarding any aspect of the CTA's trading program on the part of:

- The CTA;
- Any FCM with which the client will be required to maintain its commodity interest account;
- Any IB through which the client will be required to introduce its account to an FCM; and
- Any principal of the foregoing.

The CTA also must disclose any other material conflict involving any aspect of the offered trading program, including any arrangement whereby the CTA or principal thereof may benefit, directly or indirectly, from the maintenance of the client's commodity interest account with an FCM or IB (such as payment for order flow or soft dollar arrangements).

Section 4o of the CEA and CFTC Regulation 4.41 prohibit, among other things, a CTA from employing any device, scheme or artifice to defraud any client.

[93] Principle 21, Key Issue 8.

Principle 22. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake

Assessment: Fully Implemented

1) Are there initial and ongoing minimum capital requirements for relevant market intermediaries?

Yes. FCMs and IBs are subject to minimum capital requirements. Customer protection and the financial stability of the marketplace are central objectives of the CEA, and their achievement can be fulfilled by ensuring an adequate minimum capital requirement for FCMs and IBs.[94] With respect to FCM capital requirements, the Commission has stated in various rule revisions concerning its net capital regulation that its goal is to enhance the protection of customers' segregated funds and to ensure that the capital of FCMs appropriately takes into account risks undertaken by the firm, and those two results are of the greatest importance to the security and overall well-being of individual participants, institutions involved in the futures markets, and the markets themselves.

Section 4f(b) of the CEA provides that FCMs and IBs must meet the minimum financial requirements that the Commission "may by regulation prescribe as necessary to insure" that FCMs and IBs meets their obligations as registrants. The minimum capital requirements for FCMs and IBs are set forth in CFTC Regulation 1.17. This regulation requires each FCM and IB to maintain at all times adjusted net capital (as defined below) in an amount that meets or exceeds the greatest of several capital computations required under the regulation. Regulation 1.17 also provides an alternative means for IBs to satisfy net capital requirements, by operating pursuant to a guarantee agreement that meets the requirements set forth in Regulation 1.10(j). Such guaranteed IBs must place their trades only with the FCM guaranteeing the IB. In the annual report of "Futures Industry Registrants by Location", which is published on the Commission's Web site, there were 1,095 guaranteed IBs, 552 IBs that were not guaranteed, and 179 registered FCMs as of September 30, 2008. *See http://www.cftc.gov/stellent/ groups/public/@ecintrotofuturesindustry*.

For FCMs, the minimum capital requirement is the greatest of the following:

1. $250,000;
2. The minimum amount of net capital required by the NFA;

[94] 45 FR 79416 (December 1, 1980).

3. The risk-based capital computation, which is a risk-based component added by the Commission in September of 2004, and equals the sum of 8% of customer and 4% of "noncustomer"[95] maintenance margin requirements; and
4. For FCMs also registered as securities brokers or dealers, the amount of capital required by the SEC.

As indicated in the May 31, 2009 "Financial Data for FCMs" report, which is published on the Commission's Web site, the lowest capital requirement for any FCM was $500,000 (the minimum dollar amount required by NFA), and the highest capital requirement for any FCM was over $1.7 billion. All of the FCMs with requirements in excess of $1 billion were also registered as securities broker-dealers and had capital requirements determined under SEC regulations. *See http://www.cftc.gov/marketreports/financialdataforfcms/index.htm*.

The minimum capital requirements for IBs are lower than for FCMs, as the CEA permits only FCMs to carry customer futures and options positions and to hold customer funds. The capital requirements for IBs that are not guaranteed are the greatest of the following:

1. $30,000;
2. The minimum amount required by the NFA; and
3. For IBs also registered as securities brokers or dealers, the amount of capital required by the SEC.

Approximately half of all non-guaranteed IBs are also registered as securities broker-dealers. Moreover, as all IBs are members of the NFA, no IB has a capital requirement of less than $45,000, which is the minimum dollar amount requirement adopted by the NFA for non-guaranteed IBs.

The Commission has recently published for public comment proposed amendments to the requirements for minimum capital under Regulation 1.17. *See* 74 FR 21290 (May 7, 2009). In particular, the Commission is proposing the following revisions:

1. Increasing minimum dollar amount requirements in the regulation (from $30,000 to $45,000 for IBs, and from $250,000 to $1 million for FCMs);
2. Revising the risk-based component to require 10% of customer and noncustomer maintenance margin requirements; and
3. Applying capital requirements for OTC derivative positions in customer, noncustomer and proprietary accounts carried by the FCM that are similar to the capital requirements for exchange-traded futures carried in such accounts.[96]

[95] A noncustomer account, as defined in Commission Regulation 1.17(b)(4), is an account that is not included in the definition of either customer or proprietary account. These are usually accounts of affiliated entities and certain employees and officers of the FCM.

[96] The Commission has also requested comment on possible future proposals to revise the minimum adjusted net capital requirement of FCMs that are also registered as securities broker-dealers, by having the FCM/BD's capital requirement not based only on the higher of the CFTC's or SEC's requirements, but rather the combined requirements of the two regulations.

It also should be noted that FCMs generally have treated "early warning" notice requirements under Commission Regulation 1.12(b) as establishing a *de facto* higher capital requirement for FCMs. Specifically, Regulation 1.12(b) requires FCMs to provide immediate notification to the Commission and their DSROs if the FCM's capital falls below the following levels:

- 110% of the risk-based capital requirement;
- 150 percent of the $250,000 requirement, or of the requirement for minimum capital under NFA rules; or
- If the FCM is a securities broker-dealer, the early warning level established under SEC rules.

In order to avoid triggering the notice requirement under Regulation 1.12(b), FCMs generally seek to maintain capital at levels above the early warning levels described above.

2) Are the capital adequacy requirements structured to result in capital addressed to the full range of risks to which market intermediaries are subject, e.g., market, credit, liquidity, operational, and legal, including reputational, risks?

Yes. The key regulatory objective of the Commission's net capital rule is to require registrants to maintain a minimum base of liquid assets in excess of their liabilities to finance their business activity. The requirements in Regulation 1.17 are mostly focused on market risk, credit risk, and liquidity risk. The early warning notice requirements under Regulation 1.12, and more particularly the *de facto* higher capital requirements under that regulation, also help increase the cushion available to address the various risks to firm capital, which would include operational and legal risk.

The definitions of the terms "current assets" and "net capital" in Commission Regulation 1.17(c)(2) and (5) require the FCM to include only generally liquid assets when determining the amount of capital maintained by the firm. "Net capital" means the amount by which the FCM's "current assets", *i.e.*, cash and other assets "commonly identified as expected to be realized as cash or sold during the next 12 months", exceed the firm's total liabilities (except certain subordinated liabilities meeting the specific limitations of Commission Regulation 1.17(h)). When determining current assets, Regulation 1.17(c)(2) specifically excludes certain items such as unsecured receivables, and further requires that unrealized losses shall be deducted, and unrealized profits shall be added to the extent that they are secured or on exchange-traded positions (as such, the Commission's capital requirements take account of certain off-balance sheet items in addition to on-balance sheet items). Other assets must be marked to market, including all long and all short positions in commodity options which are traded on a contract market; all listed security options; and all long and all short securities and commodities positions. Further, the rule describes values to be attributed to any commodity option that is not traded on a contract market and to any unlisted security option.

In light of the regulatory emphasis on maintaining liquid assets, Regulation 1.17(c)(5) also requires deductions from the market values of certain assets to reflect the possibility of price depreciation when liquidated. For example, the definition of "adjusted net capital" in Regulation 1.17(c)(5) specifies certain required deductions with respect to the FCM's or IB's proprietary futures and options on futures positions; its inventory, fixed price commitments, and forward contracts; and also its securities and security options. The required deductions are also referred to as "haircuts", and are reductions of the market values of these assets by a set percentage, e.g., the firm must generally deduct twenty percent of the market value of its proprietary forward contracts.

The SEC's net capital rule for securities broker-dealers also specifies "haircuts" for certain assets of the broker-dealer. The Commission generally has harmonized the haircuts applied to securities and securities options under Regulation 1.17(c)(5) with the haircuts required under the SEC's net capital rule. For example, both the SEC's and the Commission's regulations require a deduction of fifteen percent of the value of equities. For certain firms, the SEC and CFTC also may permit the firm to apply internal models to determine "alternative" market risk and credit risk charges to be applied to a portfolio of trading securities.

3) Are capital adequacy requirements sensitive to the quantum of risks undertaken; that is, does required capital increase as risk increases, e.g., in the event of large market moves?

Yes. The "risk-based" capital requirements of FCMs are directly related to increases in margin requirements for the futures and options positions of their customers and noncustomers. Further, FCMs and IBs with proprietary positions in futures or options on futures must deduct from their net capital 100% of the margin requirements for such positions (or 150% if the FCM is not a clearing member of the organization clearing such positions). Also, FCMs' and IBs' capital requirements reflect market moves because their assets are required to be marked to market.

4) Are capital standards sufficient to allow an intermediary to absorb some losses and to wind down its business over a relatively short period without loss to its customers or disrupting the orderly functioning of the markets?

Yes, as supplemented by the procedures described in the response to Principle 24, Question 1. To date, FCMs with customers trading exchange-traded futures and options on futures have been able to absorb some losses without causing any loss to their customers, and to wind down their business without disrupting the orderly functioning of markets, including two very large FCMs that filed for bankruptcy within the past decade, Refco LLC and Lehman Bros. Inc.

5) Are relevant market intermediaries required to maintain records such that capital levels can be readily determined at any time?

Yes. Regulation 1.17(a)(3) expressly provides that each FCM and IB must be in compliance with capital requirements "at all times and must be able to demonstrate such compliance to the satisfaction of the Commission or the designated SRO". Other

relevant recordkeeping requirements relating to the financial condition of FCMs and IBs and to the customer funds held by FCMs are summarized below.

Regulation 1.18 requires FCMs and IBs to prepare and keep current ledgers which show each transaction affecting asset, liability, income, expense and capital accounts consistently with the Form 1-FR (or the FOCUS Report if a securities broker-dealer).

Regulation 1.27 requires each FCM that invests customer funds to keep a record which shows the details of the investment, including the size and type of investment, the date of the investment, and any disposition made of the investment.

Regulation 1.32 requires an FCM to compute each day the customer funds in segregated accounts and the FCM's residual interest in those funds, and to keep a record of each such computation.

Pursuant to Regulation 1.31, all books and records required by the CEA and Commission regulations must be kept for a period of five years and to be readily accessible during the first 2 years of the 5-year period. All books and records must be open to inspection by any representative of the CFTC or DOJ.

6) Are the detail, format, frequency and timeliness of reporting to the regulator and/or the SRO sufficient to reveal a significant deterioration in the capital adequacy position of market intermediaries?

Yes. Regulation 1.10(d) requires that the Form 1-FR that FCMs file on a monthly basis, and IBs on a semi-annual basis, include the following:

- A statement of financial condition as of the date for which the report is made;
- A statement of changes in ownership equity for the period between the date of the most recent statement of financial condition filed with the Commission and the date for which the report is made;
- A statement of changes in liabilities subordinated to claims of general creditors for the period between the date of the most recent statement of financial condition filed with the Commission and the date for which the report is made;
- A statement of the computation of the minimum capital requirements pursuant to 1.17 as of the date for which the report is made; For a FCM only, the statements of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges and for customers' dealer options accounts, and the statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers in accordance with CFTC Regulation 30.7 as of the date for which the report is made; and
- Such further material information as may be necessary to make the required statements and schedules not misleading.

In addition, Regulation 1.12(g)(1) requires that, if for any reason the net capital of an FCM declines by 20% or more from the amount last reported, the FCM must provide

notice within 2 business days of the event or series of events causing the reduction in net capital.

7) Is the financial position of the intermediary subject to audit by independent auditors to provide additional assurance that the financial position reflects the risk that the intermediary undertakes?

Yes. Commission Regulation 1.10 establishes a requirement for review of certain FCM operations by outside auditors, as a result of the requirement that FCMs file "certified" annual financial reports with the Commission. Commission Regulation 1.16 provides that the term "certified" means that a financial report has been audited and reported upon with an opinion expressed by an independent certified public accountant. In Regulation 1.16, the Commission provides that it will recognize any person as a certified public accountant who is duly registered and in good standing in the place of his or her residence or principal office. Examples of the meaning of the word "independence" are also provided in Regulation 1.16. For example, an accountant will not be considered independent if he or she had any direct or indirect financial interest with the registrant during the period in which the professional engagement occurred, or was otherwise connected with the firm as a promoter, underwriter, director, officer, etc., during this period. A limited exception exists for former employees of a registrant who have "completely disassociated" themselves from the registrant and do not participate in auditing financial statements or schedules of the registrant covering any period of their employment.

In order to satisfy the requirements of Regulation 1.16, the audit performed by the independent accountant must be conducted in accordance with generally accepted auditing standards. The procedures must include a review and appropriate tests of the accounting system of the FCM or IB, the FCM's or IB's internal accounting controls, and the procedures of the FCM or IB for safeguarding customer and firm assets. These procedures must be adequate to provide reasonable assurance that they will discover any material deficiencies in the accounting system, in the internal accounting controls, and in the FCM's or IB's system for safeguarding customer and firm assets. The accountant must also review the FCM's or IB's computations of minimum financial requirements and its daily computations of the segregation requirements under Section 4d(a)(2). Deficiencies in the FCM's or IB's procedures are considered to be material inadequacies if, in the absence of corrective steps, they could reasonably be expected to inhibit the FCM's or IB's ability to complete transactions promptly or to discharge responsibilities to customers or creditors; to result in material financial loss; to cause material misstatements in the FCM's or IB's financial statements and schedules; or to produce violations of the Commission's segregation, secured amount, recordkeeping, or financial reporting requirements, which could reasonably be expected to result in impediments to meeting its obligations, material financial loss, or inaccurate financial reports.

An accountant who discovers any such material inadequacy in the course of an audit is required under Regulation 1.16 to notify the FCM or IB, who, in turn, must notify the Commission, NFA and the appropriate DSRO. A copy of the notice must also be given

to the accountant within three business days after it is filed. The accountant is to advise the NFA, in the case of an applicant, or the Commission and the DSRO, in the case of a registrant, within three business days if he or she does not receive a copy of the notice and must notify those regulatory units of any disagreement with the FCM's submission within three business days after receiving the copy of the FCM's notice.

8) Does the regulator:

a) Regularly review market intermediaries' capital levels?

Yes. The Commission itself does not conduct routine on-site direct inspections of intermediaries, but may include an on-site visit to a firm as part of the responsive action taken when a firm files any early warning or other notification required under CFTC regulations. Also, under the CEA, SROs are required to develop programs to assess whether FCMs and IBs are in compliance with exchange and Commission minimum financial and related reporting requirements. Financial and Segregation Interpretations No. 4-1 and 4-2, issued by Commission staff, establish minimum components for a DSRO's financial surveillance program. These interpretations provide that a DSRO should conduct an examination of each FCM on a basis no less frequently than once every 9 to 15 months. Each examination must assess the FCM's compliance with minimum capital and customer funds protection requirements. Both the Commission and the SROs also receive monthly financial reports that include the statement of the computation of minimum capital requirements, as described in response to Principle 22, Question 6.

b) Take appropriate action when these reviews indicate material deficiencies?

Yes. If a review performed by either the SRO or the Commission indicates a material deficiency in capital, the Commission may impose the restrictions described in the response to Principle 24, Question 1.

9) Does the regulator have specific authority to impose restrictions on an intermediary's regulated business activities and more stringent capital monitoring and/or reporting requirements if an intermediary's capital deteriorates so as to endanger its capacity to fulfill its obligations or when it falls below minimum requirements? Is there evidence that the regulator exercises this authority?

Yes. Several Commission regulations enable the Commission to require more frequent reporting and/or to impose restrictions on the intermediary's business:

Regulation 1.10(b)(4) provides that upon notice of any representative of the Commission, an FCM or IB must provide more frequent Form 1-FR information, or such other financial information as may be requested by such representative. For example, when shares of the parent company of Bear Stearns and Co., a registered FCM, declined by more than 45 percent on March 14, 2008, the FCM was required to begin filing financial information on a daily basis with the Commission and the DSRO, rather than on a monthly basis.

Regulation 1.12(a) requires immediate notice and updated capital computations if the FCM's capital falls below the actual required minimum (as opposed to the capital levels that would merely trigger an early warning report under Regulation 1.12(b) described above).

Regulation 1.17(a)(4) provides that an FCM that fails to demonstrate that it holds sufficient capital to meet the required minimum must transfer all customer accounts and immediately cease doing business as a FCM until such time as the FCM is able to demonstrate compliance with the capital requirements. However, the FCM may trade for liquidation purposes only during this period unless prohibited from doing so by its DSRO or the Commission. Moreover, the Commission or DSRO, at its discretion, may provide the FCM with an additional 10 business days to achieve compliance without transferring accounts and ceasing business, if the FCM can demonstrate its ability to achieve compliance within this period.

Regulation 1.17(e) was amended in 2007 to provide that the Commission may, by written order, temporarily prohibit equity withdrawals by an FCM that would reduce excess adjusted net capital by 30 percent or more. Such orders would be based on the Commission's determination that the withdrawal transactions could be detrimental to the financial integrity of FCMs or could adversely affect their ability to meet customer obligations.[97]

10) Does the capital framework address risks from outside the regulated entity, for example from unlicensed affiliates or from off-balance sheet risks?

Yes. Affiliate risk generally is addressed through reporting and filing requirements under Regulation 1.14 and 1.15. However, the capital calculations of FCMs and IBs must exclude from their current assets any deposits at affiliates, whether licensed or not. Also, as discussed in the response to Principle 22, Question 2, certain off-balance sheet items must be reported as non-current assets in the capital computations of FCMs and IBs.

[97] 72 FR 1148 (January 10, 2007).

Principle 23. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters

Assessment: Fully Implemented

1) Is an intermediary required to have:

a) An appropriate management and organization structure?

b) Adequate internal controls?

c) Senior management that is required to bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the whole firm?

Yes, to all of the above. FCMs and independent IBs (i.e., not guaranteed by an FCM) are required to provide certified financial statements prior to registration and on an ongoing basis. The certification procedures must include a review and appropriate tests of the accounting system of the FCM or IB, the FCM's or IB's internal accounting controls, and the procedures of the FCM or IB for safeguarding customer and firm assets. These procedures must be adequate to provide reasonable assurance that they will discover any material deficiencies in the accounting system, in the internal accounting controls, and in the FCM's or IB's system for safeguarding customer and firm assets. The accountant must also review the FCM's or IB's computations of minimum financial requirements and its daily computations of the segregation requirements under Section 4d(a)(2). Deficiencies in the FCM's or IB's procedures are considered to be material inadequacies if, in the absence of corrective steps, they could reasonably be expected to inhibit the FCM's or IB's ability to complete transactions promptly or to discharge responsibilities to customers or creditors; to result in material financial loss; to cause material misstatements in the FCM's or IB's financial statements and schedules; or to produce violations of the Commission's segregation, secured amount, recordkeeping, or financial reporting requirements, which could reasonably be expected to result in impediments to meeting its obligations, material financial loss, or inaccurate financial reports.

An accountant who discovers any such material inadequacy in the course of an audit is required under Regulation 1.16 to notify the FCM or IB, who, in turn, must notify the Commission, NFA and the appropriate DSRO. A copy of the notice must also be given to the accountant within three business days after it is filed. The accountant is to advise

the NFA, in the case of an applicant, or the Commission and the DSRO, in the case of a registrant, within three business days if he or she does not receive a copy of the notice and must notify them of any disagreement with the FCM's submission within three business days after receiving the copy of the FCM's notice.

CFTC regulations also include operational requirements addressing risk management in connection with the risks that may be posed by FCM affiliates. For example, because many FCMs are affiliated with other organizations such as banks and insurance companies, the CFTC is authorized to obtain information about affiliates of an FCM that might jeopardize the FCM's ability to meet financial requirements or to otherwise remain in business. To moderate this risk, Congress amended section 4f of the CEA in 1992 to require an FCM to monitor those of its affiliates whose activities are reasonably likely to have a material impact on the FCM's financial or operational condition. Under Commission Regulations 1.14 and 1.15, all FCMs, with certain limited exemptions must, among other things, maintain, preserve and file with the Commission the following information:

- an organizational chart showing its affiliated persons;
- written policies, procedures or systems concerning methods for monitoring and controlling financial and operational risk, capital adequacy, internal controls with respect to market, credit and other risks; and
- fiscal year-end consolidated balance sheets, income statements and cash flow statements.

To help ensure compliance by registrants with these operational conduct requirements, Commission Regulation 166.3 requires each registrant (except APs with no supervisory duties), to "diligently supervise" the handling by its partners, officers, employees and agents of all activities relating to its business as a CFTC registrant. Also, the review of FCM internal procedures falls within the scope of SRO audit and surveillance obligations under Regulation 1.52. SRO obligations under this regulation include monitoring and auditing compliance by FCMs with their minimum financial and related reporting requirements, and also receiving the financial reports that all FCMs are required to file. The Commission also has issued guidance that emphasizes DSRO examination of the internal controls of FCMs, noting that the DSRO's assessment of such internal controls must include a review and evaluation of the procedures followed by an FCM in evaluating and minimizing the financial risk to the FCM and its customers. Such assessments must take into account the types, size and concentration of customer, non-customer and proprietary transactions, positions and commitments the FCM carries, on exchange and off-exchange, both domestic and foreign. *See* Interpretative Release 4-2 (August 20, 1999).

2) Is an intermediary required to cause an independent, periodic evaluation of its internal controls and risk management processes to be performed? Where the firm elects an evaluation performed by an independent auditor, is that auditor required to report material breakdowns in controls to senior management and to the regulator?

There is no requirement for an independent periodic evaluation of internal controls and risk management processes for FCMs and IBs other than those associated with the certified financial reporting requirements. CFTC Regulation 1.10 establishes a requirement for review of certain FCM operations by outside auditors, as a result of the requirement that FCMs file certified annual financial reports with the Commission. Commission Regulation 1.16 provides that the term "certified" means that a financial report has been audited and reported upon with an opinion expressed by an independent certified public accountant. In Regulation 1.16, the Commission provides that it will recognize any person as a certified public accountant who is duly registered and in good standing in the place of his or her residence or principal office. Examples of the meaning of the word "independence" are also provided in Regulation 1.16. For example, an accountant will not be considered independent if he or she had any direct or indirect financial interest with the registrant during the period in which the professional engagement occurred, or was otherwise connected with the firm as a promoter, underwriter, director, officer, etc., during this period. A limited exception exists for former employees of a registrant who have "completely disassociated" themselves from the registrant and do not participate in auditing financial statements or schedules of the registrant covering any period of their employment.

In order to satisfy the requirements of Regulation 1.16, the audit performed by the independent accountant must be conducted in accordance with generally accepted auditing standards. The procedures must include a review and appropriate tests of the accounting system of the FCM or IB, the FCM's or IB's internal accounting controls, and the procedures of the FCM or IB for safeguarding customer and firm assets. These procedures must be adequate to provide reasonable assurance that they will discover any material deficiencies in the accounting system, in the internal accounting controls, and in the FCM's or IB's system for safeguarding customer and firm assets. The accountant must also review the FCM's or IB's computations of minimum financial requirements and its daily computations of the segregation requirements under Section 4d(a)(2). Deficiencies in the FCM's or IB's procedures are considered to be material inadequacies if, in the absence of corrective steps, they could reasonably be expected to inhibit the FCM's or IB's ability to complete transactions promptly or to discharge responsibilities to customers or creditors; to result in material financial loss; to cause material misstatements in the FCM's or IB's financial statements and schedules; or to produce violations of the Commission's segregation, secured amount, recordkeeping, or financial reporting requirements, which could reasonably be expected to result in impediments to meeting its obligations, material financial loss, or inaccurate financial reports.

An accountant who discovers any such material inadequacy in the course of an audit is required under Regulation 1.16 to notify the FCM or IB, who, in turn, must notify the Commission, NFA and the appropriate DSRO. A copy of the notice must also be given to the accountant within three business days if he or she does not receive a copy of the notice and must notify these regulatory bodies of any disagreement with the FCM's submission within three business days after receiving the copy of the FCM's notice.

3) Is the intermediary required to provide for an efficient and effective mechanism for the resolution of investor complaints?

Yes. CFTC Regulation 166.5 sets forth the requirements that must be included in a customer account agreement with respect to dispute resolution procedures, including the use of arbitration procedures. Three fora exist for the resolution of disputes: civil court litigation, CFTC reparations proceedings, and arbitration conducted by an SRO or other private organization.

4) If an intermediary has control of, or is otherwise responsible for, assets belonging to a customer which it is required to safeguard, are there regulations that require proper protection for them (for example, segregation and identification of those assets) by the intermediary? Do these measures facilitate the transfer of positions; assist in the orderly winding up in the event of financial insolvency and otherwise provide protection from misuse by the intermediary?

Yes. With respect to customer funds held by FCMs, Section 4d(a)(2) of the CEA and regulation 1.20 both explicitly state that FCMs must separately account for customer funds on their books and records, and segregate such customer funds from their own funds and funds of other persons. The FCM is permitted to pool all customer funds in a single account, which must be clearly identified as belonging to customers. Customer funds must be deposited by the FCM with a bank, trust company, DCO, or another FCM. The FCM is further obligated to obtain a letter from the depository acknowledging that the funds deposited represent customer assets under the CEA and that the depository may not offset any obligation that the depositing FCM may have with the depository by the funds maintained in the Section 4d(a)(2) segregated account.

To be in compliance with the Commission's segregation requirements, an FCM must always maintain in accounts segregated in accordance with Section 4d(a)(2) of the CEA, sufficient funds in order to satisfy the net liquidating value of every futures and options customer. Each FCM is required to compute a calculation demonstrating its compliance with the segregation obligations on a daily basis, and is required to provide the Commission and its DSRO with immediate notification if it is not in compliance with its segregation obligation. Should an FCM be under its minimum capital requirements under CFTC Regulation 1.17, it must cease doing business as an FCM and transfer customer accounts. In this instance, the segregation requirements make the quick transfer of customer funds and positions between FCMs possible, and, in that circumstance, the process is directed and monitored by the DSRO and the CFTC.

5) Is an intermediary required to obtain and retain basic information from a customer about concerns and issues involving investment objectives relevant to the service to be provided?

The Commission's approach is to mandate disclosure of risks to customers prior to their opening accounts, and to require that the FCM or IB receive from the customer a signed acknowledgement that the risk disclosure statement has been received and understood. The topics covered in the risk disclosure statement required by Regulation 1.55 include the risks of futures trading, the possibility of margin calls and the liquidation of positions if such calls are not met, the potential loss of funds deposited, the possibility that a position cannot be liquidated when desired, the possibility that "stop-loss" orders may not

be executable, the acknowledgement that spread transactions may not be less risky than long or short trades, and the notice that the leverage in futures trading can result in large losses as well as large gains. The statement also urges the customer to consider his or her own suitability for trading and to study futures trading carefully before committing funds.

NFA Compliance Rule 2-30 provides that the information to be obtained from the customer shall include at least the following:

(1) the customer's true name and address, and principal occupation or business;

(2) the customer's current estimated annual income and net worth;

(3) the customer's approximate age; and

(4) an indication of the customer's previous investment and futures trading experience.

6) Is an intermediary required to "know its customer" before providing specific advice to a customer?

Yes. *See supra*, response to Principle 23, Question 5.

7) Can a customer obtain an agreement or contract or a written form of the general and specific business conditions that sets forth the terms on which the customer will be dealing?

Yes. Although the form and terms of the customer agreement are not prescribed by CFTC regulation, transactions must be specifically authorized; customer information as discussed above must be obtained; risk disclosure must be provided, signed and retained; and monthly account statements and confirmations must be provided. In addition, an agreement in advance to submit to settlement procedures (arbitration) must be voluntary and the intermediary must not require the customer to waive its right to seek reparations under Section 12 of the CEA.

8) Is an intermediary required to provide general or specific disclosures to customers of information needed to make a balanced and informed investment decision?

Yes. *See supra*, response to Principle 23, Question 5.

9) Is an intermediary required to provide a customer with a full and fair statement of account (and information regarding remuneration received by the intermediary for services provided to the customer)?

Yes. Pursuant to Regulation 1.33, FCMs must provide each customer with a monthly account statement regarding the details of transactions in its account, as well as charges and credits to the account. The FCM also must provide confirmation statements of each transaction by the next business day following the transaction.

10) Is the intermediary required to have a person or group of persons responsible for monitoring its compliance with legal and regulatory requirements as well as with its internal policies and procedures?

To help ensure compliance by registrants with operational conduct requirements, Commission Regulation 166.3 requires each registrant (except APs with no supervisory duties), to "diligently supervise" the handling by its partners, officers, employees and agents of all activities relating to its business as a CFTC registrant. There is also a requirement under CFTC Regulation 1.10 for certain signatories with sufficient authority to sign off on the submission of regulatory financial filings asserting the accuracy and completeness thereof, but there is no requirement that a person or group of persons have overall responsibility for regulatory and legal requirements.

11) Is an intermediary required to create and maintain adequate and reliable books and records, including accounting records? Is the intermediary required to maintain those books and records in a way that allows full supervision by the regulator?

Yes. The Commission imposes extensive recordkeeping requirements relating to the operations of FCMs and IBs. Pursuant to Regulation 1.31, all books and records required by the CEA and Commission regulations must be kept for a period of five years and be readily accessible during the first 2 years of the 5-year period. All books and records must be open to inspection by any representative of the CFTC or DOJ. The relevant recordkeeping provisions of several Commission regulations, which cover records pertaining to segregated funds, account activity, financial condition, customer protection, and other matters, are summarized below.

Regulation 1.18 requires FCMs and IBs to prepare and keep current ledgers which show each transaction affecting asset, liability, income, expense and capital accounts consistent with the classifications specified on the Form 1-FR (or the FOCUS Report if a securities broker-dealer).

Regulation 1.27 requires each FCM that invests customer funds to keep a record showing the details of the investment, including the size and type of investment, the date of the investment, and any disposition made of the investment.

Regulation 1.32 requires an FCM to compute each day the customer funds in segregated accounts and the FCM's residual interest in those funds, and to keep a record of each such computation.

Regulation 1.33 (a) requires that FCMs prepare a statement for each futures or options customer which shows the open contracts acquired or pertinent options transactions and their prices, the net unrealized prices in all open contracts marked to the market, any customer funds carried with the FCM and a detailed accounting of all credits and charges to the customer's account for the month. If there is no activity in an account, an account statement need only be prepared every three months. Regulation 1.33 (b) requires that each FCM must furnish no later than the next business day: (1) a written confirmation of each futures transaction; or (2) a written confirmation of an options transaction

containing the account identification number, a statement of the commission, premium or other applicable option charges, the strike price, the underlying futures contract or underlying physical, the final exercise date of the option and the date the transaction was executed.

Regulation 1.34 requires each FCM to prepare a monthly balance of all open positions which brings to the closing or settlement price all open futures and option positions.

Regulation 1.35(a) contains general recordkeeping requirements for FCMs and IBs with respect to futures, commodity options, and cash commodity transactions. FCMs and IBs must keep full, complete, and systematic records, together with all pertinent data and memoranda. Records to be kept include all orders (filled, unfilled, or cancelled), trading cards, signature cards, street books, journals, ledgers, cancelled checks, copies of confirmations, copies of statements of purchase and sale, and all other records, data and memoranda which have been prepared in the course of the firm's business.

Regulation 1.35(b) requires that the FCM maintain a financial ledger record for each customer account showing credits, debits, deposits, withdrawals or transfers, and charges or credits resulting from losses or gains on closed positions, along with a central activity record or journal showing all transactions made each day by the FCM, with trade details and the identity of the trader.

Regulation 1.36(a) requires FCMs to maintain records of all securities and property received from customers to margin, purchase, guarantee, or secure a futures or exchange-traded option transaction. The records must show where the property is deposited and any other disposition of the property.

Regulation 1.37(a) requires FCMs and IBs to keep a record of each account carried or introduced, the name and address of the person for whom such account is carried or introduced, and such person's principal occupation or business. The record must also show the name of any person guaranteeing the account or exercising any control over it.

Regulation 1.37(b) requires each FCM carrying a futures or options omnibus account for another FCM, foreign broker, or other person to maintain a daily record of the positions in each such account.

Regulation 1.40 imposes certain recordkeeping requirements relating to crop or market information or conditions that affect or tend to affect the price of any commodity.

12) Is an intermediary required to establish and maintain appropriate systems of customer protection, risk management and internal and operational controls, including policies, procedures, and controls relating to all aspects of its business intended reasonably to ensure:

a) An effective exchange of information between the firm and its clients, including required disclosures of information to clients?

b) The integrity of the firm's dealing practices, including the treatment of all clients in a fair, honest and professional manner?

c) The safeguarding of both the firm's and its clients' assets against unauthorized use or disposition?

d) The maintenance of proper accounting and other applicable records and the reliability of the information?

e) Compliance with all relevant legal and regulatory requirements?

f) Appropriate segregation of key duties and functions, particularly those duties and functions which, when performed by the same individual, may result in undetected errors or may be susceptible to abuses which expose the firm or its clients to inappropriate risks?

In response to (a)-(f), the CEA and Commission regulations impose a number of specific requirements relevant to the issue of customer protection risk disclosure, financial and other recordkeeping and net capital compliance. The CEA and CFTC regulations do not require intermediaries to adopt specific internal and risk management controls outside of these requirements, nor do they require the testing of such, other than through the certification of financial statement requirements as previously discussed.

To help ensure compliance by registrants with specific operational conduct requirements (as opposed to internal control/risk management requirements), Commission Regulation 166.3 requires each registrant (except APs with no supervisory duties), to "diligently supervise" the handling by its partners, officers, employees and agents of all activities relating to its business as a CFTC registrant.

13) Is an intermediary required:

a) To endeavor to avoid a conflict of interests arising between its interests and those of its customers or between its customers?

b) Where the potential for conflicts arise, to have mechanisms in place to ensure fair treatment of all its customers such as proper disclosure, internal rules of confidentiality, declining to act where conflict cannot be avoided?

Part 155 of the Commission's regulations requires FCMs and IBs to establish and enforce internal rules, procedures and controls to insure, to the extent possible, that orders received from customers are transmitted before any order in the same commodity for the benefit of a proprietary account. These regulations prevent FCMs and IBs and their affiliated persons from using their knowledge of customer orders to the customer's disadvantage and have helped the Commission to deter such practices as "front-running" and "trading ahead."

Principle 24. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk

Assessment: Fully Implemented

1) Does the regulator have clear plans for dealing with the eventuality of a firm's failure, including a combination of activities to restrain conduct, to ensure assets are properly managed and to provide information to the market as necessary?

Yes. The CEA and CFTC regulations provide, in conjunction with the Bankruptcy Code, a clear framework for the CFTC to follow in managing the failure of an FCM.

Early Warning Mechanisms. As described above, all FCMs are monitored by a DSRO[98] for compliance with the CEA and CFTC regulations, including CFTC Regulation 1.17 (*e.g.*, minimum capital requirement), as well as Section 4d(a)(2) of the CEA and CFTC Regulations 1.20 to 1.30 (*e.g.*, treatment of customer property).

Additionally, if an FCM is executing transactions on a DCM, then such FCM is required to clear such transactions through a DCO.[99] In order to clear such transactions, the FCM

[98] As mentioned above, an SRO (*i.e.*, a commodity exchange or a registered futures association) has the responsibility for ensuring that an FCM complies with the CEA and the Regulations. The term "DSRO" refers to the SRO that is primarily responsible for a specific FCM. If an FCM is a member of more than one SRO, all relevant SROs may decide among themselves which of them will be primarily responsible for that FCM, and that SRO will be appointed the DSRO for that FCM.

[99] *See* 7 U.S.C. 7(b)(5) (stating that, in order to become designated as a DCM, an entity must "establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into by or through the facilities of the contract market, including the clearance and settlement of the transactions with a derivatives clearing organization").

A DCO is a central counterparty that "interposes itself between counterparties" to commodity contracts, thereby "becoming the buyer to every seller and the seller to every buyer." *See* Section 1.1 of CPSS-IOSCO *Recommendations for Central Counterparties*, dated as of November 2004. A DCO guarantees that a member with net gains on its positions will receive related amounts, even if the DCO cannot collect such amounts from a member with net losses on its positions. Thus, a DCO is essential to managing systemic and counterparty risks in the event that a member fails.

To obtain and maintain its registration, a DCO must comply with fourteen core principles established in Section 5b of the CEA (7 U.S.C. 7a-1(c)(2)(A)), and Part 39 of the Regulations. Specifically, such core principles address: (i) general matters; (ii) financial resources; (iii) participant and product eligibility; (iv) risk management; (v) settlement procedures; (vi) treatment of funds; (vii) default rules and procedures; (viii) rule enforcement; (ix) system safeguards; (x) reporting; (xi) recordkeeping; (xii) public information; (xiii) information sharing; and (xiv) antitrust considerations.

generally must be a member of the DCO,[100] and must therefore comply with the rules of the DCO, especially those pertaining to payments and settlements. The FCM is monitored by the DCO for compliance with such rules.

Given the regulatory structure described above, the CFTC has a number of methods for ascertaining when an FCM may be experiencing financial distress. First, an FCM has affirmative responsibilities under the Regulations to notify the CFTC upon the occurrence of one of a number of events, any of which may indicate financial distress. For example, pursuant to CFTC Regulation 1.12:

- An FCM must provide the CFTC with notice within 24 hours, if such FCM knows or should know that its capital exceeds its minimum capital requirement, but is less than a certain percentage specified in Regulation 1.12;[101]

- An FCM must provide the CFTC with immediate notice, if such FCM knows or should know that its capital is less than the amount specified in its minimum capital requirement;[102]

- As mentioned above, an FCM must provide the CFTC with immediate notice, if such FCM determines that it has insufficient segregated property; [103] and

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The CFTC evaluates compliance with the core principles when reviewing DCO applications, and for DCOs that are already registered, the CFTC performs periodic reviews to assess their compliance with the core principles on an ongoing basis. Such reviews may focus on one or two core principles and assess the compliance of multiple DCOs with those particular core principles (horizontal review), or it may focus on a particular DCO and the compliance of that DCO with multiple core principles (vertical review). In evaluating DCO applications and performing Core Principle reviews, CFTC staff members consider not only documentary information, but also conduct on-site visits and independent analysis and testing, if appropriate. CFTC staff members draft memoranda summarizing their conclusions with respect to DCO applications and Core Principle reviews, and the CFTC bases its actions on such memoranda.

[100] Most large FCMs are members of a DCO. If an FCM is not a member of a DCO ("Non-Clearing FCM"), it may become a customer of, and thereby clear transactions through, an FCM that is a member of a DCO ("Clearing FCM"). The Clearing FCM monitors the compliance of the Non-Clearing FCM with payment obligations. Pursuant to Regulation 1.12(f)(2), the Clearing FCM has an affirmative responsibility to notify the CFTC whenever it determines that it must immediately liquidate or transfer the positions of a Non-Clearing FCM, or limit the Non-Clearing FCM to trading for liquidation only, because the Non-Clearing FCM has failed to meet its payment obligations to the Clearing FCM.

[101] Pursuant to Regulation 1.10(b)(1)(i), the FCM must continue to provide, on a monthly basis, certain financial information to the CFTC, in a Form 1-FR (or an equivalent SEC report, if the FCM is also a broker-dealer). However, the CFTC may require, pursuant to Regulation 1.12, the FCM to provide interim financial information, to facilitate CFTC monitoring of such FCM.

[102] Pursuant to Regulation 1.12, the FCM must provide, within twenty-four (24) hours of such notice, certain financial information to the CFTC, in a Form 1-FR (or an equivalent SEC report, if the FCM is also a broker-dealer).

[103] *See supra*, note 95.

- An FCM must provide the CFTC with immediate notice, if such FCM determines that a customer account is undermargined by an amount that exceeds the adjusted net capital of such FCM.[104]

Second, the CFTC may receive information from a DSRO or a DCO that an FCM is either currently not fulfilling its financial obligations, or has a risk profile indicating that it may shortly become unable to fulfill such obligations. Third, the CFTC's Risk Surveillance Group ("RSG") may identify such an FCM.[105]

Management of Potential FCM Failure Pre-Bankruptcy. If the CFTC ascertains, from the mechanisms described above, that an FCM may be experiencing financial distress, the CFTC will attempt to determine whether there is a significant likelihood that the FCM will fail.[106] The CFTC first gathers information from the DSRO, any other relevant SRO, and the DCO on the financial resources available to the FCM (including the liquidity of such resources). The CFTC then gathers information, from the same sources, on the potential causes of financial distress at the FCM (*e.g.*, extreme market volatility, or concentration of proprietary or customer positions opposite to the direction of the market), and on losses that the FCM has already sustained, or will likely sustain, from such causes. The CFTC finally considers the extent to which the FCM will be able to cover its current or future losses using its available financial resources.

If the CFTC determines that an FCM is likely to fail, then it will attempt:

- to effect the transfer of customer accounts. For example, pursuant to Regulation 1.17(a)(4), if an FCM holds less capital than the amount specified in its minimum capital requirement, then it generally must transfer all customer accounts and immediately cease conducting business as an FCM, until such time as the FCM is able to demonstrate compliance with its minimum capital requirement. The FCM itself or its DSRO would actually arrange the transfer of customer accounts. The role of the CFTC would be to facilitate such transfer as necessary (*e.g.*, grant relief from certain notice requirements applicable to such transfer under Regulation 1.65);

- to determine the effects that such failure would have on the counterparties of the FCM, as well as on the futures markets. In most instances, if the FCM is clearing transactions through a DCO, the failure would cause minimal disruption to counterparties and the futures markets. *See* the section below entitled *Proper Management of Systemic and Counterparty Risks (Whether Pre-Bankruptcy or After Bankruptcy).*

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[104] *Id.*

[105] The RSG, as described further below, endeavors on a daily basis: (i) to identify any significant financial risks posed by positions in products that (A) an FCM clears through a DCO, and (B) fall within the jurisdiction of the CFTC; and (ii) to confirm that such financial risks are being appropriately managed.

[106] In many cases, CFTC staff will receive notice from an FCM for less serious reasons, such as when a clerical error causes the capital of an FCM to temporarily fall below the percentage specified in Regulation 1.12. Such notice will generally reveal that the error has been corrected.

If the CFTC determines that an FCM is not likely to fail, then it may permit the FCM to continue operations without transferring customer accounts, despite the financial distress experienced by the FCM. For example, even if the FCM violates its minimum capital requirement, the CFTC or the relevant DSRO has the discretion, pursuant to Regulation 1.17(a)(4), to allow the FCM a maximum of ten (10) days to achieve compliance with such requirement, without transferring customer accounts and ceasing business, provided that the FCM immediately demonstrates to the CFTC or the DSRO its ability to achieve compliance within that time period. In determining whether the FCM has met its demonstration burden, the DSRO and the CFTC are in routine contact and work cooperatively.

Management of FCM Bankruptcy. If an FCM becomes the subject of bankruptcy proceedings, then Subchapter IV of Chapter 7 of the Bankruptcy Code ("Subchapter IV"), in conjunction with Regulation Part 190 ("Part 190"), would govern such proceedings. As described below, Subchapter IV and Part 190 set forth a clear structure for the liquidation of a commodity broker, including an FCM.

Restraints on Conduct. Pursuant to Regulation 190.04(d)(2), the trustee appointed to administer the bankruptcy proceedings of an FCM is not permitted to purchase or sell new commodity contracts for the customers of such FCM, with the exceptions noted below. In general, Regulation 190.04(d)(2) presumes that an FCM subject to bankruptcy proceedings is insolvent and, therefore, that such FCM does not have sufficient capital to operate its business, which business may include supporting the credit of its customers or performing on other obligations. Thus, in restricting the conduct of the trustee, Regulation 190.04(d)(2) aims to minimize the risk of loss to customers of the FCM.

However, Regulation 190.04(d)(2) recognizes that, even where an FCM is insolvent, certain purchases or sales of new commodity contracts may be risk-reducing, and thus may prevent material erosion in value of open commodity contracts constituting customer assets. Therefore, Regulation 190.04(d)(2) permits the trustee to engage in such purchases or sales to achieve any of the following purposes: (i) to offset an open commodity contract; (ii) to transfer any transferable notice applicable to an open commodity contract; or (iii) to cover or partially cover, with the approval of the CFTC, inventory or commodity contracts of the FCM that cannot be immediately liquidated due to market conditions (including price limits).

Proper Management of Assets.

> **Pre-Petition Transfers.** If, pursuant to Regulation 1.17(a)(4), the FCM had transferred customer accounts before becoming subject to bankruptcy proceedings, then Section 764(b) of the Bankruptcy Code, in conjunction with Regulation 190.06(g)(1)(i), would protect such transfer from avoidance by the trustee. Specifically, Section 764(b) of the Bankruptcy Code prohibits a trustee from avoiding a transfer of customer positions in a commodity contract (and the collateral securing such positions), if the FCM made such transfer prior to seven

(7) calendar days after becoming subject to bankruptcy proceedings, and if the CFTC had approved such transfer by rule or order. In general, the CFTC has approved such transfer by promulgating Regulation 190.06(g)(1)(i), which prohibits a trustee from avoiding a transfer of customer accounts pursuant to Regulation 1.17(a)(4), unless the CFTC has specifically disapproved such transfer.

Post-Petition Transfer. An FCM may become subject to bankruptcy proceedings before it transfers customer accounts pursuant to Regulation 1.17(a)(4). In that case, Regulation 190.02(e) requires the trustee to immediately use its best efforts to transfer eligible customer accounts, as determined in accordance with Regulation 190.06(e) and (f). If the trustee makes such transfer prior to seven (7) calendar days after the FCM becomes subject to bankruptcy proceedings, then Section 764(b) of the Bankruptcy Code, in conjunction with Regulation 190.06(g)(2), would protect such transfer from later attempts at avoidance.

Distribution of Assets in Customer Accounts. If the trustee determines, in accordance with Regulation 190.06(e) and (f), that customer accounts are not eligible for transfer, then the trustee must liquidate, in accordance with Regulation 190.02(f), the positions and accompanying collateral held in such accounts.

After such liquidation, the trustee must distribute the proceeds. Section 761(10) of the Bankruptcy Code characterizes such proceeds as "customer property." Section 766(h) of the Bankruptcy Code requires the trustee to distribute "customer property" to customers of the FCM, "in priority to all other claims," except claims attributed to the administration of such property. Therefore, under Section 766(h) of the Bankruptcy Code, the claims held by customers of an FCM will be satisfied from "customer property," before the claims held by other creditors of such FCM are satisfied, with the exception of claims attributed to the administration of "customer property."

Section 766(h) of the Bankruptcy Code further requires the trustee to allocate "customer property" between customers of an FCM on the basis of "allowed net equity claims." Regulation 190.08 specifies the manner in which the trustee must calculate such claims for each customer, and essentially defines "allowed net equity" as *pro rata* allocation. *Pro rata* allocation provides a method for mutualizing any shortfalls in "customer property" in an impartial and fair manner.

As described above, Section 4d(a)(2) of the CEA ensures the integrity of "customer property" by requiring that an FCM: (i) treat all collateral securing the positions of a customer, as well as all amounts accruing to such positions, as belonging to such customer; (ii) separately account for such collateral and amounts; and (iii) refrain from (A) commingling such collateral and amounts with proprietary funds, and (B) using the collateral and amounts belonging to one customer to margin or guarantee the transactions of, or to secure or extend credit

to, another customer. As described above, the CFTC implemented Section 4d(a)(2) of the CEA by promulgating Regulations 1.20 to 1.30, which address the treatment of customer property, including investments of such property by an FCM.

Provision of Information to the Market. Regulation 190.02(a) requires: (i) an FCM filing a voluntary bankruptcy petition to notify the CFTC, as well as its DSRO, upon or before making such filing; and (ii) an FCM subject to an involuntary bankruptcy petition to notify the CFTC, as well as its DSRO, no later than one (1) business day after the FCM receives information of such petition. Upon receiving such notification, both the CFTC and the DSRO will have the ability to provide information regarding such bankruptcy petition to the public, as necessary.

Proper Management of Systemic and Counterparty Risks (Whether Pre-Bankruptcy or After Bankruptcy). In general, if a DCO currently cannot collect payments from a member, or if a DCO believes that it will shortly be unable to collect such payments,[107] the DCO will declare the member to be in default. The rules of the DCO would govern the management of such default. Usually, such rules would permit: (i) the DCO to liquidate or transfer positions carried by the defaulting member; (ii) the DCO to access all property held in the proprietary accounts of the defaulting member; (iii) the DCO to access all property held in the customer account of the defaulting member, if the default of the member to the DCO resulted from the default of a customer to the member; and (iv) the DCO to access any amounts that the defaulting member had contributed to the guarantee fund. If the proceeds from (i) through (iv) do not cover all DCO losses, then the rules of the DCO may permit: (A) the DCO to access the amounts that non-defaulting members had contributed to the guarantee fund; (B) the DCO to look to its own capital; and (C) the DCO to levy an assessment on all members.

2) Are there early warning systems or other mechanisms in place to give the regulator notice of a potential default by a market intermediary and time to address the problem and to take corrective actions?

Yes. *See supra*, response to Principle 24, Question 1.

3) Does the regulator have the power to take appropriate actions: In particular, can it:

a) Restrict activities by the intermediary with a view to minimizing damage and loss to investors?

Yes. *See supra*, response to Principle 24, Question 1.

b) Require the intermediary to take specific actions, for example, moving client accounts to another intermediary?

[107] In general, if a DCO suspects that a member will shortly be unable to make scheduled payments, a DCO would request that such member deposit additional performance bond. If the member is unable to make such deposit, then the DCO would declare such member to be in default.

Yes. *See supra*, response to Principle 24, Question 1.

c) Request appointment of a monitor, receiver, curator or other administrator or, in the absence of such power, can the regulator apply to the relevant authorities to take possession or control of the assets held by the intermediary or by a third party on behalf of the intermediary?

Yes. Pursuant to Section 6(c) of the CEA, the CFTC has the authority to request the appointment of a monitor, receiver, curator or other administrator, with respect to an FCM that the CFTC has reason to believe is violating or has violated any provision in the CEA and the Regulations.

d) Require that relevant information concerning a firm's failure (i.e. a firm's trading status) be disclosed to the market?

Yes. *See supra*, response to Principle 24, Question 1.

e) Apply other available measures intended to minimize customer, counterparty and systemic risk in the event of intermediary failure, such as customer and settlement insurance schemes or guarantee funds?

Yes. *See supra*, response to Principle 24, Question 1.

4) Do the regulator's processes and procedures for addressing financial disruption include communication and cooperation with other regulators, both domestic and foreign, where appropriate, and is there evidence that contact arrangements are in place and that such cooperation occurs?

As a routine matter, the CFTC consults with other regulators, both domestic and foreign, on areas of mutual interest. Domestically, the CFTC regularly interacts with other financial regulatory agencies on an informal basis. The CFTC also formally interacts with other financial regulatory agencies through its participation in the President's Working Group on Financial Markets. The CFTC further enters into formal memoranda of understanding with other financial regulatory agencies, if appropriate.

Internationally, the CFTC has entered into bilateral MOUs with numerous foreign regulators, each of which calls for the sharing of information. The CFTC has posted such MOUs on its Web site, at *http://www.cftc.gov/international/memorandaofunderstanding/index.htm.* Additionally, the CFTC is a signatory of the multilateral *Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations* and the IOSCO MMOU.

SECONDARY MARKETS

PRINCIPLES 25-29

Principle 25. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight

Assessment: Fully Implemented

1) Does the establishment of an exchange or trading system require authorization?

Yes. Any market that seeks to provide a trading facility to trade futures, options on futures or options on commodities must apply to the Commission to become a DCM or to be registered as a DTEF, unless some exemption or exclusion would apply to the facility. The CFTC is the authority that analyzes the DCM or DTEF application and grants the authorization. Section 4(a) of the CEA establishes the basis for requiring markets to register. Section 4(a) of the CEA states in part that:

> Unless exempted by the Commission pursuant to subsection (c), it shall be unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting, or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery (other than a contract which is made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions) unless---
> (1) such transaction is conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission as a contract market or DTEF for such commodity . . . .

The CFTC does not rely on the judgments of another authority in granting contract market designation or registering a market as a DTEF.

The CEA is available at *http://www.cftc.gov/lawandregulation/index.htm*.

2) Are there criteria for the authorization of exchange and trading system operators that:

a) Require analysis and authorization of the market by a competent authority?

Yes.

Statutory and administrative standards for DCM status. Criteria, procedures and requirements for designation as a DCM are set forth in Section 5 of the CEA, 7 U.S.C. 7, and Part 38 of the CFTC's regulations. Appendix A and B to Part 38 provide specific information on these requirements and guidance to applicants seeking to become designated as DCMs.

Products Eligible for Trading. Boards of trade designated as a contract market may list for trading futures or option contracts based on any underlying commodity, index or instrument. However, there are special requirements for security futures products, which are subject to joint CFTC/SEC oversight under rules promulgated by these agencies in 2001.

Criteria for DCM Status. The criteria for designation as a contract market are set forth in Section 5(b) of the CEA and Part 38 of the CFTC's regulations. The criteria relate to the following standards:

(1) General Demonstration of Adherence to Designation Criteria;

(2) Prevention of Market Manipulation;

(3) Fair and Equitable Trading;

(4) Enforcement of Rules on the Trade Execution Facility;

(5) Financial Integrity of Transactions;

(6) Disciplinary Procedures;

(7) Public Access to Information on the Contract Market; and

(8) Ability of the Contract Market to Obtain Information.

Appendix A to Part 38 provides more specific information on these designation requirements as well as guidance to applicants seeking to become DCMs.

Ongoing compliance with core principles. In addition to the above requirements for designation, a DCM must comply, on a continuing basis, with the following 18 core principles. Appendix B to Part 38 provides additional information and guidance to applicants on how DCMs can remain in compliance with these core principles.

1. In general	*7. Availability of general information*	*13. Dispute resolution*
2. Compliance with rules	*8. Daily publication of trading information*	*14. Governance fitness standards*
3. Contracts not readily subject to manipulation	*9. Execution of transactions*	*15. Conflicts of interest*
4. Monitoring of trading	*10. Trade information*	*16. Composition of boards of mutually owned markets*
5. Position limits or	*11. Financial*	*17. Record-keeping*

accountability	*integrity of contracts*	
6. Emergency authority	*12. Protection of market participants*	*18. Antitrust considerations*

Application Process. The CFTC encourages applicants to contact CFTC staff for guidance and assistance in preparing an application for designation. Potential applicants are encouraged to submit a draft application to the CFTC for review and feedback by the staff prior to submission of a formal application.

Part 38 Application Procedures. Under Part 38 of the CFTC's Regulations, an application for contract market designation should include:

- A statement that the applicant is applying to become a DCM pursuant to Part 38;
- A copy of the applicant's rules, as defined in CFTC Regulation 40.1, and any technical manuals, other guides or instructions for users of, or participants in, the market, including minimum financial standards for members or market participants;
- A description of the trading system, algorithms, security and access limitation procedures with a timeline for an order from input through settlement, and a copy of any system test procedures, tests conducted, test results, and contingency or disaster recovery plans;
- A copy of any documents describing the applicant's legal status and governance structure, including fitness information;
- A signed copy of any agreements or contracts entered into by the applicant, including partnership or limited liability company, third-party regulatory service, or member or user agreements, that enable or empower the applicant to comply with a designation criterion or Core Principle (a final draft copy of such agreements may be submitted with the application; however, signed copies of such documents must be submitted prior to designation);
- A copy of any manual or other document describing, with specificity, the manner in which the applicant will conduct trade practice, market and financial surveillance;
- A regulatory chart or other document that describes the manner in which the applicant shall comply with each designation criterion and Core Principle;
- To the extent that any aspect of the application raises issues that are novel, or for which compliance with a designation criterion or a Core Principle is not self-evident, an explanation as to how the Designation Criteria or core principles are satisfied; and
- A detailed description of any information in the application for which confidential treatment is requested.

Except as provided under the 90-day review procedures described below, the Commission will review an application for designation as a contract market pursuant to the 180-day time frame and procedures specified in Section 6(a) of the CEA, 7 U.S.C. 8(a). The Commission will approve or deny the application or, if deemed appropriate, designate the applicant as a contract market subject to conditions.

An applicant may request that its application be reviewed on an expedited basis and that the applicant be designated as a contract market not later than 90 days after the date of

receipt of the application. The 90-day period begins on the first business day (during the business hours as defined in CFTC Regulation 40.1) that the Commission is in receipt of the final application.

Unless the Commission notifies the applicant during the 90-day period that the expedited review has been terminated as described below, the Commission will designate the applicant as a contract market during the 90-day period. If deemed appropriate by the Commission, the designation may be subject to such conditions as the Commission may stipulate.

To receive expedited review, an applicant must demonstrate compliance with the criteria for designation of Section 5(b) of the CEA, the core principles for operation of Section 5(d) of the CEA, and the provisions of Part 38. The application must include the necessary information and documents related to the items listed above, and the applicant must not amend or supplement the application, except as requested by the Commission or for correction of typographical errors, renumbering or other non-substantive revisions, during the 90-day review period.

The Commission may terminate expedited review and review the application under the 180-day time period and procedures of Section 6(a) of the CEA. Such action may be taken if it appears to the Commission that the application: (i) is materially incomplete, (ii) fails in form or substance to meet the requirements of this part, (iii) raises novel or complex issues that require additional time for review, or (iv) is amended or supplemented in a material manner that has not been requested by the Commission. In addition, the Commission shall terminate expedited review if requested in writing to do so by the applicant. If expedited review is terminated, the Commission will provide a written notification to the applicant specifying the reasons for this action.

A complete description of the requirements for designation as a contract market is found in Part 38 of the CFTC's rules. Appendix A to Part 38 provides guidance to applicants on how the specific conditions for initial designation may be met by an applicant. Appendix B to Part 38 provides guidance to applicants on how DCMs can remain in compliance with the core principles.

See How to Become a Contract Market at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/dcmhowto.html*.

b) Seek evidence of operational or other competence of the operator of an exchange or trading system as a secondary market?

Yes. The competency of system or market operators who apply for designation of the board of trade as a contract market will be demonstrated through the process whereby they demonstrate their capacity to operate in compliance with the core principles under CEA Section 5(d) and CFTC Regulation 38.3. *See* Appendix B to Part 38 – Guidance on, and Acceptable Practices In, Compliance with core principles (DCM Core Principle 1).

Once a market receives designation, DCM Core Principle—14 Governance Fitness Standards—requires the board of trade to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other persons with direct access to the facility.

The CFTC's guidance provides, in part, that minimum standards of fitness for persons who have member voting privileges, governing obligations or responsibilities, or who exercise disciplinary authority are bases for refusal to register a person under Section 8a(2) of the CEA. In addition, persons with governing obligations or responsibilities, or who exercise disciplinary authority, should not have a significant history of serious disciplinary offenses such as those that would be disqualifying under Regulation 1.63. *See* Appendix B to Part 38 – Guidance on, and Acceptable Practices In, Compliance with DCM core principles (DCM Core Principle 14 discussion).

c) Require the operator of an exchange or trading system that assumes principal, settlement, guarantee or performance risk to comply with prudential and other requirements designed to reduce the risk of non-completion of transactions (*e.g.*, mandatory margin assessment and collection, capital or financial resources, member contributions, guaranty fund, credit or position limits)?

Yes. Boards of trade seeking contract market designation are required to adopt and enforce rules for ensuring the financial integrity of transactions.

Designation Criterion 5 of Section 5(b) of the CEA provides that:

> The board of trade shall establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into by or through the facilities of the contract market, including the clearance and settlement of the transactions with a DCO.

Appendix A to Part 38 provides the following CFTC guidance on Core Principle 5 of Section 5(b):

> (a) A DCM should provide for the financial integrity of transactions by setting appropriate minimum financial standards for members and non-intermediated market participants, margining systems, appropriate margin forms and appropriate default rules and procedures. Absent Commission action pursuant to its exemptive authority under Section 4(c) of the CEA, transactions executed on the contract market (other than stock futures products), if cleared, must be cleared through a derivatives clearing organization registered as such with the Commission. The Commission believes ensuring and enforcing the financial integrity of transactions and intermediaries, and the protection of customer funds, should include monitoring compliance with the contract market's minimum financial standards. In order to monitor for minimum financial requirements, a contract market should routinely receive and promptly review financial and related information.

(b) A DCM should have rules concerning the protection of customer funds that address appropriate minimum financial standards for intermediaries, the segregation of customer and proprietary funds, the custody of customer funds, the investment standards for customer funds, related recordkeeping procedures and related intermediary default procedures.

See Appendix A to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

d) Permit the regulator to impose ongoing conditions (as appropriate) on the operator of an authorized exchange or regulated trading system, such as the obligation to establish rules, policies and procedures to prevent fraudulent behavior, treat all members or participants fairly, and have the capacity to carry out the market's and the competent authority's obligations?

Yes. A Board of Trade applying for designation as a contract market must satisfactorily demonstrate its capacity to operate in compliance with the core principles and Designation Criteria on an ongoing basis under CEA Section 5(b) and Section 5(d), and CFTC Regulation 38.3. *See* Appendix B to Part 38 – Guidance on, and Acceptable Practices In, Compliance with DCM core principles (DCM Core Principle 1 discussion).

3) Does regulation require an assessment of:

a) The reliability of all arrangements made by the operator for the monitoring, surveillance and supervision of an exchange or trading system and its members or participants to ensure fairness, efficiency, transparency and investor protection, as well as compliance with securities legislation?

Yes. The Commission's review of the designation requirements of Section 5(b) of the CEA and the capacity of the applicant to meet the continuing obligation requirements of Section 5(d) of the CEA (required at time of application under Guidance to Section 5(d), Appendix B to part 38) require a DCM to demonstrate that it can implement a trade practice monitoring system to monitor trading and supervise rule compliance by members; a market surveillance system to deter, detect and address manipulation; and a disciplinary process to address violations of exchange rules.

Assessing applications. An applicant must submit information that demonstrates compliance with all of the objective requirements of Section 5(b) of the CEA and the CFTC's guidance (Appendix A to Part 38) and that demonstrates the capacity to meet the ongoing requirements of Section 5(d) of the CEA and the CFTC's guidance (Appendix B to Part 38). CFTC Regulation 38.3 requires an applicant to provide the CFTC with a copy of all rules, technical manuals, other guides or instructions for users of, or participants in, the market; a description of the trading system, algorithms, security and access limitation procedures; and copies of any agreements that enable or empower the applicant to comply with the Designation Criteria. The CFTC decides whether the application meets the objective criteria of CEA Section 5 and Part 38 of the CFTC's regulations.

Note: The CEA imposes statutory continuing obligations on DCMs, and the CFTC supervises the implementation of the exchange's mechanisms and programs to meet those obligations.

The applicant must demonstrate the means to monitor trading conduct, to supervise the system, and to address disorderly trading conditions.

Designation Criterion 2 of Section 5(b) of the CEA states:

> The board of trade shall have the capacity to prevent market manipulation through market surveillance, compliance, and enforcement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

Appendix A to Part 38 provides the following CFTC guidance on Designation Criterion 2 of Section 5(b):

> A designation application should demonstrate a capacity to prevent market manipulation, including that the contract market has trading and participation rules deterring abuses and a dedicated regulatory department, or an effective delegation of that function.

Designation Criterion 4 of Section 5(b) of the CEA:

> The board of trade shall—
>
> (A) establish and enforce rules defining, or specifications detailing, the manner of operation of the trade execution facility maintained by the board of trade, including rules or specifications describing the operation of any electronic matching platform; and
>
> (B) demonstrate that the trade execution facility operates in accordance with the rules or specifications.

Appendix A to Part 38 provides the following CFTC guidance on Designation Criterion 4 of Section 5(b):

> (a) An application of a board of trade to be designated as a contract market should include the system's trade-matching algorithm and order entry procedures. An application involving a trade-matching algorithm that is based on order priority factors other than price and time should include a brief explanation of the algorithm.
>
> (b) A DCM's specifications on initial and periodic objective testing and review of proper system functioning, adequate capacity and security for any automated systems should be included in its application. A board of trade should submit in the contract market application, information on the objective testing and review

carried out on its automated system. The Commission believes that the guidelines issued by the International Organization of Securities Commissions (IOSCO) in 1990 ("Principles for Screen-Based Trading Systems"), and adopted by the Commission on November 21, 1990 (55 FR 48670), as supplemented in October, 2000, are appropriate guidelines for an electronic trading facility to apply to electronic trading systems. Any program of objective testing and review of the system should be performed by a qualified independent professional (but not necessarily a third-party contractor).

Designation Criterion 5 of Section 5(b) of the CEA provides that:

> The board of trade shall establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into by or through the facilities of the contract market, including the clearance and settlement of the transactions with a derivatives clearing organization.

Appendix A to Part 38 provides the following CFTC guidance on Designation Criterion 5 of Section 5(b):

> (a) A DCM should provide for the financial integrity of transactions by setting appropriate minimum financial standards for members and non-intermediated market participants, margining systems, appropriate margin forms and appropriate default rules and procedures. Absent Commission action pursuant to its exemptive authority under Section 4(c) of the CEA, transactions executed on the contract market (other than stock futures products), if cleared, must be cleared through a derivatives clearing organization registered as such with the Commission. The Commission believes ensuring and enforcing the financial integrity of transactions and intermediaries, and the protection of customer funds, should include monitoring compliance with the contract market's minimum financial standards. In order to monitor for minimum financial requirements, a contract market should routinely receive and promptly review financial and related information.
>
> (b) A DCM should have rules concerning the protection of customer funds that address appropriate minimum financial standards for intermediaries, the segregation of customer and proprietary funds, the custody of customer funds, the investment standards for customer funds, related recordkeeping procedures and related intermediary default procedures.

Designation Criterion 6 of Section 5(b) of the CEA provides that:

> The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.

Appendix A to Part 38 provides the following CFTC guidance on designation criterion 6 of Section 5(b):

> The disciplinary procedures established by a DCM should give the contract market both the authority and ability to discipline and limit or suspend a member's activities as well as the authority and ability to terminate a member's activities pursuant to clear and fair standards. The authority to discipline or limit or suspend the activities of a member or of a market participant could be established in a contract market's rules, user agreements or other means. An organized exchange or a trading facility could satisfy this criterion for a member with trading privileges but having no, or only nominal, equity, in the facility and for a non-member market participant by expelling or denying future access to such persons upon a finding that such a person has violated the board of trade's rules.

See Appendix A to Part 38 at:
http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm.

Core Principle 4 of Section 5(d) of the CEA:

> The board of trade shall monitor trading to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process.
>
> (a) Application Guidance. A contract market could prevent market manipulation through a dedicated regulatory department or by delegation of that function to an appropriate third party.
>
> (b) Acceptable Practices.
>
> > (1) An acceptable program for monitoring markets will generally involve the collection of various market data, including information on traders' market activity. Those data should be evaluated on an ongoing basis in order to make an appropriate regulatory response to potential market disruptions or abusive practices.
> >
> > (2) The DCM should collect data in order to assess whether the market price is responding to the forces of supply and demand. Appropriate data usually include various fundamental data about the underlying commodity, its supply, its demand, and its movement through marketing channels. Especially important are data related to the size and ownership of deliverable supplies -- the existing supply and the future or potential supply, and to the pricing of the deliverable commodity relative to the futures price and relative to similar, but nondeliverable, kinds of the commodity. For cash-settled markets, it is more appropriate to pay attention to the availability and pricing of the commodity making up the index to which the market will be settled, as well as monitoring the continued suitability of the methodology for deriving the index.

(3) To assess traders' activity and potential power in a market, at a minimum, every contract market should have routine access to the positions and trading of its market participants and, if applicable, should provide for such access through its agreements with its third-party provider of clearing services. Although clearing member data may be sufficient for some contract markets, an effective surveillance program for contract markets with substantial numbers of customers trading through intermediaries should employ a much more comprehensive large-trader reporting system (LTRS).

Core Principle 10 (Trade Technology) of Section 5(d) of the CEA provides that:

> The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 10 of Section 5(b):

> (a) Application Guidance. A DCM should have arrangements and resources for recording of full data entry and trade details and the safe storage of audit trail data. A DCM should have systems sufficient to enable the contract market to use the information for purposes of assisting in the prevention of customer and market abuses through reconstruction of trading.
>
> (b) Acceptable Practices.
>
> (1) The goal of an audit trail is to detect and deter customer and market abuse. An effective contract market audit trail should capture and retain sufficient trade-related information to permit contract market staff to detect trading abuses and to reconstruct all transactions within a reasonable period of time. An audit trail should include specialized electronic surveillance programs that would identify potentially abusive trades and trade patterns, including, for instance, withholding or disclosing customer orders, trading ahead, and preferential allocation. An acceptable audit trail must be able to track a customer order from time of receipt through fill allocation or other disposition. The contract market must create and maintain an electronic transaction history database that contains information with respect to transactions executed on the DCM.
>
> (2) An acceptable audit trail should include the following: original source documents, transaction history, electronic analysis capability, and safe storage capability. A contract market whose audit trail satisfies the following acceptable practices would satisfy Core Principle 10.

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

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

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

(b) the categories of participants for which such trades are executed, including whether the person executing a trade was executing it for his/her own account or an account for which he/she has discretion, his/her clearing member's house account, the account of another member, including market participants present on the floor, or the account of any other customer;

(c) timing and sequencing data adequate to reconstruct trading; and

(d) the identification of each account to which fills are allocated.

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

(iv) Safe Storage Capability. Safe storage capability provides for a method of storing the data included in the transaction history in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss. Data should be retained in accordance with the recordkeeping standards of Core Principle 17.

Core Principle 17 of Section 5(d) of the CEA provides that:

> The board of trade shall maintain records of all activities related to the business of the contract market in a form and manner acceptable to the Commission for a period of 5 years.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 17 of Section 5(b):

Acceptable Practices. Regulation 1.31 governs recordkeeping obligations under the Act and the Commission's regulations thereunder. In order to provide broad flexible performance standards for recordkeeping, Regulation 1.31 was updated and amended by the Commission in 1999. Accordingly, Regulation 1.31 itself establishes the guidance regarding the form and manner for keeping records.

See Appendix B to Part 38 at: *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

b) The market's dispute resolution and appeal procedures or arrangements as appropriate, its technical systems standards and procedures related to operational failure, information on its record keeping system, reports of suspected breaches of law, arrangements for holding client funds and securities, if applicable, and information on how trades are cleared and settled?

Yes. *See supra*, response to Principle 25, Questions 2(a-b) and 3(a).

c) The mechanisms that must be in place to identify and address disorderly trading conditions and to deal with any contravening conduct that is detected, including details of procedures for trading halts, other trading limitations and assistance available to the regulator in circumstances of potential trading disruption on the system?

Yes. DCM Core Principle 6 requires DCMs to adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, where necessary and appropriate.

Core Principle 6 of Section 5(d) of the CEA provides that:

> The board of trade shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, where necessary and appropriate, including the authority to—(A) liquidate or transfer open positions in any contract; (B) suspend or curtail trading in any contract; and (C) require market participants in any contract to meet special margin requirements.
>
> (a) Application guidance. A DCM should have clear procedures and guidelines for contract market decision-making regarding emergency intervention in the market, including procedures and guidelines to avoid conflicts of interest while carrying out such decision-making. A contract market should also have the authority to intervene as necessary to maintain markets with fair and orderly trading as well as procedures for carrying out the intervention. Procedures and guidelines should include notifying the Commission of the exercise of a contract market's regulatory emergency authority, explaining how conflicts of interest are minimized, and documenting the contract market's decision-making process and the reasons for using its emergency action authority. Information on steps taken under such procedures should be included in a submission of a certified rule and any

related submissions for rule approval pursuant to Part 40, when carried out pursuant to a contract market's emergency authority. To address perceived market threats, the contract market, among other things, should be able to impose position limits in the delivery month, impose or modify price limits, modify circuit breakers, call for additional margin either from customers or clearing members, order the liquidation or transfer of open positions, order the fixing of a settlement price, order a reduction in positions, extend or shorten the expiration date or the trading hours, suspend or curtail trading on the market, order the transfer of customer contracts and the margin for such contracts from one member (including non-intermediated market participants) of the contract market to another, or alter the delivery terms or conditions, or, if applicable, should provide for such actions through its agreements with its third-party provider of clearing services.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

4) With respect to securities and market participants:

a) Is the regulator informed of the types of securities to be traded and does it approve the rules governing the admission of the securities to trading or listing?

Yes. The CFTC is required to be informed of the types of products to be traded through the two listing methods – self-certification and CFTC prior approval (voluntary and required for certain enumerated agricultural commodities). Contracts listed by certification are represented by an exchange to comply with all CFTC requirements, which include the contract design Guidance of Guideline 1. There are also formal listing requirements that must be satisfied for security futures products.

DCMs may list for trading new contracts by filing a self-certification with the Commission that the new contract complies with the CEA and the Commission's regulations. DTEFs may list for trading new contracts for trading by filing a notification of the new product listing with the Commission or by requesting Commission approval.

To meet its statutory mission of ensuring market integrity and customer protection with respect to products listed under self-certification procedures, the CFTC places greater reliance on its oversight authority, including market surveillance, RERs, reviews of contract terms, dialogue with the regulated entities, and enforcement actions. For contracts filed under self-certification procedures, the regulated entities are required to assume primary responsibility for ensuring that the contracts meet, on a continuing basis, the applicable statutory and regulatory requirements.

Listing by certification. A DCM may list new products for trading by filing with the CFTC the contract's terms and conditions and a certification that the contract complies with the CEA and CFTC regulations and policies. Similarly, for contracts that have become dormant, a DCM may reactivate trading in such contract by filing a certification

that the contract complies with the CEA and CFTC regulations and policies. A self-certification filing must be received at the CFTC's Washington, DC headquarters no later than the close of business the day before the product is listed for trading. *See infra,* section entitled *Listing of Products by Self-Certification*s.

Rules and rule amendments by certification. A DCM may implement most new rules and rule amendments by filing with the CFTC a certification that the amended rule complies with the CEA and CFTC regulations and policies. Self-certification of new rules and rule amendments to terms and conditions of contracts based on enumerated agricultural commodities is not permitted for material amendments having open interest.

The CFTC's requirements and procedures for self-certification filings for listing new products and for implementing rule amendments are set forth in CFTC Regulation 40.2 and CFTC Regulation 40.6, respectively. *See infra*, section entitled *Rule Approval by Self-Certification*.

Voluntary approval of products and rules: A contract market may request CFTC approval of its futures or option products under the provisions of CFTC Regulation 40.3. Product approval requests may be submitted concurrently with the filing of a contract under self-certification procedures or any time later. A contract market also may request CFTC approval of its rules under the provisions of CFTC Regulation 40.5.

The requirements for approval of a product are contained in the CFTC's "Guideline No. 1" (Appendix A to Part 40). This guideline provides exchanges with more specific information regarding initial and continued compliance with the Act and the CFTC's rules and policies for listing contracts.

Additional detail is provided below on the following topics:

1) Listing of products by self-certification
2) Rule approval by self-certification
3) CFTC approval of rules and rule amendments
4) Rules of enumerated agricultural commodities required to be submitted for prior CFTC approval
5) Special listing standards for security futures products

Listing of Products by Self-Certification

Under CFTC Regulation 40.2, DCMs may list products for trading without prior CFTC approval by filing a written self-certification with the CFTC. Registered DTEFs, under regulation 37.7(a), need only notify the CFTC of: (1) the listing of new products for trading; (2) the posting of new product descriptions, terms and conditions or trading protocols; or (3) providing for a new system product functionality.

With one exception involving enumerated agricultural commodities, DCMs also may adopt new rules or amend existing rules of products without prior CFTC approval, by

filing a written self-certification with the CFTC. CFTC regulations 38.4 and 40.6 set forth the procedures for rule self-certification filings. DCMs may also voluntarily request CFTC approval of rules submitted under self-certification procedures. The procedures for the approval of rules or rule amendments are set forth in CFTC Regulation 40.5. Registered DTEFs, as provided in CFTC Regulation 37.7(b), need not certify rules or rule amendments and must only notify the CFTC prior to placing into effect or amending their rules, including trading protocols.

Timing of Notification. To self-certify a new product, a DCM must file its submission with the CFTC no later than the opening of business on the Commission's business day preceding the Commission's business day of the initial listing (or re-listing in the case of dormant contracts) of the product.

Required Information. A product self-certification filing should include:

- A copy of the submission cover sheet;
- A statement that the filing is made pursuant to CFTC Regulation 40.2;
- The text of the product's rules, including those relating to terms and conditions; and
- A certification that the product or instrument complies with the CEA and CFTC regulations thereunder.

In making a self-certification submission, a DCM certifies that the product does not violate any provision of the CEA or the CFTC's regulations and policies adopted thereunder. Guideline No. 1, Appendix A to Part 40 of the CFTC's regulations, contains the applicable economic requirements for rules related to the terms and conditions of a contract. Guideline No. 1 also provides exchanges with specific criteria for initial and continued compliance with the CEA and the CFTC's regulations and policies for products listed on regulated entities.

Security Futures Products. The listing of security futures products (SFPs) is subject to additional requirements and procedures.

Requests for CFTC Approval of Products. DCMs or DTEFs may voluntarily request CFTC approval of a new product. The new product may be listed prior to approval if it also is filed with the CFTC under the self-certification procedures described above. Approval requests for contracts filed under self-certification procedures may be submitted concurrently with a self-certification filing or at any time thereafter, including after initial listing of the product. A request for approval must be accompanied with the appropriate approval filing fee.

A product request for approval filing must:

- Include a copy of the submission cover sheet;
- Include the text of the product's rules, including those relating to terms and conditions; and
- Comply with the requirements of Guideline No. 1, including a demonstration of

compliance.

Guideline No. 1, Appendix A to Part 40 of the CFTC's regulations, contains the applicable economic requirements for rules related to the terms and conditions of a contract. Guideline No. 1 also provides exchanges with specific criteria for initial and continued compliance with the CEA and the CFTC's regulations and policies for products listed on regulated entities.

Timing of Approval. All products submitted for Commission approval are deemed approved by the Commission 45 days after receipt by the Commission or at the conclusion of an extended period if:

- The submission complies with the requirements of CFTC Regulation 40.3(a);
- The submitting entity does not amend the terms or conditions of the product or supplement the request for approval, except as requested by the Commission or for non-substantive revisions, during the review period.

The Commission may extend the 45-day review period for an additional 45 days if the product raises novel or complex issues that require additional time for review or is of major economic significance.

Section 5c(c) of the CEA, 7 U.S.C. 7a-2(c), requires the CFTC to approve any such new contract unless the CFTC finds that the new product would violate the CEA. In addition, the CEA requires the CFTC to take final action on an approval request no later than 90 days after the filing is received by the CFTC unless the person making the filing agrees to an extension of the review period.

See Procedures for Listing Products at *http://www.cftc.gov/industryoversight/contractsandproducts/listingprocedures.html*.

Adoption of Rules and Rule Amendments Via Self-Certification

DCMs and DCOs. DCMs and DCOs may, with one exception noted below, adopt new rules or amend existing rules without prior CFTC approval, by filing a written self-certification with the CFTC. CFTC Regulations 38.4 and 40.6 set forth the procedures for rule self-certification filings.

DTEFs. DTEFs, as provided in CFTC Regulation 37.7(b), need not certify rules or rule amendments and must only notify the CFTC prior to placing into effect or amending their rules, including trading protocols.

Approval of Rules. For rules and rule amendments filed with the CFTC under self-certification procedures, CFTC Regulations 38.4(a) and 40.5 provide that a DCM may request CFTC approval of its rules and rule amendments prior to implementation,

including concurrently with or subsequent to a self-certification filing.

Listing of Products. DCMs may also list new products for trading without prior approval, by filing a written self-certification with the CFTC. The procedures for the self-certification of products are set forth in CFTC Regulations 38.4(b) and 40.2. DTEFs, under CFTC Regulation 37.7(a), need only notify the CFTC of: (1) the listing of new products for trading; (2) the posting of new product descriptions, terms and conditions or trading protocols; or (3) providing for a new system product functionality.

CFTC Oversight. To meet its statutory mission of ensuring market integrity and customer protection with respect to rules and rule amendments implemented under self-certification procedures, the CFTC places greater reliance on its oversight authorities, including market surveillance, RERs, reviews of contract terms, dialogue with the regulated entities, and enforcement actions. For rules and amendments adopted under self-certification procedures, the regulated entities are required to assume primary responsibility for ensuring that the rules and rule amendments meet, on a continuing basis, the applicable statutory and regulatory requirements.

Rules and Amendments Not Required to be Certified. DCMs may place certain rules or rule amendments into effect without a self-certification. A DCM need only provide a weekly notification of all rule changes involving:

- nonmaterial revisions (e.g., renumbering);
- delivery standards set by third parties;
- routine changes in index products (e.g., composition or computation) made by independent third parties; and
- changes to option contract terms relating to strike prices (e.g., strike price intervals).

Certain other rules may be implemented without either self-certification or notice to the CFTC, provided only that the DCM maintain documentation of all rule changes. Rules subject to this procedure include those that govern:

- transfer of ownership or membership;
- administrative procedures (e.g., organization of boards and committees);
- administration (e.g., direction of employees, declaration of holidays); and
- standards of decorum.

Rules and Amendments Requiring Prior CFTC Approval. The only DCM rules and rule amendments not eligible for self-certification are those that materially change a term or condition of a contract for future delivery of an enumerated agricultural commodity as listed in Section 1a(4) of the CEA, 7 U.S.C. Section 1a(4), or an option on such a contract or commodity, in a delivery month having open interest. Under CFTC Regulation 40.4, such rules or rule amendments must be submitted to the CFTC for prior approval under the procedures of CFTC Regulation 40.5. A DCM may elect to submit any such new rule or rule amendment to the CFTC under the ten-day review

procedure of CFTC Regulation 40.4 for a determination as to whether such rule must be submitted for prior approval.

However, CFTC Regulation 40.4 specifies that certain categories of new rules and rule amendments affecting a term or condition of a futures contract on an enumerated agricultural commodity are deemed not to be material and thus do not require prior CFTC approval. DCMs, therefore, may implement any new rule or rule change falling within these categories pursuant to self-certification provisions.

The categories of new rules and rule amendments deemed to be not material for this purpose are:

- changes in trading hours;
- changes in lists of delivery facilities pursuant to previously set standards or criteria;
- changes in option contracts other than those relating to last trading day, expiration date, strike price de-listings, and speculative position limits;
- reductions in the minimum price tick;
- changes required by a court, or by a regulation of the CFTC or another Federal agency;
- fees or fee changes of less than $1.00 per contract; and
- fees or fee changes of $1.00 or more that are established by an independent third party or are unrelated to delivery, trading, clearing, or dispute resolution.

Timing of Self-certification. DCMs must file self-certification submissions with the CFTC no later than the opening of business on the business day preceding implementation of the rule or rule amendment.

Emergencies. Rules or rule amendments implemented under procedures of the governing board to respond to an emergency, as defined in CFTC Regulation 40.1, shall, if practicable, be filed with the CFTC prior to implementation of the rule or rule amendment, or, if not practicable, shall be filed with the CFTC at the earliest possible time but in no event more than 24 hours after implementation.

Required Information. A rule or rule amendment self-certification filing must include:

a. A Submission Cover Sheet that must be filled out in accordance with the instructions in Appendix D to Part 40 of the CFTC's regulations;

b. The text of the rule (in the case of a rule amendment, deletions and additions must be indicated);

c. The date of implementation;

d. A brief explanation of any substantive opposing views expressed to the registered entity by governing board or committee members, members of the

entity or market participants that were not incorporated into the rule; and

e. A certification by the DCM that the rule complies with the CEA and the regulations thereunder.

In making a self-certification filing, the DCM is certifying that the rule or rule amendment does not violate any provision of the CEA or the CFTC's regulations and policies adopted thereunder. The applicable economic requirements related to rules associated with the terms and conditions of a futures or option contract are contained in the CFTC's "Guideline No. 1" (Appendix A to Part 40).

CFTC Review. The CFTC may stay the effectiveness of a rule implemented pursuant to these self-certification procedures during the pendency of CFTC proceedings for filing a false self-certification or to alter or amend the rule pursuant to Section 8a(7) of the CEA, 7 U.S.C. 12a(7). The decision to stay the effectiveness of a rule in such circumstances is not delegable to any employee of the CFTC.

See Rule and Rule Amendments at
http://www.cftc.gov/industryoversight/rulesandruleamendments/index.htm.

CFTC Approval of Rules and Rule Amendments

Procedures for Requesting CFTC Approval of Rules and Amendments. *See* CFTC Regulation 40.5, which establishes procedures for a DCM or registered DTEF to request CFTC approval of a new rule or a rule amendment regarding exchange trading or listing of exchange products. These same procedures are applicable to those amendments to the terms and conditions of contracts on enumerated agricultural commodities that are required to be submitted for prior CFTC approval pursuant to CFTC Regulation 40.4.

Procedures for Listing Products. The request must:

a. Include a Submission Cover Sheet which must be filled out in accordance with the instructions in Appendix D to 17 C.F.R. Part 40;

b. Set forth the text of the proposed rule or rule amendment (in the case of a rule amendment, deletions and additions must be indicated);

c. Describe the proposed effective date of a proposed rule and any action taken or anticipated to be taken to adopt the proposed rule by the DCM or DTEF or by its governing board or by any committee thereof, and cite the rules of the entity that authorizes the adoption of the proposed rule;

d. Explain the operation, purpose, and effect of the proposed rule, including, as applicable, a description of the anticipated benefits to market participants or others, any potential anticompetitive effects on market participants or others, how the rule fits into the DCM's and DTEF's framework of self-regulation, and any

other information which may be beneficial to the CFTC in analyzing the proposed rule (if a proposed rule affects, directly or indirectly, the application of any other rule of the submitting registered entity, set forth the pertinent text of any such rule and describe the anticipated effect);

e. Briefly describe any substantive opposing views expressed to the DCM or DTEF by governing board or committee members, members of the entity or market participants with respect to the proposed rule that were not incorporated into the proposed rule;

f. Identify any CFTC Regulation that the CFTC may need to amend, or Sections of the CEA or CFTC regulations that the CFTC may need to interpret, in order to approve the proposed rule. To the extent that such an amendment or interpretation is necessary to accommodate a proposed rule, the submission should include a reasoned analysis supporting the amendment to the CFTC Regulation or the interpretation; and

g. Identify with particularity information in the submission that will be subject to a request for confidential treatment and support that request for confidential treatment with reasonable justification.

Timing for Review. In general, the review period is 45 days. To qualify for 45-day review, the request must comply with the requirements discussed above, and the DCM or DTEF must not amend the proposed rule or supplement the submission, except as requested by the CFTC, during the pendency of the review period. Any amendment or supplementation not requested by the CFTC will be treated as the submission of a new filing.

Extensions of Time. The CFTC may extend the review period for:

1. An additional 45 days, if the proposed rule raises novel or complex issues that require additional time for review or is of major economic significance, in which case the CFTC would notify the submitting DCM or DTEF within the initial 45-day review period and would briefly describe the nature of the specific issues for which additional time for review would be required; or

2. Such additional period as the submitting DCM or DTEF requests in writing.

Standard of Review. Section 5c(c)(3) of the CEA, 7 U.S.C. 7a-2(c)(3), provides that the CFTC shall approve any new rule or rule amendment unless it finds that the rule or rule amendment would violate the CEA. The general requirements for DCMs are found in Section 5 of the CEA, 7 U.S.C. 7, and Part 38 of the CFTC's regulations. DTEFs are governed by Section 5a of the CEA and Part 37 of the CFTC's regulations. The particular requirements for approval of rules and rule amendments related to the economic terms and conditions of a contract are contained in the CFTC's Guideline No. 1, Appendix A to Part 40 of the CFTC’s regulations.

What if CFTC Does not Approve. The CFTC, at any time during its review under this Section, may notify the DCM or DTEF that it will not, or is unable to, approve the proposed rule or rule amendment. This notification will briefly specify the nature of the issues raised and the specific provision of the CEA or regulations, including the form or content requirements of this Section, that the proposed rule would violate, appears to violate, or the violation of which cannot be ascertained from the submission.

This notification shall be presumptive evidence that the DCM or DTEF may not truthfully certify that the same, or substantially the same, proposed rule or rule amendment does not violate the CEA or regulations thereunder.

However, this notification does not prejudice the entity from subsequently submitting a revised version of the proposed rule or rule amendment for CFTC approval or from submitting the rule or rule amendment as initially proposed pursuant to a supplemented submission.

CFTC Regulation 40.5(f) provides for a procedure whereby amendments to the terms and conditions of a product may qualify for "Expedited Approval." To be eligible for this expedited approval procedure, the changes must be consistent with the CEA and CFTC regulations and with standards approved or established by the CFTC in a written notification to the DCM or DTEF.

See Requesting Prior Approval of a New DCM or DTEF Rule or Rule Amendment at *http://www.cftc.gov/industryoversight/rulesandruleamendments/rulerequestapprovaldcmdtef.html*.

Rules of Enumerated Agricultural Commodities required to be submitted for prior CFTC Approval.

DCMs must submit to the CFTC, and receive CFTC approval prior to implementation, all new rules and rule amendments that materially change the terms and conditions of contracts on commodities enumerated in Section 1a(4) of the CEA, 7 U.S.C. 1a(4), and that will apply to contracts with open interest.

Such new rules and rule amendments cannot be implemented pursuant to the certification procedures of CFTC Regulation 40.6, 17 C.F.R. 40.6, but must be submitted to the Commission for approval under CFTC Regulation 40.4 and CFTC Regulation 40.5, 17 C.F.R. 40.4 and 40.5, or for a determination as to whether such rules or rule amendments materially change the terms and conditions of the affected contracts pursuant to CFTC Regulation 40.4(b)(9), 17 C.F.R. 40.4(b)(9).

Staff reviews new rules and rule amendments submitted for approval to ensure that they do not violate any provision of the CEA or the CFTC's regulations and policies adopted thereunder. The general requirements for DCM rules are found in Section 5 of the CEA, 7 U.S.C. 7, and Part 38 of the CFTC's regulations, 17 C.F.R. Part 38. The particular requirements for approval of new rules and rule amendments related to the economic

terms and conditions of a futures or option contract are contained in the CFTC's Guideline No. 1, Appendix A to Part 40 of the CFTC's regulations.

If the CFTC determines that a new rule or rule amendment is consistent with the requirements of the CEA and the CFTC's regulations and policies, the new rule or rule amendment is deemed approved 45 days after CFTC receipt of the approval request, or at the conclusion of any extended review period, as provided under CFTC Regulation 40.5(b) and CFTC Regulation 40.5(c). If the CFTC determines that it will not, or is unable to, approve the new rule or rule amendment, it will provide a Notice of Non-Approval to the DCM, as provided under CFTC Regulation 40.5(d). In this Notice of Non-Approval, the CFTC will briefly specify the nature of the issues identified and the specific provision of the CEA or CFTC regulations that the new rules or rule amendments violate.

A DCM receiving a Notice of Non-Approval may not certify the same, or substantially the same, new rules or rule amendments under the certification procedures of CFTC Regulation 40.6, 17 C.F.R. 40.6. However, the DCM may submit revised new rules or rule amendments for approval under these same procedures.

Rules Deemed Not To Be Material. CFTC Regulation 40.4(b), 17 C.F.R. 40.4(b), specifies eight categories of new rules and rule amendments for contracts based on enumerated agricultural commodities that are deemed not to be material and thus are not required to be submitted to the CFTC for approval prior to implementation. New rules and rule amendments that are deemed not to be material for this purpose are:

1. Changes in trading hours;

2. Changes in lists of approved delivery facilities pursuant to previously set standards or criteria;

3. Changes to the terms and conditions of options on futures, other than those relating to the last trading day, expiration date, option strike price de-listings, and speculative position limits;

4. Reductions in the minimum price fluctuation (or "tick");

5. Changes required to comply with a binding order of a court of competent jurisdiction, or a rule, regulation, or order of the Commission, or of another Federal regulatory authority;

6. Corrections of typographical errors, renumbering, periodic routine updates to identifying information about approved entities, and such other non-substantive revisions of a product's terms and conditions that have no effect on the economic characteristics of the product;

7. Fees or fee changes of less than $1.00 per contract; and

8. Fees or fee changes that are $1.00 or more per contract and are established by an independent third party or are unrelated to delivery, trading, clearing, or dispute resolution.

A DCM wishing to implement new rules or rule amendments falling within any of the above eight categories may implement such provisions under the certification procedures of CFTC Regulation 40.6.

Rules Determined Not To Be Material Under the Ten-day Review Procedure. CFTC Regulation 40.4(b)(9), 17 C.F.R. 40.4(b)(9), establishes a ten-day review procedure for DCMs wishing to apply a new rule or rule amendment to contracts having open interest in enumerated agricultural commodities that do not fall within any of the above eight categories. This procedure provides DCMs which are uncertain as to whether a new rule or rule amendment is material with a mechanism for obtaining a CFTC determination as to whether such new rule or rule amendment materially changes the terms and conditions of the affected contracts.

Under this procedure, a DCM must submit the new rules or rule amendments to the CFTC at least ten business days prior to the anticipated implementation date.

If the CFTC determines that the new rule or rule amendment is not material, CFTC staff will advise the DCM of this non-materiality determination the day after the ten-day review period expires. The DCM may then implement the new rule or rule amendment pursuant to the self-certification provisions of CFTC Regulation 40.6. If the CFTC determines that the new rule or rule amendment is material, it will advise the DCM of that finding and commence reviewing the new rule or rule amendment under the approval procedures set forth in CFTC Regulation 40.5, 17 C.F.R. 40.5.

Enumerated Agricultural Commodities. The agricultural commodities listed here are commonly referred to as the enumerated commodities of the CEA: wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain, sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed, cottonseed meal, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice.

See Rules of Enumerated Agricultural Commodities at *http://www.cftc.gov/industryoversight/rulesandruleamendments/enumeratedagcommodities.html*.

Special Listing Standards for Security Futures Products

Security futures products include futures on single stocks and futures on narrow-based security indexes. Before a board of trade may list for trading a security futures product,

the board of trade must meet a number of requirements and make a filing to the CFTC.

Security futures products may be traded on any DCM or DTEF that also is notice registered with the SEC as a securities exchange. In addition, security futures products may be traded on any SEC-registered national securities exchange, national securities association, or alternative trading system (ATS) that is notice designated as a contract market by the CFTC.

Requirements for Underlying Securities. A futures contract based on a single security may be traded only if:

- The underlying security is registered pursuant to Section 12 of the Securities Exchange Act of 1934;
- The underlying security is common stock, or another security as the CFTC and the SEC jointly deem appropriate (the CFTC and the SEC have jointly determined that American Depositary Receipts (ADRs), Exchange-Traded Funds (ETFs), Trust Issued Receipts (TIRs), Closed-End Fund shares, and debt securities also may underlie security futures products); and
- The underlying security conforms to the listing standards for the SFP that the DCM or registered DTEF has filed with the SEC. Listing standards are discussed below.

A futures contract based on an index of two or more securities may be traded as a security future only if:

- The index is a narrow-based security index;
- The underlying securities are registered pursuant to Section 12 of the Securities Exchange Act of 1934;
- The underlying securities are common stock or other securities as the CFTC and the SEC jointly deem appropriate (the CFTC and the SEC have jointly determined that American Depositary Receipts (ADRs), Exchange-Traded Funds (ETFs), Trust Issued Receipts (TIRs), Closed-End Fund shares, and debt securities also may underlie security futures products); and
- The underlying securities conform to the listing standards for SFPs that the DCM or registered DTEF has filed with the SEC. Listing standards are also discussed below.

CFTC Procedures for Listing Security Futures Products. Before a board of trade lists a new SFP for trading, the board of trade must file with the CFTC, a filing that contains the following items:

- A copy of the product's rules, including the terms and conditions;
- The required certifications enumerated below under "Required Certifications for Listing SFPs";
- A certification that the terms and conditions of the contract meet CFTC requirements regarding speculative position limits, cash settlement, and trading halts

procedures; and

- A certification that the security futures product complies with the CEA and the CFTC rules.

A board of trade may request voluntarily Commission approval of any security futures product by following the procedures set forth in CFTC Regulation 40.3, 17 C.F.R. 40.3.

A board of trade may request Commission approval for any rule or rule change relating to a security futures product by following the procedures of CFTC Regulation 40.5.

Required Certifications for Listing Security Futures Products. A board of trade's filing with the CFTC to list for trading a futures contract on a single stock or on a narrow-based security index must include the following certifications:

- The security or securities that underlie the SFP meet the requirements discussed above regarding SEC registration, type of security, and make-up of the security index, if applicable.
- If the SFP is settled through physical delivery, arrangements are in place with a clearing agency registered with the SEC for the payment and delivery of the underlying security or securities.
- Only FCMs, IBs, CTAs, CPOs or associated persons may solicit, accept any order for, or otherwise deal in any transaction in or in connection with the SFP.
- Dual trading is restricted in accordance with CFTC Regulation 41.27.
- Trading in the SFP is not readily susceptible to price manipulation.
- In order to detect manipulation and insider trading, the board of trade has coordinated surveillance among the board of trade, any market on which any underlying security trades, and any other market on which any related security is traded. This coordinated surveillance requirement may be satisfied by certifying that:
- The board of trade is a Full Member of the Intermarket Surveillance Group (ISG);
- The board of trade is an Affiliate Member of the ISG and has entered into supplemental information-sharing agreements with Full Members and other Affiliate Members; or
- The board of trade has entered into bilateral agreements with all necessary boards of trade to share information and such agreements should require the same type of information sharing that takes place between Full Members of the ISG (a board of trade that is an ATS does not need to make this certification, provided that the ATS is a member of a national securities association or national securities exchange, and the national securities association or national securities exchange has coordinated surveillance procedures);
- The board of trade has an audit trail in place to facilitate the coordinated surveillance (a board of trade that is an ATS does not need to make this certification, provided that the ATS is a member of a national securities association or national securities exchange, and the national securities association or national securities exchange has an audit trail in place);
- The board of trade has procedures in place to coordinate regulatory trading halts

between the board of trade, markets on which any underlying security is traded, and markets on which any related security is traded (a board of trade that is an ATS does not need to make this certification, provided that the ATS is a member of a national securities association or national securities exchange, and the national securities association or national securities exchange has procedures to coordinate trading halts);

- The board of trade's margin requirements for security futures products comply with CFTC Regulations 41.42 through 41.49; and
- Coordinated trading halts.

b) Where applicable, does the regulator or the market take product design and trading conditions into account in order to admit a product for trading?

Yes. Express authorization prior to trading is required only for contracts based on enumerated agricultural commodities. As explained in response to Principle 25, Question 4(a), a DCM may list new products for trading by filing with the CFTC the contract's terms and conditions and a certification that the contract complies with the CEA and CFTC regulations and policies. The CFTC's requirements and procedures for self-certification filings for listing new products and for implementing rule amendments are set forth in CFTC Regulation 40.2 and CFTC Regulation 40.6, respectively. However, self-certification of rule amendments to terms and conditions is not permitted for material amendments to contracts based on enumerated agricultural commodities having open interest. A contract market may request CFTC approval of its futures or option products under the provisions of CFTC Regulation 40.3.

Standards for contract design. The requirements for approval of a product are contained in the CFTC's "Guideline No. 1" (Appendix A to Part 40). This guideline provides exchanges with more specific information regarding initial and continued compliance with the Act and the CFTC's rules and policies for listing contracts.

To be an effective economic tool for hedging and price discovery, commodity contracts must accurately reflect the operation of the cash market. Where contract terms are not consistent with commercial practices or contain features that interfere with or bias the delivery process there is an increase in the likelihood of nonconvergence of cash and commodity prices, of manipulation or a disorderly market. Such conditions reduce the economic utility, and therefore, the success of the contract. Guideline 1 helps to ensure that the design of a commodity contract accurately reflects the operation of the cash market in question and does not contain factors which may inhibit or bias the delivery process.

c) Does the regulatory framework provide for fair access to the exchange or trading system through oversight of the related rules for participation?

Yes. The following statutory DCM Designation Criteria and core principles ensure that access to a trading system or exchange is fair and objective:

Designation Criterion 3 of Section 5(b) of the CEA provides that:

> The board of trade shall establish and enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and the capacity to detect, investigate, and discipline any person that violates the rules. The rules may authorize—
>
> (A) transfer trades or office trades;
>
> (B) an exchange of—
>
> (i) futures in connection with a cash commodity transaction;
>
> (ii) futures for cash commodities; or
>
> (iii) futures for swaps; or
>
> (C) a FCM, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization.

Appendix A to Part 38 provides the following CFTC guidance on Designation Criterion 3 of Section 5(b):

> (a) Establishing and enforcing trading rules to ensure fair and equitable trading on a contract market, among other things, includes providing to market participants, on a fair, equitable and timely basis, information regarding, prices, bids and offers, as applicable to the market.
>
> (b) Such trading rules should be designed with adequate specificity.
>
> (c) A contract market that authorizes transfer trades or office trades; an exchange of futures for physicals or futures for swaps; or any other non-competitive transactions, including block trades, should have rules particularly authorizing such transactions and establishing appropriate recordkeeping requirements.

See Appendix A to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

Designation Criterion 7 of Section 5(b) of the CEA provides that:

> The board of trade shall provide the public with access to the rules, regulations, and contract specifications of the board of trade.

Appendix A to Part 38 provides the following CFTC guidance on Designation Criterion 7 of Section 5(b):

> A board of trade operating as a contract market may provide information to the public by placing the information on its web site.

See Appendix A to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

Core Principle 12 of Section 5(d) of the CEA provides that:

> The board of trade shall establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 12 of Section 5(d):

> (a) Application Guidance. A DCM should have rules prohibiting conduct by intermediaries that is fraudulent, noncompetitive, unfair, or an abusive practice in connection with the execution of trades and a program to detect and discipline such behavior. The contract market should have methods and resources appropriate to the nature of the trading system and the structure of the market to detect trade practice abuses.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

Core Principle 18 of Section 5(d) of the CEA provides that:

> Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall endeavor to avoid—
>
> (A) adopting any rules or taking any actions that result in any unreasonable restraints of trade; or
> (B) imposing any material anticompetitive burden on trading on the contract market.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 18 of Section 5(d):

> (a) Application Guidance. An entity seeking designation as a contract market may request that the Commission consider under the provisions of Section 15(b) of the CEA any of the entity's rules, including trading protocols or policies, and including both operational rules and the terms or conditions of products listed for trading, at the time of designation or thereafter. The Commission intends to apply Section 15(b) of the CEA to its consideration of issues under this Core Principle in a manner consistent with that previously applied to contract markets.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

5) With respect to fairness of order execution procedures:

a) Are order routing procedures clearly disclosed, applied fairly and not inconsistent with relevant securities regulation (e.g., requirements with respect to precedence of client orders and prohibition of front-running or trading ahead of customers)?

Yes. The statutory duties and CFTC guidance regarding the requirement to offer fair and objective access discussed in the response to Principle 25, Question 5(c), below, and the requirement to apply execution rules fairly to all participants is discussed in response to Principle 25, Question 5(b), below. These requirements operate to ensure that a system's order routing procedures are clearly disclosed to the regulator and to market participants, are applied fairly and are not inconsistent with relevant securities regulations. *See also* DCM Core Principle 12—Protection Of Market Participants, requiring that a board of trade shall establish and enforce rules to protect market participants from abusive practices committed by any party acting as agent for the participants. Appendix B to Part 38 of the CFTC's regulations provides guidance on, and acceptable practices in, compliance with the core principles.

b) Are execution rules disclosed to the regulator and to market participants, and consistently applied to all participants?

Yes. Boards of trade applying for contract market designation must meet statutory requirements that execution rules are disclosed to the regulator and to market participants, and are fairly applied to all participants.

The CEA standard is "fair and equitable" as set forth in Designation Criterion 3 of Section 5(b) of the CEA and "competitive, open and efficient" under Core Principle 9 of Section 5(d). CEA Section 5(d)(12) Core Principle requires that a board of trade shall establish and enforce rules to protect market participants from abusive practices committed by any party acting as agent for the participants. CFTC Regulation 1.38, which applies to contract markets pursuant to rule 38.2, requires competitive execution. Note: CFTC Regulation 1.38 permits certain noncompetitive trades that are executed pursuant to rules that have been approved by the CFTC.

Designation Criterion 3 of Section 5(b) of the CEA provides that:

> The board of trade shall establish and enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and the capacity to detect, investigate, and discipline any person that violates the rules. The rules may authorize—
>
> (A) transfer trades or office trades;

(B) an exchange of—

(i) futures in connection with a cash commodity transaction;

(ii) futures for cash commodities; or

(iii) futures for swaps; or

(C) FCM, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization.

Appendix A to Part 38 provides the following CFTC guidance on Designation Criterion 3 of Section 5(b):

(a) Establishing and enforcing trading rules to ensure fair and equitable trading on a contract market, among other things, includes providing to market participants, on a fair, equitable and timely basis, information regarding, prices, bids and offers, as applicable to the market.

(b) Such trading rules should be designed with adequate specificity.

(c) A contract market that authorizes transfer trades or office trades; an exchange of futures for physicals or futures for swaps; or any other non-competitive transactions, including block trades, should have rules particularly authorizing such transactions and establishing appropriate recordkeeping requirements.

See Appendix A to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

Core Principle 9 of Section 5(d) of the CEA provides that:

The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 9 of Section 5(d):

(a) Application Guidance.

(1) A competitive, open and efficient market and mechanism for executing transactions includes a board of trade's methodology for entering orders and executing transactions.

(2) Appropriate objective testing and review of any automated systems should occur initially and periodically to ensure proper system functioning, adequate capacity and security. A DCM's analysis of its automated system should address appropriate principles for the oversight of automated systems, ensuring proper system function, adequate capacity and security. The Commission believes that the guidelines issued by the International Organization of Securities Commissions (IOSCO) in 1990 ("Principles for Screen-Based Trading Systems"), and adopted by the Commission on November 21, 1990 (55 FR 48670), as supplemented in October 2000, are appropriate guidelines for a DCM to apply to electronic trading systems. Any program of objective testing and review of the system should be performed by a qualified independent professional. The Commission believes that information gathered by analysis, oversight or any program of objective testing and review of any automated systems regarding system functioning, capacity and security should be made available to the Commission.

(3) A DCM that determines to allow block trading should ensure that the block trading does not operate in a manner that compromises the integrity of prices or price discovery on the relevant market.

(b) Acceptable Practices. A professional that is a certified member of the Information Systems Audit and Control Association experienced in the industry would be an example of an acceptable party to carry out testing and review of an electronic trading system.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

CFTC Regulation 1.38 requires contract market transactions to be executed openly and competitively by open outcry or posting of bids and offers or by other equally open and competitive methods. Regulation 1.38 permits certain noncompetitive trades that are executed pursuant to rules that have been approved by the CFTC.

In order to maintain designation, Core Principle 12 of Section 5(d) of the CEA provides that:

The board of trade shall establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 12 of Section 5(d):

(a) Application Guidance. A DCM should have rules prohibiting conduct by intermediaries that is fraudulent, noncompetitive, unfair, or an abusive practice in connection with the execution of trades and a program to detect and discipline such behavior. The contract market should have methods and

resources appropriate to the nature of the trading system and the structure of the market to detect trade practice abuses.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

c) Where applicable, does the regulator review the trade matching or execution algorithm of automated trading systems for fairness?

Yes. The CFTC reviews the trade matching or execution algorithm according to IOSCO standards for screen-based trading systems.

Designation Criterion 4 of Section 5(b) of the CEA provides that:

> The board of trade shall—
>
> (A) establish and enforce rules defining, or specifications detailing, the manner of operation of the trade execution facility maintained by the board of trade, including rules or specifications describing the operation of any electronic matching platform; and
>
> (B) demonstrate that the trade execution facility operates in accordance with the rules or specifications.

Appendix A to Part 38 provides the following CFTC guidance on Designation Criterion 4 of Section 5(b):

> (a) An application of a board of trade to be designated as a contract market should include the system's trade-matching algorithm and order entry procedures. An application involving a trade-matching algorithm that is based on order priority factors other than price and time should include a brief explanation of the algorithm.
>
> (b) A DCM's specifications on initial and periodic objective testing and review of proper system functioning, adequate capacity and security for any automated systems should be included in its application. A board of trade should submit in the contract market application, information on the objective testing and review carried out on its automated system. The Commission believes that the guidelines issued by the International Organization of Securities Commissions (IOSCO) in 1990 ("Principles for Screen-Based Trading Systems"), and adopted by the Commission on November 21, 1990 (55 FR 48670), as supplemented in October, 2000, are appropriate guidelines for an electronic trading facility to apply to electronic trading systems. Any program of objective testing and review of the system should be performed by a qualified independent professional (but not necessarily a third-party contractor).

See Appendix A to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

6) With respect to trading information:

a) Do similarly situated market participants have equitable access to market rules and operating procedures?

Yes. The statutory designation requirements of Section 5(b) of the CEA and the ongoing requirements of Section 5(d) of the CEA (which a market must demonstrate its capacity to meet) ensure that that all market rules and operating procedures are available to market participants.

Designation Criterion 7 of Section 5(b) of the CEA provides that:

> The board of trade shall provide the public with access to the rules, regulations, and contract specifications of the board of trade.

Appendix A to Part 38 provides the following CFTC guidance on Designation Criterion 7 of Section 5(b):

> A board of trade operating as a contract market may provide information to the public by placing the information on its web site.

See Appendix A to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

Core Principle 7 of Section 5(d) of the CEA provides that:

> The board of trade shall make available to market authorities, market participants, and the public information concerning—
>
> (A) the terms and conditions of the contracts of the contract market; and
>
> (B) the mechanisms for executing transactions on or through the facilities of the contract market.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 7 of Section 5(d):

> (a) *Application guidance.* A DCM should have arrangements and resources for the disclosure of contract terms and conditions and trading mechanisms to the Commission, market participants and the public. Procedures should also include providing information on listing new products, rule amendments or other changes to previously disclosed information to the Commission, market participants and

the public. Provision of all such information to market participants and the public could be by timely placement of the information on a contract market's web site.

(b) *Acceptable practices*. In making information available to market participants and the public, on its web site, a DCM should place information on the Web site no later than the day a new product is listed, the day a new or amended rule is implemented or the day previously disclosed information is changed. For example, the timely provision of this information on a contract market's Web site could be done through press releases, newsletters or notices to members. Additionally, a contract market should ensure that the rulebook posted on its Web site is available to the public (*i.e.* , can be accessed by visitors to the Web site without the need to register, log in, provide a user name or obtain a password) and is kept current. A rulebook will be considered current if: (1) Notice of any substantive new or amended rule is provided within one day of implementation, either by press release, newsletter, notice to members or actual posting of the change in the rulebook; and (2) all new rules, both substantive and non-substantive, are posted in the rulebook within five days of implementation.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

b) Are there adequate arrangements for transparency?

Yes. The CEA and CFTC regulations require transparency and fair treatment. As noted above, the CFTC's guidance concerning DCM Designation Criteria 3 of Section 5(b) of the CEA–Fair and Equitable Trading, provides, in part, that:

> Establishing and enforcing trading rules to ensure fair and equitable trading on a contract market, among other things, *includes providing to market participants, on a fair, equitable and timely basis, information regarding, prices, bids and offers, as applicable to the market*. (emphasis added).

In addition, a board of trade applying for contract market designation must satisfactorily demonstrate its capacity to operate in compliance with Section 5(d) of the CEA. *See* Appendix B to Part 38, guidance under DCM Core Principle 1—In General.

Among other things, Core Principle 8 of Section 5(d) of the CEA provides that:

> The board of trade shall make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 8 of Section 5(d):

(a) Application Guidance. A contract market should provide to the public information regarding settlement prices, price range, volume, open interest and other related market information for all actively traded contracts, as determined by the Commission, on a fair, equitable and timely basis. The Commission believes that Section 5(d)(8) requires contract markets to publicize trading information for any non-dormant contract. Provision of information for any applicable contract could be through such means as provision of the information to a financial information service and by timely placement of the information on a contract market's web site.

(b) Acceptable Practices. The mandatory compliance with Section 16.01, "Trading volume, open contracts, prices and critical dates," required under the regulations, would constitute an acceptable practice under Core Principle 8.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

c) Are adequate records (i.e., audit trails) available to reconstruct trading activity within a reasonable time?

Yes. A board of trade applying for contract market designation must satisfactorily demonstrate its capacity to operate in compliance with Section 5(d) of the CEA. *See* Appendix B to Part 38, guidance under Core Principle 1.

Among other things, Core Principle 10 of Section 5(d) requires the creation of an audit trail.

Core Principle 10 of Section 5(d) of the CEA provides that:

The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 10 of Section 5(d):

(a) Application Guidance. A DCM should have arrangements and resources for recording of full data entry and trade details and the safe storage of audit trail data. A DCM should have systems sufficient to enable the contract market to use the information for purposes of assisting in the prevention of customer and market abuses through reconstruction of trading.

(b) Acceptable Practices.

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

(2) An acceptable audit trail should include the following: original source documents, transaction history, electronic analysis capability, and safe storage capability. A contract market whose audit trail satisfies the following acceptable practices would satisfy Core Principle 10.

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

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

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

(b) the categories of participants for which such trades are executed, including whether the person executing a trade was executing it for his/her own account or an account for which he/she has discretion, his/her clearing member's house account, the account of another member, including market participants present on the floor, or the account of any other customer;

(c) timing and sequencing data adequate to reconstruct trading; and

(d) the identification of each account to which fills are allocated.

(iii) Electronic Analysis Capability. An electronic analysis capability that permits sorting and presenting data included in the transaction history so

as to reconstruct trading and to identify possible trading violations with respect to both customer and market abuse.

(iv) Safe Storage Capability. Safe storage capability provides for a method of storing the data included in the transaction history in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss. Data should be retained in accordance with the recordkeeping standards of Core Principle 17.

See Appendix B to Part 38 at:
http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm.

d) Is the system capable of disclosing the types of information that it is designed to make available, and, conversely, of providing safeguards to preserve the confidentiality of other information, the disclosure of which is not intended?

Yes. Fair and equitable trading on a contract market, among other things, includes providing to market participants, on a fair, equitable and timely basis, information regarding prices, bids and offers, as applicable to the market. A board of trade applying for contract market designation must satisfactorily demonstrate its capacity to operate in compliance with DCM Designation Criterion 7 of Section 5(b) and DCM Core Principles 7, 8, and 10 of Section 5(d) of the CEA. DCM Designation Criterion 7 requires the board of trade to provide the public with access to the rule, regulations, and contract specifications of the board of trade. DCM Core Principle 7 ensures disclosure of general information to market authorities, market participants, and the public information. DCM Core Principle 8 requires the daily publication of trade information. DCM Core Principle 10 requires the creation of an audit trail. An acceptable audit trail will include a safe storage capability providing for the storing of data included in the transaction history in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss.

Designation Criterion 7 of Section 5(b) of the CEA:

> The board of trade shall provide the public with access to the rules, regulations, and contract specifications of the board of trade.

Appendix A to Part 38 provides the following CFTC guidance on designation criterion 7 of Section 5(b):

> A DCM should provide information to the public by placing the information on its Web site.

See Appendix A to Part 38 at
http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm.

Core Principle 7 of Section 5(d) of the CEA:

> The board of trade shall make available to market authorities, market participants, and the public information concerning—
>
> (A) the terms and conditions of the contracts of the contract market; and
>
> (B) the mechanisms for executing transactions on or through the facilities of the contract market.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 7 of Section 5(d):

> (a) *Application guidance.* A DCM should have arrangements and resources for the disclosure of contract terms and conditions and trading mechanisms to the Commission, market participants and the public. Procedures should also include providing information on listing new products, rule amendments or other changes to previously disclosed information to the Commission, market participants and the public. Provision of all such information to market participants and the public could be by timely placement of the information on a contract market's web site.
>
> (b) *Acceptable practices* . In making information available to market participants and the public, on its web site, a DCM should place information on the web site no later than the day a new product is listed, the day a new or amended rule is implemented or the day previously disclosed information is changed. For example, the timely provision of this information on a contract market's web site could be done through press releases, newsletters or notices to members. Additionally, a contract market should ensure that the rulebook posted on its web site is available to the public (*i.e.* , can be accessed by visitors to the web site without the need to register, log in, provide a user name or obtain a password) and is kept current. A rulebook will be considered current if: (1) Notice of any substantive new or amended rule is provided within one day of implementation, either by press release, newsletter, notice to members or actual posting of the change in the rulebook; and (2) all new rules, both substantive and non-substantive, are posted in the rulebook within five days of implementation.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

Core Principle 8 of Section 5(d) of the CEA provides that:

> The board of trade shall make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 8 of Section 5(d):

(a) Application Guidance. A contract market should provide to the public information regarding settlement prices, price range, volume, open interest and other related market information for all actively traded contracts, as determined by the Commission, on a fair, equitable and timely basis. The Commission believes that Section 5(d)(8) requires contract markets to publicize trading information for any non-dormant contract. Provision of information for any applicable contract could be through such means as provision of the information to a financial information service and by timely placement of the information on a contract market's web site.

(b) Acceptable Practices. The mandatory compliance with Section 16.01, "Trading volume, open contracts, prices and critical dates," required under the regulations, would constitute an acceptable practice under Core Principle 8.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

Core Principle 10 of Section 5(d) of the CEA:

The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

Appendix B to Part 38 provides the following CFTC guidance on Core Principle 10 of Section 5(d):

(a) Application Guidance. A DCM should have arrangements and resources for recording of full data entry and trade details and the safe storage of audit trail data. A DCM should have systems sufficient to enable the contract market to use the information for purposes of assisting in the prevention of customer and market abuses through reconstruction of trading.

(b) Acceptable Practices.

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

transaction history database that contains information with respect to transactions executed on the DCM.

(2) An acceptable audit trail should include the following: original source documents, transaction history, electronic analysis capability, and safe storage capability. A contract market whose audit trail satisfies the following acceptable practices would satisfy Core Principle 10.

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

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

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

(b) the categories of participants for which such trades are executed, including whether the person executing a trade was executing it for his/her own account or an account for which he/she has discretion, his/her clearing member's house account, the account of another member, including market participants present on the floor, or the account of any other customer;

(c) timing and sequencing data adequate to reconstruct trading; and

(d) the identification of each account to which fills are allocated.

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

(iv) Safe Storage Capability. Safe storage capability provides for a method of storing the data included in the transaction history in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss. Data should be retained in accordance with the recordkeeping standards of Core Principle 17.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

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ADDENDUM

If any member/participant/intermediary of the Exchange will be able to enter orders directly into the Exchange's trade matching algorithm from within the U.S., then the Exchange would require a direct access no-action letter from the Division of Market Oversight (Division). If the orders are entered into the Exchange's trade matching algorithm from *outside* the U.S., then the Exchange would *not* require a direct access no-action letter.

With respect to a request for no-action relief, the following is provided:

> Pursuant to the November 2, 2006 policy statement "Boards of Trade Located Outside of the United States and No-Action Relief From the Requirement To Become a Designated Contract Market or Derivatives Transaction Execution Facility," foreign boards of trade that wish to permit their U.S. members and other participants in the U.S. to have direct access to their electronic trade matching system (not through an intermediary located outside the U.S.) may request no-action relief to do so from the Division. Such a request must be submitted pursuant to CFTC Regulation 140.99, which contains certain regulatory requirements with respect to requests for no-action relief generally.

General. Requests for such no-action relief generally request that the Division confirm that it will not recommend enforcement action if the foreign board of trade does not seek designation as a contract market (DCM) or registration as a derivatives transaction execution facility (DTEF) pursuant to Sections 5 and 5a of the Commodity Exchange Act or comply with other sections of the Act or Commission regulations that relate to DCMs or DTEFs in connection with direct access from the U.S.

Generally, foreign boards of trade request no-action relief to permit:

> 1. Members in the U.S. to trade for their own accounts through the trading system;
>
> 2. Members who are registered with the Commission as futures commission merchants (FCMs) or who are exempt from registration as FCMs pursuant to Commission Rule 30.10 (Rule 30.10 Firms) to submit orders and trade for U.S. customers through the trading system; and
>
> 3. Members who are registered as FCMs or who are Rule 30.10 Firms to accept orders from U.S. customers through automated order routing systems for submission to the trading system.

Some foreign boards of trade also request relief to permit members who are registered with the Commission as CPOs or CTAs, or are exempt from such registration pursuant to CFTC regulations 4.13 or 4.14, to submit orders for execution on behalf of U.S. pools they operate or U.S. customer accounts for which they have discretionary authority, respectively, provided that an FCM or Regulation 30.10 Firm acts as clearing firm and guarantees without limitation all such trades of the CPO or CTA effected through submission of orders on the trading system;

Scope of Review. In reviewing a request for no-action relief, Commission staff reviews, among other things, general information about the foreign board of trade, as well as detailed information about:

1. membership criteria (including financial and fit and proper requirements);

2. various aspects of the automated trading system (including the order-matching system, the audit trail, response time, reliability, security, and, of particular importance, adherence to the IOSCO principles for screen-based trading);

3. settlement and clearing (including financial requirements and default procedures);

4. terms and specifications of the contracts to be made available from within the U.S.;

5. the regulatory regime governing the foreign board of trade in its home jurisdiction;

6. the foreign board of trade's status in its home jurisdiction and its rules and enforcement thereof (including market surveillance and trade practice surveillance); and

7. existing information-sharing agreements among the Commission, the foreign board of trade, and the foreign board of trade's regulatory authority.

When issued, the no-action letters conclude with a standard set of terms and conditions for the granting of the relief which include, among other things, a quarterly volume reporting requirement.

Principle 26. There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants

Assessment: Fully Implemented

1) Does the regulatory system include:

a) A program whereby the regulator or an SRO, subject to oversight by the regulator, monitors day-to-day trading activity on the exchange or trading system (through a market surveillance program), monitors conduct of market intermediaries (through examinations of business operations) and collects and analyzes the information gathered through these activities?

Yes. Both the CFTC and DCMs conduct market surveillance. The following discussion describes the CFTC's market surveillance activities.

The CFTC Market Surveillance Program. Futures prices are widely quoted and disseminated throughout the U.S. and abroad. Business, agricultural, and financial enterprises use futures markets for pricing information and for hedging against price risk. The goals of the CFTC's market surveillance program are to preserve these economic functions of the futures and option markets under its jurisdiction by monitoring trading activity to detect and prevent manipulation or abusive practices, to keep the Commission informed of significant market developments, to enforce Commission and exchange speculative position limits, and to ensure compliance with Commission reporting requirements. In conducting market surveillance, Staff has a close working relationship with the exchanges' market surveillance staff.

The Market Surveillance Mission. The primary mission of the market surveillance program is to identify situations that could pose a threat of manipulation and to initiate appropriate preventive actions. Each day, for all active futures and option contract markets, the CFTC's market surveillance staff monitors the daily activities of large traders, key price relationships, and relevant supply and demand factors in a continuous review for potential market problems.

From the perspective of surveillance, markets can be grouped according to their settlement provisions despite the great diversity among the underlying commodities on which futures contracts are based.

Physical Delivery Commodities. Futures contracts that require the delivery of a physical commodity are most susceptible to manipulation when the deliverable supply on such contracts is small relative to the size of positions held by traders, individually or in related groups, as the contract approaches expiration.

The more difficult and costly it is to augment deliverable supplies within the time constraints of the expiring futures contract's delivery terms, the more susceptible to manipulation the contract becomes. Examples of some pertinent surveillance questions for these markets include:

- Are the positions held by the largest long trader(s) greater in size than deliverable supplies not already owned by such trader(s)?
- Are the long traders likely to demand delivery?
- Is taking delivery the least costly means of acquiring the commodity?
- To what extent are the largest short traders capable of making delivery?
- Is making futures delivery a better alternative than selling the commodity in the cash market?
- Is the futures price, as the contract approaches expiration, reflecting the cash market value of the deliverable commodity?
- Is the price spread between the expiring future and the next delivery month reflective of underlying supply and demand conditions in the cash market?

An excellent barometer for potential liquidation problems is the basis relationship (i.e., the difference between cash and futures price). When the price of the liquidating future is abnormally higher than underlying cash prices or both the futures and underlying cash price are abnormally higher than comparable cash prices, there is ample reason to examine the causes and to assess the motives of traders holding sizable long futures positions.

Financial Instruments. Futures contracts that require the delivery of a financial instrument generally are less likely than futures on physical commodities to be subject to manipulation in the form of squeezes. This assertion is based on the premise that the underlying cash markets for financial instruments tend to be deeper, more liquid, more transparent, and more readily arbitraged than physical commodity markets. Nonetheless, there are situations when the questions specified above still pertain to futures on financial instruments. For example, when a particular financial futures contract provides for a deliverable supply that either is of finite size or is a narrow segment of the broader cash market for the underlying financial instrument, then all the questions raised in the prior Section on physical commodities would apply.

In addition, price aberrations in the cash market for the underlying financial instrument may provide an indication of (or an opportunity for) an attempted manipulation. Surveillance staff monitors cash prices of the financial instrument specified for delivery on the futures contract in relation to cash prices for non-deliverable instruments that are close, or identical substitutes. High deliverable prices relative to non-deliverable prices

for financial instruments may signal an attempt to remove deliverable supplies from the futures market as part of an attempted manipulation.

To the extent participants in the markets take positions vastly beyond their financial capacity to take delivery or make settlement, this may also signal some manipulative activity.

Several financial products involve U.S. Treasury or agency instruments (e.g., bonds or notes). CFTC surveillance staff maintains open lines of communication with the U.S. Treasury Department, the Federal Reserve Bank of New York, the SEC, among others.

Cash-Settled Markets. The surveillance emphasis in cash-settled contracts is on the integrity of the cash price series used to settle the futures contract. The size of a trader's position at the expiration of a cash-settled futures contract cannot affect the price of that contract because the trader cannot demand or make delivery of the underlying commodity.

Since manipulation of the cash market can yield a profit in the futures contract, CFTC staff monitors large reportable futures positions and is alert for any unusual cash market activity on the part of large futures traders. Examples of some pertinent surveillance questions for these markets are:

- As the futures contract expiration approaches, is the cash price moving in a manner consistent with supply and demand factors and with other comparable cash prices, which are not used in the cash-settlement process?
- Do traders with large positions in the expiring future have the capacity and ability to affect the cash price series used to settle the futures contract?
- What information can be obtained from the organization that compiles the cash price series regarding how the price is determined? Is anyone reporting prices that appear to be out of line with prices reported by others? If yes, can it be determined that the party reporting those prices holds a futures position that would benefit by those prices?

Equity Futures: Special Concerns. Generally, equities and equity futures markets are closely linked through intermarket arbitrage. Therefore, effective surveillance of equity futures markets requires coordination with the exchanges trading the underlying equities and equity options to address intermarket trading abuses.

If the stock index underlying the futures and/or option contract is a broad-based index in terms of number of stocks and market capitalization, then intermarket price manipulation and insider trading concerns is greatly reduced. However, narrower indices and single-stock futures may require more vigilance with added protections with respect to misuse of information, especially to the extent that the market is, or acts like, a market in a single security. The Commission cooperates and works with the SEC on surveillance issues.

Sources of Market Information. The CFTC's market surveillance program uses many sources of market information to accomplish its objectives. Some of this information is publicly available, including data on the overall supply, demand, and marketing of the underlying commodity; futures, option, and cash prices; and trading volume and open interest data. Some of the information is highly confidential, which includes data from exchanges, intermediaries, and large traders.

Exchanges report daily positions and transactions of each clearing member to the Commission. The data are transmitted electronically during the morning after the "as of" date. They show, separately for proprietary and customer accounts, the aggregate position and trading volume of each clearing member in each futures and option contract. The data is used to identify quickly the firms that clear the largest buy or sell volumes or hold the biggest positions in a particular market. The clearing member data, however, do not identify the beneficial owners of the positions. Beneficial owners are identified by our large trader reporting system, which is the heart of the CFTC's market surveillance program.

Regulatory Response When Problems Develop. Surveillance economists prepare weekly summary reports of futures and option contracts for regional surveillance supervisors, who immediately review these reports. Surveillance staff informs Commission and senior staff of potential problems and significant market developments at weekly surveillance meetings so that they will be prepared to take prompt action when necessary.

The market surveillance process is not conducted exclusively at the CFTC. Surveillance issues are usually handled jointly by the CFTC and the appropriate exchange. Relevant surveillance information is shared and corrective actions are taken, when appropriate. Potential problem situations are jointly monitored and, if necessary, verbal contacts are made with the participants in question. These contacts may be for the purpose of understanding their trading, confirming reported positions, alerting the brokers or traders as to the regulatory concern for the situation, or warning them to trade responsibly. This "jawboning" activity by the Commission and the exchanges has been effective in resolving most potential problems at an early stage.

The Commission customarily gives an exchange the first opportunity to resolve problems in its markets, either informally or through emergency action. If an exchange fails to take actions that the Commission deems appropriate, the Commission has broad emergency powers under which it can order the exchange to take actions specified by the Commission. Such actions could include imposing or reducing limits on positions, requiring the liquidation of positions, extending a delivery period, or closing a market. Fortunately, most issues are resolved without the need to use the CFTC's emergency powers. The fact that the CFTC has had to take emergency actions only four times in its history demonstrates the potency of the other available tools to avoid disorderly liquidations or default.

Enforcement of Position Limits. The CFTC surveillance staff also monitors compliance with Commission or exchange speculative limits. These rules help prevent traders from accumulating concentrated positions that could disrupt a market. To monitor those limits, the market surveillance staff reviews daily for potential violations. Although bona fide hedgers are exempt from speculative limits, Commission staff monitors hedgers' compliance with their exemption levels. Commercial traders that carry futures and option positions in excess of Commission speculative position limit levels are required to submit a monthly statement of cash positions. These statements show the total cash position of each trader, which reflects the amount of the trader's actual physical ownership of each commodity and the amount of the trader's fixed-price purchases and sales for which the trader has a legitimate cash exposure at risk. Commission staff compares each trader's cash position to the trader's futures and option positions. The CFTC has a comprehensive market surveillance program to detect and prevent corruption of the economic functions of the futures and option markets that it oversees.

b) Regulatory oversight mechanisms to verify compliance by the exchange or trading system with its statutory or administrative responsibilities, particularly as they relate to the integrity of the markets, market surveillance, the monitoring of risks, and the ability to respond to such risks?

Yes.

DCM core principles. Section 5(d) of the CEA sets out the "core principles" with which a DCM must comply in order to maintain designation. The CFTC's guidance on these requirements states under Core Principle 1 that: "A board of trade applying for designation as a contract market must satisfactorily demonstrate its capacity to operate in compliance with the core principles under Section 5(d) of the [CEA] and [Regulation] 38.3."

In order to maintain designation, contract markets must comply with the following core principles:

> Core Principle 1 - Must meet and adhere to the following core principles for Contract Markets on a continuing basis:[108]
>
> Core Principle 2 - Compliance with Rules: monitor and enforce compliance with all contract market rules,[109]
>
> Core Principle 3 - Contracts Not Readily Subject to Manipulation: list contracts that are not readily susceptible to manipulation,

[108] Section 5(d) of the CEA.

[109] Section 5(d)(2) of the CEA provides that a "board of trade shall monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market."

Core Principle 4 - Monitoring of Trading: monitor trading to prevent manipulation, price distortion and disruption,

Core Principle 5 - Position Limitations or Accountability: adopt position limitations or position accountability where necessary and appropriate,

Core Principle 6 - Emergency Authority: adopt rules to provide for the exercise of emergency authority,

Core Principle 7 - Availability of General Information: make certain contract and execution information available to market authorities, participants and the public,

Core Principle 8 - Daily Publication of Trading Information: make public daily certain transaction information,

Core Principle 9 Execution of Transactions: provide a competitive, open and efficient market and mechanism for executing transactions,

Core Principle 10 - Trade Information: maintain rules and procedures to provide for the recording and safe storage of trade information for the purpose of preventing customer and market abuses and providing evidence of rule violations,

Core Principle 11 - Financial Integrity of Contracts: establish and enforce rules providing for the financial integrity of any contracts traded on the exchange (including the clearing and settlement with a DCO), and rules to ensure the financial integrity of any FCMs and IBs and protection of customer funds,

Core Principle 12 - Protection of Market Participants: establish and enforce rules to protect market participants from abusive practices,

Core Principle 13 - Dispute Resolution: establish and enforce rules regarding and providing for alternative dispute resolution, as appropriate for market participants and intermediaries,

Core Principle 14 - Governance Fitness Standards: establish and enforce appropriate fitness standards for directors, members of disciplinary committees, members of the contract market and any other person with direct access to the facility,

Core Principle 15 - Conflicts of Interest: establish and enforce rules to minimize and resolve conflicts of interest in the contract market's decision making process,

Core Principle 16 - Composition of Boards of Mutually Owned Contract Markets: ensure that the composition of the governing board reflects market participants,

Core Principle 17 - Record Keeping: maintain records for five years, and

Core Principle 18 - Antitrust Considerations: endeavour to avoid unreasonable restraints of trade or imposing any material anticompetitive burden on trading on the contract market.

Rules implementing the core principles, as well as illustrative guidance and acceptable practices for satisfaction of the Core Principle, are set forth in Part 38 of the Commission's regulations.[110]

Commission Oversight Procedures. The Commission's regulatory scheme is based upon the assumption of self-regulatory responsibilities by the exchanges and DCOs and continuing oversight by the Commission of the exercise of those responsibilities.

In addition to monitoring exchange and DCO operations on an ongoing basis through compliance reporting and "for cause" inquiries, the Commission's staff periodically reviews the programs and procedures adopted by each DCM and DCO to ensure compliance with the relevant core principles and to assess the effectiveness of those rules and procedures.

The operational integrity of exchanges is addressed through the CFTC's periodic RERs that broadly address market surveillance, trade practice surveillance and disciplinary programs. DMO's Market Compliance Section conducts regular reviews of each DCM's ongoing compliance with core principles through the self-regulatory programs operated by the exchange in order to enforce its rules, prevent market manipulation and customer and market abuses, and ensure the recording and safe storage of trade information.

Periodic RERs normally examine a DCM's audit trail, trade practice surveillance, disciplinary, and dispute resolution programs for compliance with the relevant core principles, which include Core Principle 10, Trade Information, and Core Principle 17, Recordkeeping with respect to audit trail programs; Core Principle 2, Compliance With Rules, and Core Principle 12, Protection of Market Participants with respect to trade practice surveillance and disciplinary programs; and Core Principle 13, Dispute Resolution, with respect to dispute resolution programs.

Other periodic RERs normally examine a DCM's market surveillance program for compliance with Core Principle 4, Monitoring of Trading, and Core Principle 5, Position Limitations or Accountability. On some occasions, these two types of RERs may be combined in a single RER. Market Compliance can also conduct horizontal RERs of the compliance of multiple exchanges in regard to particular core principles.

In conducting an RER, Staff examine trading and compliance activities at the exchange in question over an extended time period selected by DMO, typically the twelve months immediately preceding the start of the review. Staff conduct extensive review and analysis of documents and systems used by the exchange in carrying out its self-

[110] 17 C.F.R. Part 38 – *Designated Contract Markets*. *See* Appendix A to Part 38 *Application Guidance* and Appendix B *Guidance on Acceptable Practices in Compliance with core principles. See also* 66 FR 42256 (August 10, 2001)(final rules) for a discussion of these rules.

regulatory responsibilities; interview compliance officials and staff of the exchange; and prepare a detailed written report of their findings. In nearly all cases, the RER report is made available to the public and posted on cftc.gov.

c) Provides the regulator with adequate access to all pre-trade and post-trade information available to market participants.

Yes. Core Principle 7 of Section 5(d) of the CEA requires the DCM to make available to market authorities, market participants, and the public information concerning the terms and conditions of the contract market and the mechanisms for executing transactions on or through the facilities of the contract market.

Core Principle 8 of Section 5(d) of the CEA requires the DCM to make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market.

2) Does the regulatory framework require that amendments to the rules of the exchange or trading system must be provided to, or approved by, the regulator?

Yes. DCMs generally may implement new rules or rule amendments by filing with the Commission a certification that the new rule or rule amendment complies with the CEA and the Commission's regulations and/or by requesting CFTC approval of such rules and amendments (*See* CFTC Regulation 40.6(a)).

3) When the regulator determines that the exchange or trading system is unable to comply with the conditions of its approval, or with securities law or regulation, is there a mechanism that permits the regulator to:

a) Re-examine the exchange or trading system and impose a range of actions, such as restrictions or conditions on the market operator?

b) Withdraw the exchange or trading system's authorization?

Yes, to all of the above. The CFTC has the power to direct DCMs to alter or supplement their rules and to take such action as it deems to be necessary to maintain or restore orderly trading. Section 8a(7) and (9) of the CEA, respectively. CEA Sections 5b, 5c(d) and 6(b) authorize the CFTC to suspend or revoke a contract market's designation based on a failure or refusal to comply with any of the provisions of the CEA, CFTC regulations or CFTC orders.

Principle 27. Regulation should promote transparency of trading

Assessment: Fully Implemented

1) Does the regulatory framework include:

a) Requirements or arrangements for providing pre-trade (e.g., posting of bids and offers) and post-trade (e.g., last sale price and volume of transaction) information to market participants on a timely basis?

Yes. CEA Sections 5(b), 5(d), and 2(h)(7), as well as the Commission's guidance and regulations, require pre-trade and post-trade transparency. DCM Designation Criteria 3—Fair And Equitable Trading, requires a board of trade to establish fair and equitable trading rules. The CFTC's guidance provides that this obligation includes, among other things, providing to market participants, on a fair, equitable and timely basis, information regarding, prices, bids, and offers, as applicable to the market. DCM Core Principle 8—Daily Publication Of Trading Information—requires the daily publication of trading information. Additionally, DCM Core Principle 7—Availability Of General Information—requires the daily publication of trading information for significant price discovery contracts traded or executed on electronic trading facilities. The CFTC's guidance provides that an acceptable practice for DCM Core Principle Section 5(d) and Section 2(h)(7)(C)(ii)(VI) is mandatory compliance with Regulation Section16.01. Regulation 16.01 provides that reporting markets shall make readily available data pertaining to trading volume, open contracts, and price to the news media and general public without charge, in a format that readily enables the consideration of such data, no later than the business day following the day to which the information pertains.

The CFTC also publishes a variety of market transaction data, such as the *Commitment of Traders* ("COT")[111] reports and *This Month in Futures Markets*.

CFTC Regulation 16.01 states the following:

[111] The COT report provides a breakdown of the open interest in futures contracts in which 20 or more traders hold positions that equal or exceed the reporting levels set by the CFTC. The CFTC has redesigned the COT reports for August 2009 to begin including more detailed information on futures markets and market participants. Traders will be classified in a more nuanced way than in prior years, into four categories: (1) producers and merchants; (2) swap dealers; (3) managed funds; and (4) other market participants. Data regarding contracts that perform a significant price discovery function will also be highlighted. The enhanced data will keep market participants and the public better informed about the positions of various types of traders.

(a) Trading volume and open contracts. Each reporting market shall record for each business day the following information separately for futures by commodity and by future, and, for options, by underlying futures contract for options on futures contracts or by underlying physical for options on physicals, and by put, by call, by expiration date and by strike price:

(1) The option delta, where a delta system is used;

(2) The total gross open contracts, excluding from futures those contracts against which notices have been stopped;

(3) For futures, open contracts against which delivery notices have been stopped on that business day;

(4) The total volume of trading, excluding transfer trades or office trades;

(5) The total volume of futures exchanged for commodities or for derivatives positions which are included in the total volume of trading;

(6) The total volume of block trades which are included in the total volume of trading.

(b) Prices. Each reporting market shall record the following information separately for futures, by commodity and by future, and, for options, by underlying futures contract for options on futures contracts or by underlying physical for options on physicals, and by put, by call, by expiration date and by strike price:

(1) For the trading session and for the opening and closing periods of trading as determined by each reporting market:

(i) The lowest price of a sale or offer, whichever is lower, and the highest price of a sale or bid, whichever is higher, that the reporting market reasonably determines accurately reflect market conditions. If vacated or withdrawn, bids and offers shall not be used in making this determination. A bid is vacated if followed by a higher bid or price and an offer is vacated if followed by a lower offer or price.

(ii) If there are no transactions, bids, or offers during the opening or closing periods, the reporting market may record as appropriate:

(A) The first price (in lieu of opening price data) or the last price (in lieu of closing price data) occurring during the trading session, clearly indicating that such prices are the first and the last price; or

(B) Nominal opening or nominal closing prices which the reporting market reasonably determines accurately reflect market conditions, clearly indicating that such prices are nominal.

(2) The settlement price established by each reporting market or its clearing organization.

(3) Additional information. Each reporting market shall record the following information with respect to transactions in commodity futures and commodity options on that reporting market:

(i) The method used by the reporting market in determining nominal prices and settlement prices; and

(ii) If discretion is used by the reporting market in determining the opening and closing ranges or the settlement prices, an explanation that certain discretion may be employed by the reporting market and a description of the manner in which that discretion may be employed.

(c) Critical dates. Each reporting market shall report to the Commission for each futures contract the first notice date and the last trading date and for each option contract the expiration date in accordance with paragraph (d) of this Section.

(d) Form, manner and time of filing reports. Unless otherwise approved by the Commission or its designee, reporting markets shall submit to the Commission the information specified in paragraphs (a)(1) through (a)(5), (b) and (c) of this Section as follows:

(1) Using the format, coding structure and electronic data transmission procedures approved in writing by the Commission or its designee; provided however , the information shall be made available to the Commission or its designee in hard copy upon request; and

(2) When each such form of the data is first available but not later than 7:00 a.m. on the business day following the day to which the information pertains for the delta factor and settlement price and not later than 12:00 p.m. for the remainder of the information. Unless otherwise specified by the Commission or its designee, the stated time is eastern time for information concerning markets located in that time zone, and central time for information concerning all other markets.

(e) Publication of recorded information.

(1) Reporting markets shall make the information in paragraph (a) of this Section readily available to the news media and the general public without charge, in a format that readily enables the consideration of such data, no later

than the business day following the day to which the information pertains. The information in paragraphs (a)(4) through (a)(6) of this Section shall be made readily available in a format that presents the information together.

(2) Reporting markets shall make the information in paragraphs (b)(1) and (b)(2) of this Section readily available to the news media and the general public, and the information in paragraph (b)(3) of this Section readily available to the general public, in a format that readily enables the consideration of such data, no later than the business day following the day to which the information pertains.

See CFTC Regulation 16.01 at *http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=38e11e5c012f7958d7ddd4b3237420e8&rgn=div8&view=text&node=17:1.0.1.1.15.0.7.2&idno=17*.

COT Reports. The first COT report was published for 13 agricultural commodities as of June 30, 1962. At the time, this report was proclaimed as "another step forward in the policy of providing the public with current and basic data on futures market operations." Those original reports were compiled on an end-of-month basis and were published on the 11th or 12th calendar day of the following month.

Over the years, in a continuous effort to better inform the public about futures markets, the CFTC has improved the COT report in several ways. The COT report is published more often—switching to mid-month and month-end in 1990, to every 2 weeks in 1992, and to weekly in 2000. The COT report is released more quickly—moving the publication to the 6th business day after the "as of" date (1990) and then to the 3rd business day after the "as of" date (1992). The report includes more information—adding data on the numbers of traders in each category, a crop-year breakout, and concentration ratios (early 1970s) and data on option positions (1995). The report also is more widely available—moving from a subscription-based mailing list to fee-based electronic access (1993) to being freely available on the Commission's Web site (1995).

The COT reports provide a breakdown of each Tuesday's open interest for markets in which 20 or more traders hold positions equal to or above the reporting levels established by the CFTC. The weekly reports for *Futures-Only Commitments of Traders* and for *Futures-and-Options-Combined Commitments of Traders* are released every Friday at 3:30 p.m. Eastern time.

Reports are available in both a short and long format. The short report shows open interest separately by reportable and nonreportable positions. For reportable positions, additional data are provided for commercial and non-commercial holdings, spreading, changes from the previous report, percent of open interest by category, and numbers of traders. The long report, in addition to the information in the short report, also groups the data by crop year, where appropriate, and shows the concentration of positions held by the largest four and eight traders.

Additionally, in a December 5, 2006 press release, the CFTC announced that, in addition to the existing COT reports, a supplemental report would be published beginning January 5, 2007. Supplemental reports show aggregate futures and option positions of Noncommercial, Commercial, and Index Traders in 12 selected agricultural commodities. To begin release in August 2009, the CFTC has redesigned the COT reports to include more detailed information on futures markets and market participants. Traders will be classified in a more nuanced way than in prior years, into four categories: (1) producers and merchants; (2) swap dealers; (3) managed funds; and (4) other market participants. The enhanced data will keep market participants and the public better informed about the positions of various types of traders.[112]

Current and historical COT data are available on the Commission's Web site, *http://www.cftc.gov*. Also available at that Web site are historical COT data going back to 1986 for futures-only reports and to 1995 for option-and-futures-combined reports.

See http://www.cftc.gov/cftc/cftccotreports.htm for current and archived COTs.

CFTC Reports: This Month's Futures Markets. This report is based on the COT report. For each commodity, the COT reports provide information on the size and the direction of the positions taken, across all maturities, by three categories of futures traders. These three trader categories are called "commercial", "non-commercial", and "non-reportable".

See http://www.cftc.gov/OCE/WEB/index.htm for This Month's Futures Markets.

b) Requirements or arrangements that information on completed transactions be provided on an equitable basis to all participants?

Yes. DCM Core Principle 8—Daily Publication of Trading Information—requires the daily publication of trading information. Additionally, DCM Core Principle 7—Availability Of General Information—requires the daily publication of trading information for significant price discovery contracts traded or executed on electronic trading facilities. The CFTC's guidance provides that an acceptable practice for Section 5(d) and Section 2(h)(7)(C)(ii)(VI) is mandatory compliance with CFTC Regulation 16.01. Regulation 16.01 provides that reporting markets shall make readily available data pertaining to trading volume, open contracts, and price to the news media and general public without charge, in a format that readily enables the consideration of such data, no later than the business day following the day to which the information pertains.

CFTC Regulation 16 requires each contract market to submit to the CFTC for each business day a report showing for each clearing member, by proprietary and customer account, and by future or underlying futures contract for options on futures or by underlying physicals for options on physicals, information such as the total long and short

[112] *See supra*, note 112.

open contracts carried at the end of the day; and the quantity of contracts bought and sold during the day.

CFTC Regulation 16.01 requires a contract market to publish each business day for futures and options the total volume, quantity of futures for cash transactions, total gross open contracts, for futures open contracts against which delivery notices have been stopped and the option delta, and to make this information readily available to the public.

See infra, response to Principle 29, Question 1, concerning the CFTC's Large Trader Reporting system.

2) Where an authorized exchange or trading system's operator permits derogation from the objective of real-time transparency, are:

a) The conditions clearly defined?

Yes. DCM Designation Criterion 3 of Section 5(b) of the CEA—Fair And Equitable Trading—requires DCMs to establish and enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and the capacity to detect, investigate, and discipline any person that violates the rules. But Designation Criterion 3 also allows DCM rules to authorize—(A) transfer trades or office trades; (B) an exchange of—(i) futures in connection with a cash commodity transaction; (ii) futures for cash commodities; or (iii) futures for swaps; or (C) an FCM, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a DCO.

Moreover, DCM Core Principle 9—Execution of transactions, states ''The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions." CFTC Regulation 1.38 sets forth a requirement that all purchases and sales of a commodity for future delivery or a commodity option on or subject to the rules of a DCM should be executed by open and competitive methods. This ''open and competitive'' requirement is modified by a proviso that allows transactions to be executed in a ''non-competitive'' manner if the transaction is in compliance with DCM rules specifically providing for the noncompetitive execution of such transactions, and such rules have been submitted to, and approved by, the Commission. Specifically, the CEA permits DCMs to establish trading rules that: (1) authorize the exchange of futures for swaps; or (2) allow a FCM, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of a contract market or DCO.

Core Principle 9 of Section 5(d) of the CEA provides that:

> The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions.

The Commission’s proposed guidance in Appendix B to Part 38 provides that:

(1) Transactions on the centralized market.

(i) Purchases and sales of any commodity for future delivery, and of any commodity option, on or subject to the rules of a contract market shall be executed openly and competitively by open outcry, by posting of bids and offers, or by other equally open and competitive methods, in a place or through an electronic system provided by the contract market, during the hours prescribed by the contract market for trading in such commodity or commodity option.

(ii) A competitive and open market's mechanism for executing transactions includes a contract market's methodology for entering orders and executing transactions.

(iii) Appropriate objective testing and review of a contract market's automated systems should occur initially and periodically to ensure proper system functioning, adequate capacity and security. A DCM's analysis of its automated system shall address compliance with appropriate principles for the oversight of automated systems, ensuring proper system functionality, adequate capacity and security.

(2) Transactions off the centralized market.

(i) In order to facilitate the execution of transactions, transactions may be executed off the centralized market, including by transfer trades, office trades, block trades, inter-exchange spread transactions, or trades involving the exchange of futures for a commodity or for a derivatives position, if transacted in accordance with written rules of a contract market that specifically provide for execution of such transactions away from the centralized market and that have been certified to or approved by the Commission.

(ii) Every person handling, executing, clearing, or carrying trades off the centralized market shall comply with the rules of the applicable DCM and DCO, including to identify and mark by appropriate symbol or designation all such transactions or contracts and all orders, records, and memoranda pertaining thereto.

(iii) A DCM that determines to allow trades off the centralized market shall ensure that such trading does not operate in a manner that compromises the integrity of price discovery on the centralized market or facilitate illegal or non-bona fide transactions.

(3) Block trades-minimum size.

(i) When determining the number of contracts that constitutes the appropriate minimum size for block trades, a contract market should ensure that block trades are limited to large transactions and that the minimum size is appropriate for that specific contract, by applying the principles set forth in this Section. For any contract that has been trading for one calendar quarter or longer, the acceptable minimum block trade size should be a number larger than the size at which a single buy or sell order is customarily able to be filled in its entirety at a single price in that contract's centralized market. Factors to consider in determining what constitutes a large transaction could include an analysis of the market's volume, liquidity and depth; a review of typical trade sizes and/or order sizes; and input from floor brokers, floor traders and/or market users. For any contract that has been listed for trading for less than one calendar quarter, an acceptable minimum block trade size in such contract should be the size of trade the exchange reasonably anticipates will not be able to be filled in its entirety at a single price in that contract's centralized market. An appropriate minimum size could be estimated based on centralized market data in a related futures contract, the same contract traded on another exchange, or trading activity in the underlying cash market. The exchange could also consider the anticipated volume, liquidity and depth of the contract; input from potential market users; or consider that exchange's experience with offering similar new contracts. The minimum size thresholds for block trades should be reviewed periodically to ensure that the minimum size remains appropriate for each contract. Such review should take into account the sizes of trades in the centralized market and the market's volume and liquidity.

See Proposed DCM Core Principle 9 guidance at *http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e8-21865a.pdf*.

b) Does the operator and/or the regulator have access to the complete information to be able to assess the need for derogation and if necessary, to prescribe alternatives?

Yes. As discussed in detail in Principle 27, Question 1 above, DCMs must comply with DCM Core Principle 8—Daily Publication of Trading Information and Commission Regulation 16.01. Additionally, most current DCM rules require reporting of block trades within 5 minutes of execution with a small number of DCM rules allowing as many as 15 minutes to report. On September 11, 2009, the Commission re-proposed in 73 FR 5407 that block trades should be reported to the contract market within a reasonable period of time. The Commission also re-proposed that DCMs would publicize details about transactions off the centralized market immediately upon the receipt of the transaction report. The proposed acceptable practices would also require the DCM to identify block trades on its trade register.

Relevant parts of the Commission's proposed acceptable practices in Appendix B to Part 38 provide that:

(b) *Acceptable practices.*

(2) Transactions off the centralized market.

(i) General provisions.

(A) Allowable trades. Acceptable transactions off the centralized market include: transfer trades, office trades, block trades, inter-exchange spread transactions or trades involving the exchange of futures for commodities or for derivatives positions, if transacted in accordance with written rules of a contract market that specifically provide for execution away from the centralized market and that have been certified to or approved by the Commission.

(B) Reporting. Transactions executed off the centralized market should be reported to the contract market within a reasonable period of time.

(C) Publication. The contract market should publicize details about block trade transactions immediately upon the receipt of the transaction report and publicize daily the total quantity of the exchange of futures for commodities or for derivatives positions and the total quantity of the block trades that are included in the total volume of trading, as required by Reg. 16.01.

(D) Recordkeeping. Parties to, and members facilitating, transactions off the centralized market should keep appropriate records. Appropriate recordkeeping for transactions off the centralized market would comply with Core Principle 10 and Core Principle 17.

(E) Identification of trades. Reg. 1.38(b) establishes the requirements regarding the identification of trades off the centralized market. It requires contract market rules to require every person handling, executing, clearing, or carrying trades, transactions or positions that are executed off the centralized market, including transfer trades, office trades, block trades or trades involving the exchange of futures for a commodity or for a derivatives position, to identify and mark by appropriate symbol or designation all such transactions or contracts and all orders, records, and memoranda pertaining thereto.

(F) Identification in the trade register. The contract market should identify transactions executed off the centralized market in its trade register, using separate indicators for each such type of transaction.

See Proposed Core Principle 9 guidance at *http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e8-21865a.pdf.*

Principle 28. Regulation should be designed to detect and deter manipulation and other unfair trading practices

Assessment: Fully Implemented

1) Does the regulatory system prohibit the following with respect to securities admitted to trading on authorized exchanges and regulated trading systems:

a) Market or price manipulation?

b) Misleading information?

c) Insider trading?

d) Front running?

e) Other fraudulent or deceptive conduct and market abuses?

Yes, to all of the above. In general, CEA Section 4b(a) makes it unlawful for any registered entity, defined in CEA Section 1a(29) to include DCMs and DTEFs, any agent or employee of any member, or any other person, in or in connection with such order, to make any contract of sale of any commodity in interstate commerce on or subject to the rules of a registered entity, for or on behalf of any other person –

- To cheat or defraud or attempt to cheat or defraud such other person;
- Willfully to make or cause to be made to such other person any false report or statement thereof;
- Willfully to deceive or attempt to deceive such other person; or
- Bucket such order, fill such order by offset against the order of any other person, or willfully or knowingly and without prior consent of the other person to become the buyer in respect of selling orders or become the seller in respect of any buying order of such person.

CEA Section 4c prohibits fictitious trading or trading which would cause the market to reflect a price that is not "true and bona fide." Sections 6c and 9(a)(2) of the CEA authorize CFTC action against manipulation. Section 9(a) also authorizes criminal penalties for manipulation and all other willful violations of the CEA and CFTC regulations, including fraud.

CFTC Regulation 33.10 (which applies to DCMs pursuant to CFTC Regulation 38.2) makes it unlawful for any person to cheat or defraud or attempt to defraud any other

person; to make or cause to be made to any other person any false report or statement or record; or deceive or attempt to deceive any other person by any means whatsoever in connection with commodity option transactions.

Finally, Section 9(e) of the CEA provides an explicit prohibition against insider trading for certain persons, making it a felony: (1) for any person who is an employee, member of the governing board, or member of any committee of a board of trade, registered entity, or registered futures association, in violation of a regulation issued by the Commission, willfully and knowingly to trade for such person's own account, or for or on behalf of any other account, in contracts for future delivery or options thereon on the basis of, or willfully and knowingly disclose for any purpose inconsistent with the performance of such person's official duties as an employee or member, any material nonpublic information obtained through special access related to the performance of such duties, and (2) willfully and knowingly to trade for such person's own account, or for or on behalf of any other account, in contracts for future delivery or options thereon on the basis of material, nonpublic information that such person knows was obtained in violation of paragraph (1) employee, member of the governing board, or member of any committee of a board of trade, registered entity, or registered futures association

2) Does the regulatory approach to detect and deter such conduct include an effective and appropriate combination of:

a) Direct surveillance, inspection, reporting, such as, for example, securities listing or product design requirements (where applicable), position limits, audit trail requirements, quotation display rules, order handling rules, settlement price rules or market halts complemented by enforcement of the law and trading rules?

b) Effective, proportionate and dissuasive sanctions for violations?

Yes, to all of the above. The DCMs have the primary obligation to detect and deter unlawful conduct and use a combination of direct surveillance, inspection, reporting, product design requirements, position limits, settlement price rules or market halts complemented by vigorous enforcement of the law and trading rules. The CFTC conducts oversight of the exchanges' program to ensure effectiveness. *See supra*, response to Principle 26, Question 1(b) regarding the CFTC's rule enforcement program.

In addition to the exchange surveillance program, the CFTC independently conducts an extensive market surveillance program, utilizing large trader reports. *See supra*, response to Principle 26, Question 1(a) regarding the CFTC's market surveillance program.

The CFTC has robust sanctioning powers, including trading prohibitions and civil penalties. DOE also actively investigates illegal exchange activity, working independently and in conjunction with exchange staff.

3) Are there arrangements in place for:

a) The continuous collection and analysis of information concerning trading activities?

b) Providing the results of such analysis to market and regulatory officials in a position to take remedial action if necessary?

c) Monitoring the conduct of market intermediaries participating in the market?

d) Triggering further inquiry as to suspicious transactions or patterns of trading?

Yes, to all of the above. Both the CFTC and DCMs conduct market surveillance. *See supra*, response to Principle 26, Question 1(a), regarding the CFTC's market surveillance program.

4) If there is potential for domestic cross-market trading, are there inspection, assistance and information-sharing requirements or arrangements in place to monitor and/or address domestic cross-market trading abuses?

Yes, there are information sharing arrangements and MOUs for enforcement and investigative assistance in place to monitor and address domestic cross-market trading abuses. Both individual markets and the CFTC have these arrangements and some involve foreign markets and regulators.

The CFTC's market surveillance program, previously described in the response to Principle 26, Question 1(a), enables the CFTC to monitor and address domestic cross-market trading abuses.

MOUs. The CFTC cooperates with foreign regulatory and enforcement authorities through formal MOUs and other arrangements to combat cross-border fraud and other illegal practices that could harm customers or threaten market integrity.

Cross-border information sharing among market authorities plays an integral role in the effective surveillance of global markets that are linked by products, participants, and technology. Information sharing arrangements can be critical in combating cross-border fraud and manipulation, addressing the financial risks of market participants, and sharing regulatory expertise on market oversight and supervision. The CFTC makes and receives a significant number of requests for assistance and information to and from foreign authorities in connection with various surveillance and enforcement issues.

The CFTC has entered into MOUs and cooperative arrangements with many jurisdictions, including cooperative enforcement arrangements, arrangements relating to sharing financial and other types of fitness information, and arrangements for sharing information on matters related to the implementation of the CFTC's Part 30 Regulations, which grant foreign firms an exemption from certain CFTC requirements.

Intermarket Surveillance Group. The purpose of the Intermarket Surveillance Group (ISG) is to provide a framework for the sharing of information and the coordination of regulatory efforts among exchanges trading securities and related products to address potential intermarket manipulations and trading abuses. The ISG plays a crucial role in information sharing among markets that trade securities, options on securities, security

futures products, and futures and options on broad-based security indexes. The ISG also provides a forum for discussing common regulatory concerns, thus enhancing members' ability to fulfill efficiently their regulatory responsibilities. In effect, the ISG is an information-sharing cooperative governed by a written agreement. The ISG is not subject to regulatory oversight, nor does it file rule changes with the CFTC or the SEC or seek approval when it considers requests from securities or futures exchanges to become a member.

Membership in the ISG carries with it a commitment to share information required for regulatory purposes with other members. ISG agreements provide that information that is shared must be kept strictly confidential and used only for regulatory purposes. Such information is shared on an as-needed basis and only upon request. In addition, U.S. securities participants, via the facilities of the Securities Industry Automation Corporation (SIAC), routinely share trading information electronically.

In connection with the routine sharing of information, the ISG has defined certain types of violations which can occur across markets, and has allocated responsibility for surveillance for such activity to the appropriate member. This enables participants to avoid duplicative efforts while continuing to ensure effective intermarket surveillance.

Generally, the full ISG meets two times per year. Meetings are open only to representatives of members, prospective members, SIAC representatives, and appropriate governmental authorities such as the CFTC, SEC, the UK Financial Services Authority, and, on occasion, international organizations such as IOSCO. Senior market surveillance or market regulation personnel represent member organizations.

From time to time, and at the discretion of the Chairman, subgroups may be formed to address specific issues of importance to the group. Such subgroups may be permanent or have a limited time depending on the subject. Subgroups are headed by a representative of a member or affiliate and are appointed by the Chairman. Meetings of subgroup members are generally independent of regular ISG meetings and may take place either at a location directed by the subgroup chairperson or telephonically during the interval between ISG meetings. Ordinarily, standing subgroups meet on the day preceding a full ISG meeting. Affiliate membership in the ISG is open to all recognized market centers that trade products that have rules and regulations designed to detect and deter possible abuses in their marketplaces. Participants in the ISG must have the ability to share regulatory information and otherwise cooperate with other ISG participants in connection with regulatory matters affecting their markets.

Intermarket Financial Surveillance Group. The Intermarket Financial Surveillance Group was formed in 1988 to provide a coordinating body to address financial surveillance issues relevant to both futures and securities markets. The IFSG includes most of the principal commodity and securities exchanges as well as the NFA and Financial Industry Regulatory Authority (FINRA). The members of the IFSG have agreed to share financial information with respect to "high risk" member firms as commonly defined by the group. The agreement also provides for the exchange of

information upon request regarding capital, segregation of customer funds, margins, liquidity problems, omnibus accounts carried and/or carrying brokers, and pay/collect data with respect to such high risk firms.

Joint Audit Committee. The JAC, which consists of representatives of the financial compliance departments of each of the futures industry SROs, was established in 1979 to coordinate the SROs' audit and financial surveillance programs, including information-sharing, disciplinary actions, audit procedures, assignment of audit responsibility for dual-membership firms, and to review current financial reporting issues and interpretations. CFTC staff frequently attends JAC meetings to discuss financial compliance issues.

Joint Compliance Committee. To foster improvements and uniformity in their systems and procedures used for trade practice compliance, the futures exchanges, at the CFTC's urging, formed the Joint Compliance Committee ("JCC"). The JCC has developed uniform definitions of trade practice offenses and routinely meets to share information on automated compliance systems and other surveillance matters with a view to improving exchange compliance programs.

Unified Clearing Group. The CFTC endorsed the formation of the Unified Clearing Group ("UCG") in 1995. The UCG was formed to coordinate the flow of information concerning common clearing members of the nation's principal securities and futures exchanges. The related clearing entities established mechanisms to share information on cash flow streams, such as daily pay outs, collections and settlements.

International Exchange MOU. As noted above, in 1995 numerous derivatives exchanges developed an Exchange MOU that was created to address the problem of accessing information about large exposures where exchange member firms and market participants typically trade on multiple exchanges and no one regulator or market authority will have all of the information necessary to evaluate the risks in its markets. Like the Declaration, under the Exchange MOU the occurrence of agreed triggering events affecting an exchange member's financial resources, positions, price movements or price relationships will prompt the sharing of information.

5) If there are foreign linkages, substantial foreign participation, or cross listings, are there cooperation arrangements with relevant foreign regulators and/or markets that address manipulation or other abusive trading practices?

Yes. The Commission has attached additional conditions to staff direct access no-action letters issued to foreign boards of trade that elect to list for direct access from the U.S. contracts which settle against any price, including the daily or final settlement price, of (1) a contract listed for trading on a DCM or DTEF, or (2) a contract listed for trading on an ECM that has been determined to be a significant price discovery contract (SPDC) (collectively, linked contracts). These conditions apply to ICE Futures Europe, which has made available from the U.S. by direct access four contracts which settle on prices established at the New York Mercantile Exchange (NYMEX). In addition to a special CFTC-FSA MOU that enhances information sharing among the regulatory authorities

and scheduled monthly telephone conversations between the two, and enhanced cooperation with ICE Futures Europe, the additional conditions require that (1) ICE Futures Europe's linked contracts must have position limits or position accountability levels (including related hedge exemption provisions) that are comparable to those for the target contract at NYMEX; (2) ICE Futures Europe must inform the CFTC of any trader that exceeds the linked contract's position limit and what, if any, responsive action was taken; (3) ICE Futures Europe must publish daily trading information (*e.g.*, settlement prices, volume, open interest, and opening and closing ranges) that is comparable to the information published for the target contract; and (4) ICE Futures Europe must provide to the CFTC, either directly or through the FSA, a daily report of large trader positions in each linked contract for all contract months in a form and manner that can be integrated into the CFTC's market surveillance systems and COT report.

Principle 29. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption

Assessment: Fully Implemented

1) Does the market authority have a mechanism in place that is intended to monitor and evaluate continuously the risk of open positions or credit exposures that are sufficiently large to expose a risk to the market or to a clearing firm that includes:

a) Qualitative or quantitative trigger levels appropriate to the market for the purpose of identifying large exposures, continuous monitoring and an evaluative process?

Yes. The CFTC established the RSG in 2005 to fulfill its obligation, under Section 3(b) of the CEA, "to ensure the financial integrity of all transactions subject to [the CEA] and the avoidance of systemic risk." As mentioned above, the RSG attempts on a daily basis: (i) to identify any significant financial risks posed by positions in products that (A) an FCM clears through a DCO, and (B) fall within the jurisdiction of the CFTC; and (ii) to confirm that such financial risks are being appropriately managed. In essence, the RSG identifies (i) traders that pose risks to FCMs, and (ii) FCMs that pose risks to DCOs. It also reviews financial resources and risk management practices at traders, FCMs, and DCOs.

The RSG has developed or obtained access to a number of automated systems and applications that it uses in its work. On an ongoing basis, the RSG strives to upgrade these systems and to develop more effective links among them. The following are the primary systems used.

ISS (Integrated Surveillance System). ISS is a large-trader reporting system (LTRS). The RSG uses the LTRS to identify traders with positions that warrant further analysis, and to gather information about such traders. The CFTC market surveillance program also uses the LTRS, in the manner described below.

Under the Commission's LTRS, clearing members, FCMs, and foreign brokers (collectively called "reporting firms") file daily reports with the Commission.[113] Those reports show the futures and option positions of traders that hold positions at or above specific reporting levels set by the Commission.[114] If, at the daily market close, a reporting firm has a trader with a position at or above the Commission's reporting level in any single futures month or option expiration, the firm reports that trader's entire

[113] 17 C.F.R. Part 17.
[114] Reporting levels are specified in 17 C.F.R. Part 15.

position in all futures and options expiration months in that commodity, regardless of size.

The aggregate of all large-traders' positions reported to the Commission usually represents 70 to 90 percent of the total open interest in any given market. The minimum reporting level for large-trader reports is currently 25 contracts. A greater level may be specified as the Commission gains experience with a commodity. The level for any given market is based on the total open positions in that market, the size of positions held by traders in the market, the surveillance history of the market, and, for the physical-delivery markets, the size of deliverable supplies. From time to time, the Commission will raise or lower the reporting levels in specific markets to strike a balance between collecting sufficient information to oversee the markets and minimizing the reporting burden on the futures industry and the public. (The Commission publishes aggregate data concerning reported positions in its weekly COT reports, which are available at the Commission's Web site and are the subject of a separate Backgrounder.)

Exchanges also provide the daily positions that each clearing member is carrying in each futures and options contract on each underlying commodity.[115] Each day as of the previous day's close, exchanges report each clearing member's open long and short positions, purchases and sales, exchanges of futures for cash, and futures delivery notices. These data are reported separately by proprietary and customer accounts by futures month and, for options, by puts and calls by expiration date and strike price. The Commission staff use these data to identify large cleared positions, in single markets or across many markets and exchanges, to audit large-trader reports, and to identify account aggregation issues.

The Commission employs surveillance staff economists and futures trading specialists to continually monitor large-trader data and the financial integrity of clearing members. The market surveillance process is not conducted exclusively at the CFTC. Contract markets conduct and maintain their own market surveillance programs as part of their self-regulatory responsibilities.

Through various software tools, the raw large-trader data are transformed into analytical reports. A Commission economist may view the largest traders in a specific market, a single trader across several markets, or a trader's pattern of trading over a specific time period.

The Commission uses various means to ensure the accuracy of its large-trader data. For example, the large-trader positions reported by clearing members are compared to clearing-member data reported by the exchanges. An inquiry is made if: a) the sum of a clearing member's large-trader positions exceeds the member's open cleared position; or b) a clearing member has a cleared position many times the reporting level for a given market, but reports little or no large-trader positions. This same procedure is used to compare large-trader data reported by non-clearing FCMs and foreign brokers to the total

[115] 17 C.F.R. Part 16.

positions they are carrying at other brokers or clearing members. Reporting firms are also subject to on-site audits by exchange and Commission staff.

In the several markets with Federal speculative position limits (grains, the soy complex, and cotton), hedgers that hold positions in excess of those limits must file periodic reports with the Commission.[116] Those reports show the trader's positions in the cash market and are used to determine whether the trader has sufficient cash positions to justify futures and option positions above the speculative limits. The Commission also publishes a weekly *Cotton On Call* report, as a service to the cotton industry, showing how many unfixed-price cash cotton purchases and sales are outstanding against each cotton futures month.

Traders that hold reportable positions in designated futures and option markets must keep records showing all details concerning their positions and transactions in the futures and options and in the underlying commodity.[117] This includes inventories, purchases, and sales of the cash commodity represented by the futures market, as well as its products and by-products. Upon request by the Commission, a trader must furnish the Commission with any pertinent information about those positions or transactions.

In summary, the Commission operates an extensive reporting system that includes timely data on clearing members and large traders. These data are the core of a comprehensive market surveillance program that monitors futures markets on a daily basis in order to preserve these markets' economic functions of hedging and price discovery.

SPARK (Stressing Positions at Risk). SPARK is a system that was developed by DCIO staff. It is used to sort and to analyze data at the trader level, the FCM level, and the DCO level based on a variety of criteria. As discussed in greater detail below, RSG uses SPARK, in conjunction with LTRS, to identify large traders and FCMs with positions that warrant closer monitoring during periods of market volatility.

SRM (SPAN Risk Manager). SRM is the system used by the futures industry in the United States and many other countries to calculate performance bond requirements. The RSG uses it to determine the current performance bond requirements for positions of interest and to conduct stress tests of such positions.

SHAMIS (Shared Market Information System). SHAMIS is a system developed by the DCOs through which they share data about daily settlements. For any given FCM, information is shared among those DCOs at which it is a clearing member. The RSG receives data about all members at all participating DCOs.

DCO Performance Bond Reports. On a monthly basis, each DCO reports to the RSG the amount of performance bond required and on deposit for each clearing FCM. This data is used by the RSG in assessing the financial resources available to meet risks at each clearing FCM and DCO.

[116] Reports include Form 204 for grains and the soy complex and Form 304 for cotton. 17 C.F.R. Part 19.
[117] 17 C.F.R. Part 18.

RSR (Regulatory System Review) Express. RSR is the system used by CFTC staff to review the monthly financial statements filed by FCMs. The RSG uses RSR in evaluating the capital resources of FCMs relative to the risks posed to them by their proprietary and customer positions.

DCO Financial Statements. The RSG periodically obtains and reviews financial statements prepared by DCOs in contexts such as SEC public company filings. The RSG uses this information in evaluating the financial resources of DCOs relative to the risks posed by their clearing FCMs.

News/Price Sources. The RSG monitors several online news and price sources throughout the day. For example, price data from a service called Futures Source is used each day in determining the extent to which price changes have eroded performance bond coverage.

Risk surveillance essentially contains four components: (1) identifying traders, FCMs, and DCOs at risk; (2) estimating the magnitude of the risk; (3) comparing the risk to the available financial resources; and (4) assessing the risk management practices of traders, FCMs, and DCOs. The RSG uses the tools and resources noted above in a variety of ways to accomplish these tasks.

Identify Traders/FCMs/DCOs at Risk

Based on current market conditions. Each member of the RSG is assigned to monitor a particular set of products. Currently, the categories are: (1) agricultural; (2) currencies; (3) energy; (4) equities; (5) interest rates; and (6) metals. When a particular market becomes volatile, the assigned analyst uses LTRS and SPARK to identify large traders and their clearing FCMs, SRM to determine performance bond requirements for these traders and clearing FCMs, the DCO Performance Bond Report to gauge the amount of performance bond on deposit, and RSR to review capital information for the FCMs.

Within the SPARK system, the RSG has also developed other features that are used to identify market participants of interest. For example, the Daily Price Report shows for each contract the percentage of the performance bond requirement that would be used by that day's price change. The Top Day analysis enables the RSG to calculate the actual loss incurred by a trader or FCM in a given contract based on that day's price change and its positions as of the beginning of the day. The RSG can perform Top Day analysis for any contract and does so routinely for all markets where the price change is greater than or equal to 100% of the performance bond requirement (70% for Eurodollars, energies, and S&Ps).

Based on account characteristics. The RSG attempts to be proactive rather than reactive. Accordingly, RSG staff attempts to identify traders and FCMs who might pose risk before a market becomes volatile, not just after the volatility appears. A number of different characteristics may trigger further scrutiny.

Absolute size. Simple size can be an indicator of risk. Assigning responsibility to RSG staff on a market-by-market basis permits analysts to develop familiarity over time with the identity of the largest participants in their respective markets.

Short option size. Unlike futures, the risk of options is non-linear. That is, a price change that would cause a $1,000 change in the value of a futures position might cause a $20,000 change in the value of an option on that futures position. Accordingly, the RSG pays particular attention to large net short option positions.

Size relative to the market. A position that is not large in absolute terms but is large relative to the market may pose additional risk. Such a concentrated position may be difficult to liquidate quickly and without moving the market.

Size relative to the FCM's capital. Similarly, a position that is not large in absolute terms but is large relative to the FCM or DCO may pose additional risk. As discussed further below, the resources of the FCM and DCO are always a factor in assessing financial risk.

Size relative to the performance bond on deposit. Performance bond is the first layer of financial protection. A trader or FCM that is currently subject to a performance bond call poses greater risk than a trader or FCM with an identical position that has excess performance bond on deposit.

Size relative to the trader's assets. A large position held by a trader who is known to be well-capitalized would be of less concern than the same position held by a trader who did not have such "deep pockets." The RSG will contact the trader directly or obtain additional information about the trader from the DCO and/or FCM.

Size relative to a DCO's resources. In evaluating a DCO's financial resources, the RSG measures a DCO's ability to cover a default by the clearing FCM carrying the largest position. Greater concern would arise if positions on one side of a market were concentrated among a few clearing FCMs than if they were dispersed over many clearing FCMs.

Cumulative size across multiple markets. Although DCOs receive settlement information about common members through SHAMIS, they do not receive position information. The RSG attempts to identify traders and FCMs that pose significant risk at multiple DCOs.

News about a particular trader or FCM. The RSG may decide to perform additional analysis of a particular trader or FCM based on information that RSG staff learns from the newswires or CFTC or industry sources.

Estimate the Magnitude of the Risk

After identifying traders or FCMs at risk, the RSG estimates the magnitude of the risk. The SRM system enables RSG staff to calculate the current performance bond requirement for any trader or FCM. This amount is generally designed to cover approximately 99% of potential one-day moves.

SRM also enables RSG staff to conduct stress tests. RSG staff can determine how much a position would lose in a variety of circumstances such as extreme market moves. This is a particularly important tool with respect to option positions. As noted, the non-linear nature of options means that the loss resulting from a given price change may be many multiples greater for an option position than for a futures position in the same market. Moreover, the complexity of option positions can result in situations where the greatest loss does not correspond to the most extreme price move.

Data from SHAMIS also provides context in estimating potential risk. RSG staff is able to see what a typical daily settlement amount would be for each FCM at each DCO, as well as what the record amounts have been for each FCM at each DCO.

Compare Risks to Available Assets

After identifying accounts at risk and estimating the size of the risk, the third step is to compare that risk to assets available to cover it. Relevant assets include those of the trader, the FCM, and the DCO.

The first layer of protection is performance bond. As noted, the amount DCOs collect from FCMs is designed to cover approximately 99% of one-day moves. FCMs, in turn, are required to collect from their customers an amount that is set by exchange rules. This level is generally about 30% higher than at the DCO. Furthermore, FCMs may charge any customer an amount above the exchange minimum based on an assessment of that customer's risk profile. Therefore, in the great majority of cases, the amount of performance bond on deposit will cover any price change.

To confirm that this remains the case, the RSG monitors the actual level of coverage being achieved by DCO performance bond levels. Using the information collected in SPARK, the RSG prepares two monthly reports analyzing the adequacy of performance bond levels. One report focuses on twenty-four (24) benchmark contracts and compares each contract's performance bond level to the largest market moves over the last six (6) and twelve (12) months. The other reviews all contracts for breaches of performance bond levels during the last thirty (30) days and notes whether performance bond changes were made.

Of course, even 99% coverage means that on 2 or 3 days a year a price change may exceed the performance bond amount. In such instances, the issue then becomes whether the trader can meet its obligations. A well-capitalized corporation holding a particular position might be deemed a lesser risk than a smaller company holding the same position.

The second layer of protection is the FCM's capital. As noted, RSR provides the RSG with access to detailed information about an FCM's financial resources. These resources can be compared to the risks posed by particular traders with large positions or the cumulative risk to the FCM across all customers and markets. Concentration of positions is a key factor. For example, one customer with a 1,000-lot position is riskier to an FCM than 1,000 customers with one lot each.

The third layer of protection is the DCO. The RSG compares the risk posed by the largest clearing member to a DCO's financial resource package. The RSG analyzes not only the size of the DCO package but also its composition. In the event of a default, a DCO must have access to sufficient liquidity to meet its obligations as a central counterparty on very short notice.

In conclusion, the RSG has implemented a comprehensive regime for monitoring and continuously evaluating the risk that open positions or credit exposures pose to the market or to an FCM.

b) Access to information, if needed, on the size and beneficial ownership of positions held by direct customers of market intermediaries?

Yes. The CFTC's large trader reporting system (LTRS) daily collects information on beneficial ownership of reportable positions. Since traders frequently carry futures positions through more than one reporting firm and since individuals sometimes control, or have a financial interest in more than one account, the Commission routinely collects information that enables its surveillance staff to aggregate related accounts. Reporting firms must file a form which identifies each new account with reportable positions for each futures contract. In addition, if a trader's position reaches a reportable level, the trader may be required to file a more detailed identification report to identify accounts and reveal any relationships that may exist with other accounts or traders.[118]

An additional monitoring mechanism allows surveillance economists to investigate further the positions of large traders by instituting a "special call," which requires a trader to report their futures and option positions with all firms, or their cash market or OTC positions.[119] The trader is required to give information on their trading and delivery activity. This mechanism may be used when a trader is using too many firms to be easily monitored through required reports. Special calls also may be used to examine cash market positions and commitments in relation to futures market positions to access the

[118] The FCM, clearing member or foreign broker identifies special accounts on CFTC Form 102. 17 C.F.R. 17.01. The trader furnishes required information on CFTC Form 40. 17 C.F.R. 18.04. CFTC daily enters these forms into its Integrated Surveillance System. Blank copies of the Form 102 and Form 40 are available for viewing and downloading at the CFTC's Web site.

[119] *See, generally*, 17 C.F.R. Parts 18 and 21.

economic rationale of the trader's overall position. The Commission thus has the authority and techniques to investigate and discover the identities of the true account owners and controllers of large positions, whether domestic or foreign.

c) The power to take appropriate action against a market participant that does not provide relevant information needed to evaluate an exposure (e.g., require liquidation of positions, increase margin requirements and/or revoke trading privileges)?

Yes. Both the CFTC and DCMs have the power to suspend and halt trading, set margin, position limits, price limits, "circuit breakers" or otherwise intervene in the market.

CFTC Authority. CEA Section 5(d) requires a board of trade to adopt rules to provide for the exercise of emergency power and Section 8a(7) of the CEA authorizes the CFTC to alter or supplement the rules of a registered entity, and Section 8a(9) of the CEA authorizes the CFTC to direct a registered entity to take such action as in the CFTC's judgment is necessary to maintain or restore orderly trading in or liquidation of any futures contract, including but not limited to the setting of temporary emergency margin levels on any futures contract and the fixing of limits that may apply to a market position. CFTC enforcement powers are comprehensive and authorize civil injunctive actions for failing to comply with requests for required information and subpoena enforcement actions for failure to comply with subpoena demand for documents or testimony. Failure to comply with a court order is punishable by contempt of court.

Contract market Requirements.

Core Principle 6 of Section 5(d) of the CEA provides that:

> The board of trade shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, where necessary and appropriate, including the authority to –
>
> (A) liquidate or transfer open positions in any contract;
>
> (B) suspend or curtail trading in any contract; and
>
> (C) require market participants in any contract to meet special margin requirements.

Appendix B to Part 38 of the CEA provides the following CFTC Guidance on Core Principle 6 of Section 5(d):

> (a) Application Guidance. A DCM should have clear procedures and guidelines for contract market decision-making regarding emergency intervention in the market, including procedures and guidelines to avoid conflicts of interest while carrying out such decision-making. A contract market should also have the authority to intervene as necessary to maintain markets with fair and orderly trading as well as procedures for carrying out the intervention. Procedures and guidelines should also include notifying the Commission of the exercise of a

contract market's regulatory emergency authority, minimizing conflicts of interest, and documenting the contract market's decision-making process and the reasons for using its emergency action authority.

(b) Acceptable Practices. As is necessary to address perceived market threats, the contract market, among other things, should be able to impose position limits in particular in the delivery month, impose or modify price limits, modify circuit breakers, call for additional margin either from customers or clearing members, order the liquidation or transfer of open positions, order the fixing of a settlement price, order a reduction in positions, extend or shorten the expiration date or the trading hours, suspend or curtail trading on the market, order the transfer of customer contracts and the margin for such contracts from one member (including non-intermediated market participants) of the contract market to another, or alter the delivery terms or conditions, or, if applicable, should provide for such actions through its agreements with its third-party provider of clearing services.

See Appendix B to Part 38 at *http://www.cftc.gov/industryoversight/tradingorganizations/designatedcontractmarkets/index.htm*.

d) The general power to take appropriate action, such as to compel market participants carrying or controlling large positions to reduce their exposures or to post increased margin?

Yes. Both the CFTC and exchanges have the power to compel market participants to reduce their exposures or to post increased margin.

The market surveillance process is not conducted exclusively at the CFTC. Surveillance issues are usually handled jointly by the CFTC and the affected exchange. Relevant surveillance information is shared and, when appropriate, corrective actions are coordinated. Potential problem situations are jointly monitored and, if necessary, verbal contacts are made with the brokers or traders who are significant participants in the market in question. These contacts may be for the purpose of asking questions, confirming reported positions, alerting the brokers or traders as to the regulatory concern for the situation, or warning them to conduct their trading responsibly. This “jawboning” activity by the Commission and the exchanges has been quite effective in resolving most potential problems at an early stage.

The Commission customarily gives the exchange the first opportunity to resolve problems in its markets, either informally or through emergency action. If an exchange fails to take actions that the Commission deems appropriate, the Commission has broad emergency powers under which it can order the exchange to take actions specified by the Commission. Such actions could include limiting trading to liquidating transactions, imposing or reducing limits on positions, requiring the liquidation of positions, extending a delivery period, or closing a market. Fortunately, most issues are resolved without the need to use the CFTC's emergency powers. The fact that the CFTC has had to take

emergency actions only four times in its history demonstrates the potency of the other available tools to avoid disorderly liquidations or default.

See CFTC Emergency Authority Background at *http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/cftcemergencyauthoritybackgrou.pdf.*

2) Do arrangements, whether formal or informal, exist to enable markets and regulators to share information on large exposures of common market participants or on related products with regulators and markets:

a) In the domestic jurisdiction?

Yes.

With DCMs. The CFTC and futures exchanges have executed agreements to share information that is prompted by, among other things, large exposures. The Commission essentially has the same information that DCMs have with respect to large exposure information. Wherever the exchanges manage position limits, they inform the Commission of any exemptions granted. The Exchanges are able to monitor the exposure size within each contract on an intraday basis. Frequent conversations occur between exchange and Commission staff when liquidation or acquisitions of large exposures create a heightened concern. This has become more relevant with the increased open interest held by large passive long-only traders (index traders).

In some specific contracts, when traders hold positions above a certain threshold they are required to disclose their full portfolio of related products. This rule was implemented in the wake of the disruptive activity by Amaranth Advisors in the Natural Gas futures contract traded on the NYMEX. These "exposure forms" are filed before the last day of trading of a specific contract month and are forwarded to CFTC surveillance staff. The need for this special disclosure derives from the existence of a large OTC market that is directly linked to the futures contract, and for positions which are not observable by the Exchange. This model could be replicated in other contracts as the need arises.

With Exempt Commercial Markets. The increasing volume traded on ECMs that settle off a futures contract has prompted the Commission to increase oversight of certain "linked contracts". The Commission has issued rules regarding a category of contract deemed to be Significant Price Discovery Contracts (SPDCs) which encompasses linked contracts. Under these rules, ECMs and Clearinghouses will have the same reporting obligations with respect to SPDCs as DCMs have for futures contracts. In the meantime, a hybrid situation exists in which the ECM is reporting a form of large trader positions but not yet meeting the quality standards the CFTC requires.

With cash market regulators. Surveillance staff briefs Commissioners every Friday on current issues with various contracts and will regularly invite staff from the corresponding cash market regulatory agency. In two instances the need to formalize communications has led to the establishment of MOUs.

FERC - Though the MOU is focused in the sharing of retrospective information, the relation supports ongoing communications between surveillance staffs. The majority of communications relates to market fundamentals but it may cover position or market power related information when it is relevant and available. For example, the control over strategic assets (pipelines, storage) and trading conditions in cash markets.

USDA - An MOU is currently under development to facilitate the exchange information in cash and futures markets and will include information relevant to position and market power.

FTC - As the FTC develops its anti-manipulation rule in petroleum markets, CFTC staff anticipate an MOU will be entered into in similar terms to those with USDA and FERC.

EPA - The EPA posts in its Web site the current holdings of SO2 and NOx permits by party. Since this information is public, CFTC staff does not regularly engage with the EPA in the monitoring of exposures.

On the environmental markets, the CFTC is engaged in talks with two regional regulators of greenhouse gases (the Regional Greenhouse Gases Initiative and the Western Climate Initiative) to find ways of exchanging information to prevent market manipulation or distortions arising from large exposures or any other means.

For information on the coordinating mechanisms with other domestic financial regulators (*e.g.*, SEC), *see infra*, response to Principle 28, Question 4.

b) In other relevant jurisdictions?

The Declaration on Cooperation and Supervision of International Futures Markets and Clearing Organizations ("Declaration"), and its companion Exchange Memorandum of Understanding (Exchange MOU),[120] was at the core of improvements in international cooperation contemplated at the 1995 Windsor meeting (which was convened following the collapse of Barings Plc.) That meeting, and the resulting *Windsor Declaration*, set in motion a series of international initiatives at both the regulatory and market level intended to enhance the resilience of the financial marketplace against the shocks or stress caused by such defaults. The *Declaration* (and companion Exchange MOU) were created to address the problem of accessing information about large exposures where exchange member firms and market participants typically trade on multiple exchanges and no one regulator or market authority will have all of the information necessary to evaluate the risks in its markets.

Under the *Declaration*, the occurrence of agreed triggering events affecting an exchange member's financial resources, positions, price movements or price relationships, or events suggesting manipulation or other abusive conduct, will prompt the sharing of

[120] *Report on Cooperation Between Market Authorities and Default Procedures, supra*, at page 4 ¶ 8 regarding the promotion of formal/informal mechanisms. See also *Report on Trading Halts and Market Closures.* (October 2002). pp. 23-24.

information. *See Declaration* paragraphs 2.2 and 2.3. Although the *Declaration* is a multilateral arrangement containing appropriate confidentiality and use restrictions (and can serve as an independent arrangement for structuring the sharing of information), the *specific* implementation of any request pursuant to the *Declaration* will be on a bilateral basis and remain subject to any existing bilateral arrangements. Similarly, under the *Declaration*, the occurrence of agreed triggering events affecting an exchange member's financial resources, positions, price movements or price relationships will prompt the sharing of information.

A special situation has arisen in WTI Crude Oil with the trading of a financially settled futures contract on ICE Europe which settlement price is directly linked to a contract trading on the NYMEX. Given that these two contracts are in effect a single market, on November 17, 2006 the CFTC and the United Kingdom Financial Services Authority (FSA) entered into Memorandum of Understanding concerning consultation, cooperation and the exchange of information related to market oversight. Under this MOU, the FSA and CFTC share information on a daily basis regarding large exposures.

3) **Does a market authority make its default procedures available to market participants, including specifically information concerning:**

a) The general circumstances in which action may be taken?

b) Who may take it?

c) The scope of actions which may be taken?

As mentioned above, if an FCM is executing transactions on a DCM, then such FCM must clear such transactions through a DCO. A DCO is essential to managing systemic and counterparty risks in the event that a member FCM fails. Because of the importance of the DCO in the management of such risks, Section 5b(c)(2)(L) of the CEA requires that a DCO provide "information concerning the rules and operating procedures governing the clearing and settlement systems (including default procedures) available to market participants." In general, most DCOs make their default procedures, including information concerning (a), (b), and (c) above, accessible to the public via their Web site.

Also as mentioned above, if an FCM becomes the subject of bankruptcy proceedings, then Subchapter IV and Part 190 set forth a clear structure for the liquidation of such FCM. Both Subchapter IV and Part 190 are publicly available.

4) Do default procedures and/or national law permit markets and/or the clearing and settlement system(s) promptly to isolate the problem of a failing firm by addressing its open proprietary positions and positions it holds on behalf of customers or otherwise protect customer funds and assets from an intermediary's default under national law.

Yes. *See* response to Principle 24, Question 1.

5) Is there a mechanism by which market authorities for related products can consult with each other in order to minimize the adverse effects of market disruptions?

Yes. *See* response to Principle 24, Question 1.

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ADDENDUM

CFTC Regulation of DCOs

Introduction. A DCO is a central counterparty that "interposes itself between counterparties" to commodity contracts, thereby "becoming the buyer to every seller and the seller to every buyer."[121] A DCO guarantees that a member with net gains on its positions will receive related amounts, even if the DCO cannot collect such amounts from a member with net losses on its positions. Thus, a DCO is essential to managing systemic and counterparty risks, especially in the event that a member defaults.

Currently, if an FCM is executing transactions in commodity futures on a DCM, then such FCM is required to clear such transactions through a DCO. In order to clear such transactions, the FCM generally must be a member of the DCO,[122] and must therefore comply with the rules of the DCO, especially those pertaining to payments and settlements. The DCO monitors the FCM for compliance with such rules.

In general, if a DCO cannot collect payments from a member, or if a DCO believes that it will shortly be unable to collect such payments,[123] the DCO will declare the member to be in default. The rules of the DCO would govern the management of such default. Usually, such rules would permit: (i) the DCO to liquidate or transfer positions carried by the defaulting member; (ii) the DCO to access all property held in the proprietary accounts of the defaulting member; (iii) the DCO to access all property held in the omnibus customer account of the defaulting member, if such member defaulted to the DCO as a result of a customer default; and (iv) the DCO to access any amounts that the defaulting member had contributed to the guarantee fund. If the proceeds from (i) through (iv) do not cover all DCO losses, then the rules of the DCO may permit: (A) the DCO to access the amounts that non-defaulting members had contributed to the guarantee

[121] *See* Section 1.1 of CPSS-IOSCO *Recommendations for Central Counterparties*, dated as of November 2004.

[122] Most large FCMs are members of a DCO. If an FCM is not a member of a DCO ("Non-Clearing FCM"), it may become a customer of, and thereby clear transactions through, an FCM that is a member of a DCO ("Clearing FCM"). The Clearing FCM monitors the compliance of the Non-Clearing FCM with payment obligations. Pursuant to Regulation (as such term is defined below) 1.12(f)(2), the Clearing FCM has an affirmative responsibility to notify the CFTC whenever it determines that it must immediately liquidate or transfer the positions of a Non-Clearing FCM, or limit the Non-Clearing FCM to trading for liquidation only, because the Non-Clearing FCM has failed to meet its payment obligations to the Clearing FCM.

[123] In general, if a DCO suspects that a member would shortly be unable to make scheduled payments, a DCO would request that such member deposit additional performance bond. If the member is unable to make such deposit, then the DCO would declare such member to be in default.

fund; (B) the DCO to look to its own capital; and (C) the DCO to levy an assessment on all members.

The CFTC supervises DCOs in three main ways. First, the CFTC evaluates applications from entities seeking to become DCOs. Second, the CFTC conducts periodic reviews of already registered DCOs. Third, the CFTC surveys, on a daily basis, DCO exposures and compares such exposures to DCO financial resources. Additionally, the CFTC may review and approve DCO rules.

Procedures for Registration of DCOs. Under Section 5b of the CEA (7 U.S.C. 7a-1(a)), an entity that wants to register as a DCO must submit an application to the CFTC which demonstrates that it complies with the core principles applicable to DCOs under Section 5b(c)(2)(A) through (N) of the CEA (7 U.S.C. 7a-1(c)(2)(A) –(N)). Part 39 of the Regulations sets forth the application procedures, with Appendix A thereto providing guidance to applicants on how to demonstrate compliance with the core principles.

The core principles require DCOs to have (i) adequate financial, operational, and managerial resources, (ii) appropriate standards for participant and product eligibility, (iii) adequate and appropriate risk management capabilities, (iv) the ability to complete settlements on a timely basis under varying circumstances, (v) standards and procedures to protect member and participant funds, (vi) efficient and fair default rules and procedures, (vii) adequate rule enforcement and dispute resolution procedures, and (viii) adequate and appropriate systems safeguards, emergency procedures, and plans for disaster recovery.

Additionally, the core principles require DCOs to (A) provide necessary reports to facilitate CFTC oversight, (B) maintain all business records for five years in a form acceptable to the CFTC, (C) make available to the public its rules and operating procedures, (D) participate in appropriate domestic and international information-sharing agreements, and (E) avoid actions that are unreasonable restraints of trade or that impose anti-competitive burdens on trading.

Under Regulation 39.3(a)(2), a DCO application must include a copy of the applicant's rules and an explanation of how the applicant is able to satisfy each of the core principles. The DCO application also must provide a copy of relevant agreements with participants or others, as well as descriptions of relevant system test procedures, tests conducted, or test results. The CFTC publishes non-confidential portions of the DCO application on its website for public comment, although such publication is not required by statute or regulation. [124]

Staff members from DCIO evaluate DCO applications and make a recommendation to the CFTC. Based on such recommendation, the CFTC will approve the application, register the applicant as a DCO subject to conditions, or deny the application. If an

[124] For an example of the types of information that may be included in a DCO application, please refer to the DCO application submitted by ICE Clear Europe Limited, which could be accessed at: http://www.cftc.gov/newsroom/generalpressreleases/2009/pr5687-09.html.

application is denied, the applicant will be afforded the opportunity for a hearing on the record before the CFTC, with the right to appeal an adverse decision to the court of appeals.

Core Principle Reviews of DCOs. As mentioned above, Section 5b(c)(2)(A) through (N) of the CEA sets forth core principles that a DCO must comply with to be registered with the CFTC. DCOs are given reasonable discretion in establishing the manner in which they comply, consistent with guidance provided by the CFTC in Part 39 of the Regulations.

The CFTC evaluates compliance with the core principles when reviewing DCO applications, and for DCOs that are already registered, the CFTC conducts periodic reviews to assess their compliance with the core principles on an ongoing basis. The objectives of the Core Principle reviews are: (i) to gain a thorough understanding of the DCO's methods for meeting Core Principle standards; (ii) to identify any deficiencies in compliance; and (iii) to initiate corrective action if necessary.

A Core Principle review may focus on one or two core principles and assess the compliance of multiple DCOs with those particular core principles (horizontal review), or it may focus on a particular DCO and the compliance of that DCO with multiple core principles (vertical review). The CFTC plans its Core Principle reviews based on an assessment of risk.

Once DCIO staff members are selected to participate in the review, the CFTC sends an engagement letter to the DCO, which usually includes a request that the DCO provide relevant documents and information to the CFTC. DCIO staff members review these materials and use them to formulate a list of questions to ask in a site visit.

After the site visit, DCIO staff members compile their notes from the site visit, conduct independent analysis and testing, and prepare any follow-up questions for the DCO. Once DCIO staff members are satisfied that the review is complete, a detailed written report for the CFTC is prepared. The report includes DCIO analysis, conclusions, and recommendations, if any, for corrective action.

Once the CFTC has considered the report and decided on the appropriate response, the DCO is notified of the review's significant findings and any recommendations for corrective action. After a reasonable amount of time has passed, the CFTC will follow up with the DCO to find out what steps the DCO has taken to implement the CFTC's recommendations.

Risk Surveillance Program. On a daily basis, the Risk Surveillance Group within DCIO endeavors: (i) to identify significant financial risks from positions in products that (A) an FCM clears through a DCO, and (B) fall within the jurisdiction of the CFTC; and (ii) to confirm that such financial risks are being appropriately managed. The Risk Surveillance Group undertakes these tasks at the trader level, the firm level, and the clearing level. It

identifies both traders that pose risks to FCMs and FCMs that pose risks to DCOs. It also reviews financial resources and risk management practices at traders, FCMs, and DCOs.

As described in greater detail in CFTC responses to IOSCO Principle 29, the Risk Surveillance Group reviews the following data: (i) large trader position information; (ii) performance bond information; (iii) FCM financial information; and (iv) DCO financial information. The Risk Surveillance Group gathers such information using the following tools: (i) SPARK, an internally-developed CFTC system, and (ii) SPAN Risk Manager, a DCO-developed margining and stress testing system. Upon identifying positions that have significant risk, the Risk Surveillance Group conducts stress tests to estimate the size of the risk and compares potential losses to available resources. Stress testing is conducted both for individual traders and for FCMs. The Risk Surveillance Group then compares results from stress testing to performance bond on deposit, FCM capital, and DCO resources.

After such comparison, the Risk Surveillance Group follows up, as appropriate, with traders, FCMs, and/or DCOs. The discussions may address trading strategies, financial resources, operational procedures, and/or risk management procedures. Follow-up may include on-site visits.

The Risk Surveillance Group prepares and maintains a number of reports that are used in its risk evaluation and follow-up process. For example, the Risk Surveillance Group monitors the actual level of coverage being achieved by performance bond requirements and prepares two monthly reports analyzing the adequacy of performance bond levels. One report focuses on 24 benchmark contracts and compares each contract's performance bond level to the largest market moves over the last 6 and 12 months. The other reviews all contracts for performance bond level breaches during the last 30 days and notes whether changes were made. The Risk Surveillance Group also maintains records showing the daily settlement amount and record amounts for each FCM at each DCO.

DCO Rule Approvals. Under Section 5c(c)(2) of the CEA (7 U.S.C. 7a-2(c)(2)) and as provided in Regulation 40.5, a DCO may request that the CFTC approve a new or amended rule prior to implementation.

The submission must include the text of the rule, the proposed effective date, any action taken or anticipated to be taken to adopt the proposed rule, and the rules of the DCO that authorize the adoption of the proposed rule. The request must explain the operation, purpose, and effect of the proposed new or amended rule, including, as applicable, a description of the anticipated benefits to market participants or others, any potential anticompetitive effects on market participants or others, how the rule fits into the DCO's framework of self-regulation, and any other information that may be beneficial to CFTC staff in analyzing the proposed rule. If a proposed rule affects the application of any other rule of the DCO, the request must set forth the relevant text of any such rule and describe the anticipated effect. The request must describe any substantive opposing views expressed to the DCO by its governing board, board committee members, members of the DCO, or its market participants if such views are not incorporated into the

proposed rule. In addition, the request must identify and discuss any Regulation that may need to be amended, or CEA section or Regulation that may need to be interpreted, in order to approve the proposed rule.

The CFTC usually publishes requests for approval on its website and typically allows a public comment period, although public notice and comment are not required by the CEA or the Regulations.

Section 5c(c)(3) of the CEA (7 U.S.C. 7a-2(c)(3)) provides that the CFTC shall approve any new rule or rule amendment unless it finds that it would violate the CEA. If the CFTC finds a rule would violate the CEA it will notify the DCO and explain the issues raised.

ANNEX: MEMORANDA OF UNDERSTANDING

Cooperative Enforcement

- Argentina – Comision Nacional de Valores (CNV), MOU on Consultation, Technical Assistance, and Mutual Assistance for the Exchange of Information, May 30, 1995
- Australia – Australian Securities Commission (now Australian Securities and Investments Commission) ASIC, MOU concerning Consultation and Cooperation in the Administration and Enforcement of Futures Laws, October 19, 1994
- Brazil – Comissão de Valores Mobiliários (CVM), MOU on Mutual Assistance and Exchange of Information, April 12, 1991
- Canada – Ontario Securities Commission (OSC), MOU, July 7, 1992
- Canada – Commission des valeurs mobilières du Québec (CVMQ), MOU, July 7, 1992
- Dubai – Dubai Financial Services Authority (DFSA), Protocol Concerning Mutual Assistance, Information Sharing and Cooperation Agreements, December 1, 2005
- France – Commission des Opérations de Bourse (COB), Administrative Agreement, June 6, 1990. The CFTC and the COB also signed a Mutual Recognition MOU (MRMOU) that provides for information sharing to facilitate monitoring and compliance matters related to the mutual recognition of intermediaries and products. 55 Fed. Reg. 23902 (June 13, 1990)
- Germany – Bundesaufsichtsamt für den Wertpapierhandel (BAWe), MOU concerning Consultation and Cooperation in the Administration and Enforcement of Futures Laws, October 17, 1997
- Hong Kong – Securities and Futures Commission (SFC), MOU concerning Consultation and Cooperation in the Administration and Enforcement of Futures Laws, October 5, 1995
- Ireland – Irish Financial Services Regulatory Authority (IFSRA), The CFTC-IFSRA Statement of Intent concerns consultation and cooperation in the administration and enforcement of futures laws, March 17, 2004. The Statement of Intent (SOI) provides a framework for information sharing, thereby facilitating cooperation in cross-border investigations of potential violations of commodity futures and options laws.
- Isle of Man – Financial Supervision Commission (FSC), Statement of Intent Concerning Mutual Assistance and Cooperation Arrangements, April 12, 2005
- Italy – Commissione Nazionale per le Società e la Borsa (CONSOB), MOU on Consultation and Mutual Assistance for the Exchange of Information, June 22, 1995

- Japan – The Japanese Financial Services Agency (FSA) and the U.S. Securities and Exchange Commission (SEC), Statement of Intent Concerning Cooperation, Consultation and the Exchange of Information, May 17, 2002

- Jersey – The Jersey Financial Services Commission (FSC) and the U.S. Securities and Exchange Commission (SEC), MOU Concerning Cooperation, Consultation and the Exchange of Information, May 30, 2002

- Mexico – Comisión Nacional Bancaria y de Valores (CNBV), MOU on Consultation, Technical Assistance, and Mutual Assistance for the Exchange of Information, May 11, 1995

- The Netherlands – Government of the Kingdom of the Netherlands, Agreement (through the Government of the United States of America) on Mutual Administrative Assistance in the Exchange of Information in Futures Matters, April 29, 1993. The Ministry of Finance designated the Securities Board of the Netherlands (the Dutch futures, options, and securities regulator) and the Dutch Central Bank (the regulator for collective investment schemes) to implement the Agreement, which entered into force on February 1, 1994, after approval by the Dutch Parliament.

- New Zealand – New Zealand Securities Commission (NZSC), MOU on Consultation and Mutual Assistance for the Exchange of Information, September 16, 1996

- Portugal – Commissão do Mercado de Valores Mobiliários (CMVM), MOU concerning Consultation and Cooperation in the Administration and Enforcement of Futures Laws, February 4, 1999

- Singapore – Monetary Authority of Singapore, MOU concerning Consultation, Cooperation and the Exchange of Information (concluded jointly with the U.S. Securities and Exchange Commission), May 16, 2000

- South Africa – Financial Services Board of the Republic of South Africa (FSB), Joint Communiqué on Exchange of Information for Cooperation and Consultation, May 27, 1997

- Spain – Comisión Nacional del Mercado de Valores (CNMV), MOU on Mutual Assistance and Exchange of Information, October 26, 1992

- Switzerland – Swiss Confederation, Diplomatic Notes (through the U.S. government) amending Article 1, Paragraph 3 of the Treaty on Mutual Assistance in Criminal Matters (MLAT), November 3, 1993

- Taiwan – Securities and Futures Commission, MOU between the CFTC and the Taiwan Securities & Exchange Commission (now the Securities & Futures Commission) through, respectively, the American Institute in Taiwan and the Coordination Council for North American Affairs (now the Taipei Economic and Cultural Representative Office in the United States), January 11, 1993

- Turkey – Capital Markets Board Of Turkey, MOU between the CFTC and the Capital Markets Board of Turkey concerning Consultation, Cooperation, and the Exchange of Information, June 25, 2001

- United Kingdom – Department of Trade and Industry, MOU on Exchange of Information in matters relating to Securities and Futures concluded jointly with the U.S. Securities and Exchange Commission, September 23, 1986

- United Kingdom – Department of Trade and Industry (DTI), Securities and Investments Board (SIB) (now Financial Services Authority (FSA)), MOU on Mutual Assistance and Exchange of Information, concluded jointly with the U.S. Securities and Exchange Commission, September 25, 1991; HM Treasury (HMT) (added on May 9, 1994)

Information Sharing for Supervisory, Prudential, and Risk Assessment Purposes and Regulation of Cross-border Futures Activity

- France – Conseil des Marches Financiers, MOU regarding information sharing on remote members of regulated markets, March 21, 2002
- Hong Kong – Securities and Futures Commission (SFC), Declaration on Cooperation and Supervision of Cross-Border Managed Futures Activity, October 5, 1995
- Italy – Commissione Nazionale per le Società e la Borsa (CONSOB), Exchange of letters relating to the listing of equity-based futures contracts, April 5, 2000
- Italy – Commissione Nazionale per le Società e la Borsa (CONSOB), Supplemental MOU to facilitate the recognition of regulated markets, September 11, 2000
- Multilateral Arrangement – Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations, March 15, 1996 (as amended) ("Boca Declaration").[125]

[125] The Boca Declaration and a companion exchange MOU constitute multilateral mechanisms for sharing information on a bilateral basis between the requesting and requested market authority consistent with their legal and contractual obligations. The documents establish mechanisms whereby the occurrence of certain agreed triggering events affecting an exchange member's financial resources or positions will prompt the sharing of information under the Boca Declaration and/or MOU. The trigger levels are designed to facilitate the identification of large exposures by firms that could have a potentially adverse effect on markets.

The Boca Declaration signed in March 1996 was amended in October 1997 to delete language that had prevented certain regulators from signing the Declaration. In March 1998, the Declaration was amended again to permit regulators to make requests for information based upon possible manipulative or other disruptive conduct.

Signatories as of April 2002: Comisión Nacional de Valores (Argentina); Australian Securities and Investments Commission (Australia); Ministry of Finance (Austria); Commission bancaire et financière (Belgium); Comissão de Valores Mobiliários (Brazil); Commission des valeurs mobilières du Québec (Canada, Québec); Ontario Securities Commission (Canada, Ontario); Danish Financial Supervisory Authority/Finanstilsynet (Denmark); Commission des Opérations de Bourse (France); Bundesaufsichtsamt für den Wertpapierhandel (Germany); Securities and Futures Commission (Hong Kong); Hungarian Banking and Capital Market Supervision (Hungary); Central Bank of Ireland (Ireland); Commissione Nazionale per le Società e la Borsa (Italy); Ministry of International Trade and Industry (Japan); Ministry of Agriculture, Forestry and Fisheries (Japan); Securities Commission (Malaysia); Securities Board of the Netherlands (Netherlands); New Zealand Securities Commission (New Zealand); Comissão do Mercado de Valores Mobiliários (Portugal); Monetary Authority of Singapore (Singapore); Financial Services Board (South Africa); Comisión Nacional del Mercado de Valores (Spain); Financial Supervisory Authority/Finansinspektionen (Sweden); Securities and Futures Commission (Taiwan); Capital Markets Board (Turkey); Financial Services Authority (United Kingdom); Commodity Futures Trading Commission (United States).

- United Kingdom – Financial Services Authority (FSA), MOU concluded jointly with the US SEC, October 28, 1997

- United Kingdom – Financial Services Authority (FSA), Arrangement on Warehouse Information to facilitate exchanges of information for surveillance and enforcement purposes regarding deliverable commodities, May 17, 2000

- United Kingdom – Financial Services Authority (FSA), MOU concerning consultation, cooperation and the exchange of information related to market oversight, November 17, 2006

Financial Information Sharing

- Canada – Ontario Securities Commission, Commission des valeurs mobilieres de Quebec (and Canadian SROs), Financial Information-Sharing MOU, September 23, 1991
- United Kingdom – Securities and Investments Board (now Financial Services Authority) (and UK SROs), Financial Information-Sharing MOU, September 1, 1988; Addendum to Financial Information-Sharing MOU, May 15, 1989

Information Sharing related to Technical Assistance

- Chile – Superintendencia de Valores y Seguros de Chile, MOU regarding futures regulatory cooperation and the provision of technical assistance, September 13, 2002
- China – China Securities Regulatory Commission, MOU regarding regulatory cooperation and the provision of technical assistance, January 18, 2002
- India – Forward Markets Commission, Arrangement regarding regulatory cooperation and technical assistance, October 18, 2006
- India – Securities and Exchange Board of India (SEBI), MOU regarding regulatory cooperation, consultation, and the provision of technical assistance, April 28, 2004
- Russia – Commodities' Exchanges Commission of the Ministry of the Russian Federation Anti-Monopoly Policy and Support of Entrepreneurship, Joint Statement regarding cooperation, consultation, and the provision of technical assistance, December 11, 2000
- Thailand – Office of the Agricultural Futures Trading Commission, Arrangement regarding regulatory cooperation and technical assistance, March 26, 2006

Multilateral Arrangements and Information Sharing with US Government Agencies

- United States – CFTC and SEC, MOU Regarding the Oversight of Security Futures Product Trading and the Sharing of Security Futures Product Information, March 17, 2004[126]

- IOSCO – IOSCO MMOU Concerning Consultation and Cooperation and the Exchange of Information, May 2002[127]

[126] The CFTC-SEC MOU covers the oversight of security futures product (SFP) trading and the sharing of security futures product information. Pursuant to the Commodity Futures Modernization Act of 2000 the CFTC and the SEC have joint authority for the oversight and regulation of security futures products. With respect to security futures products, the MOU provides that the CFTC and the SEC will notify each other of any planned examinations, advise the other of reasons for an intended examination, provide each other with examination-related information, and conduct examinations jointly, if feasible. The CFTC and the SEC will also notify each other of significant issues arising from these markets and share trading data and related information for SFP activity. Implementation of this MOU should serve to increase the effectiveness and efficiency of the joint CFTC/SEC oversight of SFPs. In November 2002, OneChicago and NQLX began trading these products under the joint supervision of the agencies. The sharing of information and coordination recognized under this memorandum is an important element in providing oversight that is effective but avoids unnecessary regulatory burdens.

[127] The IOSCO MMOU is the first worldwide multilateral enforcement cooperation arrangement among securities and derivatives regulators. The IOSCO MMOU provides for the exchange of essential information to investigate cross-border securities and derivatives violations, including the most serious offenses, such as manipulation, insider trading and customer fraud. The MOU enables regulators to share critical information, including bank, brokerage, and client identification records and to use that information in civil and criminal prosecutions.

Signatories: Alberta: Alberta Securities Commission; Australia: Australian Securities and Investments Commission; British Columbia: British Columbia Securities Commission; France: Commission des opérations de bourse; Germany: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin); Greece: Capital Market Commission; Hong Kong: Securities and Futures Commission; Hungary: Hungarian Financial Supervisory Authority; India: Securities and Exchange Board of India (SEBI); Italy: Commissione Nazionale per le Società e la Borsa; Jersey: Jersey Financial Services Commission; Lithuania: Lithuanian Securities Commission; Mexico: Comisión Nacional Bancaria y de Valores; New Zealand:New Zealand Securities Commission; Ontario: Ontario Securities Commission; Poland: Polish Securities and Exchange Commission; Portugal: Comissão do Mercado de Valores Mobiliários; Quebec: Commission des valeurs mobilières du Québec; Spain: Comisión Nacional del Mercado de Valores; South Africa: Financial Services Board; Turkey: Capital Markets Board; United Kingdom: Financial Services Authority; United States of America: CFTC and SEC.