

## COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 5, 15, 36, 37, 38, 40, 41, 100, 166, 170 and 180

RIN 3038-AB63

### A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed rules.

**SUMMARY:** The Commodity Futures Trading Commission (Commission or CFTC) is proposing rules to implement the Commodity Futures Modernization Act of 2000 and the Commission's new regulatory framework. These proposed rules apply to trading facilities. The proposed rules implement the new statutory framework establishing three new market categories, including exempt markets and two categories of markets subject to Commission regulatory oversight—designated contract markets and registered derivatives transaction execution facilities. These proposed rules implement statutory changes that profoundly alter federal regulation of commodity futures and option markets. Nothing in these rules, however, diminishes the Commission's responsibility for overseeing and enforcing compliance by self-regulatory organizations, Commission registrants and market participants with the provisions of the Commodity Exchange Act.

The remaining parts of the framework relating to clearing organizations and to intermediaries will be repropounded shortly.

**DATES:** Comments must be received by April 9, 2001.

**ADDRESSES:** Comments should be sent to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581, attention: Office of the Secretariat. Comments may be sent by facsimile transmission to (202) 418-5521 or, by e-mail to [secretary@cftc.gov](mailto:secretary@cftc.gov). Reference should be made to "Regulatory Reinvention."

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#### SUPPLEMENTARY INFORMATION:

##### I. Background

The Commission on June 22, 2000, proposed (65 FR 38986) and on December 13, 2000, issued (65 FR 77962) final rules promulgating a new regulatory framework to apply to multilateral transaction execution facilities that trade contracts for sale of a commodity for future delivery or commodity options. The final rules were to become effective on February 12, 2001. However, Congress on December 15, 2000, passed, and the President on December 21, 2000, signed into law, the Commodity Futures Modernization Act of 2000 (CFMA),<sup>1</sup> which substantially amended the Commodity Exchange Act, 7 U.S.C. 1 *et seq.* (Act). The Commission on December 28, 2000, withdrew most of the final rules in order to determine their consistency with the Act as amended. 65 FR 82272.

The Commission's new regulatory framework was intended to "promote innovation, maintain U.S. competitiveness, and at the same time reduce systemic risk and protect customers," 65 FR 38986, and to provide U.S. futures exchanges greater flexibility with which to respond to the competitive challenges brought about by new technologies.<sup>2</sup> Specifically, the

framework replaced "one-size-fits-all" regulation for futures markets with broad, flexible "core principles," and established three regulatory tiers for markets.

In general, the framework provided a lower level of regulatory oversight where access to an exchange or facility would have been restricted to eligible participants or commercial participants or where the nature of the underlying commodity would have posed a relatively low susceptibility to manipulation. This reflects the reduced need to monitor closely such markets. The Commission also provided that markets serving a price discovery function, irrespective of the product traded or market participants, offer a degree of price transparency. The framework therefore balanced the public interests of market and price integrity, protection against manipulation and customer protection with the need to permit exchanges and other trading facilities to operate more flexibly in today's competitive environment.

##### II. The Statutory Scheme

The Act, as amended by the CFMA, establishes two tiers of regulated markets, designated contract markets (contract markets) and registered derivatives transaction execution facilities (DTFs). In addition, the Act, as amended, provides for two markets exempt from regulation, exempt boards of trade and, under section 2(h)(3) of the Act, as amended, exempt commercial markets.

The CFMA, in both its broad contours and in many of its specific provisions, codifies the Commission's regulatory framework without significant change. It varies from the rules withdrawn by the Commission in a number of its details and renders unnecessary a number of Commission rules by enacting their provisions into statute. The Commission therefore is repropounding rules conforming to and implementing the amended statutory scheme.

##### III. The Proposed Rules

###### A. Designated Contract Markets

Proposed part 38 governs designated contract markets. Under the Act as amended, "designated contract markets" are those approved boards of trade or trading facilities on which contracts for future delivery on any commodity may be traded by any type

<sup>1</sup> See Commodity Futures Modernization Act of 2000, Appendix E, Pub. L. No. 106-554, 114 Stat. 2763 (2000).

<sup>2</sup> The President's Working Group on Financial Markets (PWG) and the chairmen of the Commission's congressional oversight committees encouraged the Commission to consider proposing such major revisions to the regulatory framework. 65 FR at 38987. Recognizing the importance of the OTC derivatives markets, the chairmen of the Senate and House Agriculture Committees asked the PWG to conduct a study of OTC derivatives markets. After studying OTC derivatives, the PWG on November 9, 1999, reported to Congress its recommendations. See *Over-the-Counter Derivatives Markets and the Commodity Exchange Act*, Report of the President's Working Group. The PWG report focused on promoting innovation, competition, efficiency, and transparency in OTC derivatives markets and in reducing systemic risk. Although specific recommendations about the regulatory structure applicable to exchange-traded futures were beyond the scope of its report, the PWG suggested that the Commission review existing regulatory structures (particularly those applicable to markets for financial futures) to determine whether they were appropriately tailored to serve valid regulatory goals.

Subsequently, by letter dated November 30, 1999, the Chairmen of the Senate and House Agriculture Committees, joined by additional senior Senators and Members of the House of Representatives, "encourag[ed] the Commission to use the exemptive

authority granted it by the Commodity Exchange Act to lessen regulatory burdens on United States' futures markets so that they may compete more effectively."

of market participant.<sup>3</sup> Proposed rule 38.2 exempts designated contract markets operating under this part from all other Commission rules not specifically reserved.<sup>4</sup>

Proposed rule 38.3 establishes the application and approval procedure for designation of new contract markets.<sup>5</sup> As proposed, applicants meeting the criteria will be deemed to be designated by the Commission 60 days after receipt of the application.<sup>6</sup> The proposed procedure permits the Commission to designate a contract market upon conditions. Applications must demonstrate that the contract market satisfies the criteria for designation under section 5(b) of the Act and the core principles for operation under section 5(d) of the Act. The application also must include a copy of the contract market's rules and, to the extent that compliance with the conditions for designation is not self-evident, a brief explanation of how the conditions for designation are satisfied. As provided under the Commission's current fast-track review rules, the applicant may not make substantive amendments to the application during the 60-day review period unless requested to do so by the Commission. Amended applications would be treated as being filed anew for purposes of fast-track review.

As proposed, the Commission may terminate the 60-day fast-track review if it appears during that period that the application violates or appears to violate, or if there is insufficient information to determine whether it would violate, the Act or Commission rules. The Commission, after terminating a fast-track review, will continue to review the application under the deadlines of section 6 of the

Act. Alternatively, within ten days of receiving a termination notification, the applicant may seek to have the Commission determine whether or not to institute a proceeding to deny a proposed designation application under section 6 of the Act.

Section 5 of the Act, as amended, requires that an applicant meet a number of designation requirements. Under the proposed rules, an applicant must also demonstrate its ability to comply with core regulatory principles. The Commission has proposed rules giving notice of how it will interpret the meaning of several of the statutory requirements.<sup>7</sup> In addition, the Commission has provided an appendix containing general guidance regarding application criteria and guidance with regard to acceptable practices for meeting the core principles.<sup>8</sup> As the Commission previously noted, the guidance establishes non-exclusive safe harbors. It does not establish a mandatory means of compliance with the core principles.

Section 5c of the Act permits designated contract markets to request that the Commission provide "prior" approval of the facility's rules and products. Proposed rule 38.4, pursuant to the Commission's exemptive authority under section 4(c) of the Act, provides designated contract markets the additional flexibility to request such approval at any time. Contract markets,

for competitive reasons, may wish to choose to list a new product for trading by certification and subsequently to request Commission approval. The Commission believes that, in light of the increased competitiveness of these markets, such procedural flexibility is in the public interest. Based on the Commission's prior administrative experience, it has simplified and streamlined the review procedures. Under these procedures, qualifying contract market rules that are voluntarily submitted for review would be eligible for review and approval in 45 days, half the time permitted under the Act.<sup>9</sup>

The Commission further proposes to exercise its section 4(c) exemptive authority to make less burdensome the statutory certification provision regarding contract market rules. Section 5c of the Act requires contract markets to certify that each and every rule or rule change does not violate the Act and Commission rules. However, based upon its experience administering the Act prior to its recent amendment, the Commission is of the view that many rules need not be so certified. Indeed, under prior practice, contract markets were required only to provide notice to the Commission when amending certain types of administrative rules, and in some instances, no notice was required. In light of the past successful conduct of its oversight duties without the submission of every rule change, the Commission believes that it is in the public interest to exempt contract markets from the requirement that they certify all rules. The Commission also believes that this additional flexibility is consistent with the overall intent and structure of the recent amendments to the Act.

As proposed, the Commission would permit contract markets simply to notify the Commission on a weekly basis of amendments to some types of rules, and would not require a certification or

<sup>3</sup> Prior to its recent amendment, the Act referred to "designated contract markets" as the Commission-approved products traded on a board of trade. Commission rules were consistent with that usage. The Act, as amended, however, uses the term "designated contract market" to refer to the approved or licensed market on which futures contracts and commodity options are traded. Part 38 refers to "designated contract markets" in this sense. The meaning of "designated contract market" in all other Commission rules must be inferred from the context.

<sup>4</sup> In addition, the Commission is proposing to delete a number of rules herein. With respect to those rules not reserved or deleted, the Commission intends to review its rulebook in its entirety and to remove all rules that have been superseded or that are otherwise no longer in force following completion of all of the rulemakings necessary to implement the CFMA.

<sup>5</sup> Section 5(c) of the Act, as amended, provides that existing boards of trade designated as a contract market are considered to be designated contract markets under the Act as amended.

<sup>6</sup> This 60-day review period is one-third of the 180-day review period permitted by the Act. *See* 7 U.S.C. 8(a).

<sup>7</sup> In particular, in proposed rule 38.3(b)(1) the Commission notes that the statutory designation requirement relating to preventing market manipulation includes the requirement that designated contract markets have a dedicated regulatory department or delegate that function. Proposed rule 38.3(b)(2) provides that the designation requirement relating to fair and equitable trading rules includes fair and timely availability to market participants of information regarding prices, bids and offers. This requirement may be satisfied by making such information available to traders through commercial vendors.

In addition, proposed rule 38.3(b)(3) makes clear that a trading facility applying for designation may satisfy the requirement that it have disciplinary procedures with respect to non-members by having the capacity to sanction non-member violations by expelling them or by denying them future access. The proposed guidance with respect to acceptable practices for core principles applicable to contract markets and DTFs has similar provisions.

<sup>8</sup> Separate from the Appendix providing guidance on compliance with the core principles, proposed rule 38.3(b)(4) clarifies that the core principle on fitness standards, in the context of proprietary, rather than mutually-owned exchanges, applies to natural persons with greater than a ten percent ownership interest in the facility or in its owners. Moreover, fitness requirements that apply to members are required by the Act. However, the Commission, in providing guidance with regard to this requirement, has made clear that some types of members, such as those who do not have voting rights or exercise disciplinary or governing responsibilities, meet the fitness requirements by meeting the applicable requirements for market access or participation.

<sup>9</sup> As noted above, prior to adoption of the CFMA, a board of trade or trading facility was required to be designated as a contract market in each specific contract traded thereon. As amended by the CFMA, however, the trading facility itself and not each contract is required to be designated as a contract market and contracts may be listed for trading pursuant to exchange certification. The facility also may request that the Commission review and approve new products.

Proposed rule 38.4(a) provides that any contract that has been submitted for Commission review and approved by the Commission may be labeled in the facility's rules as "Listed for trading pursuant to Commission approval." Contracts that were designated by the Commission as contract markets prior to December 21, 2000, may be labeled as approved by the Commission. Contracts listed for trading by exchange certification under the procedures then in effect under rule 5.3 are not eligible to be so labeled.

notification of changes to rules that relate solely to administrative or ministerial matters. Nevertheless, each contract market is required to have available a full and accurate record of the procedural history of each of its rules.

Proposed rule 38.5 provides for information requests to contract markets regarding compliance with the conditions for designation. These requests may be made for any oversight purpose.<sup>10</sup> In this regard, for example, the Commission may request designated contract markets to provide information relating to their operations or their practices in connection with their compliance with particular core principles or other conditions of their designation or in connection with the Commission's formulation of statements of acceptable practice and its general oversight responsibilities under the Act.

Proposed rule 38.6 makes clear that a violation of these part 38 rules is not intended to and does not constitute a basis for voiding an agreement, contract, or transaction that has been duly entered into. Under rule 38.6, a Commission proceeding to alter or supplement a rule, term, or condition of a contract for trading on the facility under section 8a(7) of the Act, to declare an emergency under section 8a(9), or to take any other action to require a designated contract market to take or refrain from taking specific action would not constitute grounds for rescinding contracts. This provision does not change applicable law and merely restates the existing understanding of the effect of such a Commission action on contracts entered into already.

#### *B. Derivatives Transaction Execution Facilities*

Proposed part 37 implements section 5a of the Act, as amended. Section 5a of the Act provides for registration by the Commission of a board of trade or trading facility under an intermediate level of regulation as a DTF. This new category of market is available to eligible traders for futures and option contracts on commodities that have a

nearly inexhaustible deliverable supply; are highly unlikely to be susceptible to the threat of manipulation; have no cash market; security futures products; or 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. In addition, except as provided in section 5(e)(2) of the Act, eligible commercial entities trading for their own account may do so on a DTF with respect to futures and option contracts on commodities other than those enumerated in section 1a(4) of the Act. Furthermore, a board of trade operating as a DTF may trade on the facility agreements, contracts, or transactions involving commodities excluded or exempt pursuant to sections 2(c), 2(d), 2(g), or 2(h) as provided by section 5a(g) of the Act, subject to the Commission's exclusive jurisdiction. Proposed rule 37.2 exempts DTFs from all Commission regulations applicable to a trading facility that are not reserved. It also makes clear that the reserved regulations apply as though DTFs were specifically referenced therein.

Proposed rule 37.3 identifies the commodities eligible to be traded on a DTF under section 5a of the Act. Specifically, proposed rule 37.3 identifies those commodities that qualify under the requirements of section 5a(b)(2)(A) through (C) of the Act<sup>11</sup> as those commodities defined as an "excluded commodity" in section 1a(13) of the Act.<sup>12</sup> Excluded commodities under section 1a(13) of the Act include exempt securities. Unlike the provisions governing exempt boards of trade, the CFMA imposes no specific limitations or requirements for exempt securities to trade on a DTF. The Commission is requesting comment on whether additional regulatory requirements, such as large trader reporting, should be imposed as a condition for such trading on a DTF.

Proposed rule 37.3 also establishes a procedure whereby a specific DTF

would be able to make a showing under section 5a(b)(2)(E) of the Act that a contract is highly unlikely to be susceptible to the threat of manipulation and should be eligible for trading on that DTF in light of the characteristics of the commodity and the market's surveillance history, including its self-regulatory record, capacity and undertakings. Proposed rule 37.3(a)(3)(ii)(B) lists those factors that are relevant in making such a showing. The rule does not require that the written demonstration include explanations of information that is self-evident. Agricultural commodities that are not enumerated in the Act, such as soft, world commodities, may trade on a DTF upon successfully making such a demonstration, or under section 5a(b)(2)(F) of the Act, by limiting trading access to eligible commercial entities.<sup>13</sup>

Consistent with section 5(e)(2) of the Act, as amended, the Commission will determine in a future rulemaking whether those agricultural commodities that are enumerated in the Act should be eligible for trading on a DTF and, if so, the appropriate conditions for such trading. The Commission has reserved a paragraph in rule 37.3 for this purpose.

Proposed part 37 includes a number of procedural provisions to provide greater administrative flexibility in the registration and oversight of DTFs. For example, proposed rule 37.5(b) permits the Commission to register a DTF upon conditions. This would enable the Commission to register a facility conditioned upon its subsequent compliance with a particular condition for registration. In addition, the Commission is proposing a fast-track review procedure for applications for registration that are not amended while under review. Such applicants would be deemed to be registered 30 days after receipt.<sup>14</sup>

Section 5a(c)(1) of the Act provides that applicants for DTF registration shall be required to demonstrate only that they comply with the requirements for trading specified in section 5a(b) and the criteria for registration specified in

<sup>11</sup> Section 5a(b)(2)(A) through (C) of the Act as amended provides that a registered derivatives transaction execution facility may trade any contract of sale of a commodity for future delivery (or option on such a contract) only if—

“(A) the underlying commodity has a nearly inexhaustible deliverable supply;

(B) the underlying commodity has a deliverable supply that is sufficiently large that the contract is highly unlikely to be susceptible to the threat of manipulation; [or]

(C) the underlying commodity has no cash market[.]”

<sup>12</sup> Section 1a(13) of the Act as amended 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.

<sup>13</sup> The Commission, pursuant to section 1a(11)(C) of the Act, has proposed to include within the definition of eligible commercial entity floor traders or floor brokers whose trading obligations are guaranteed by a futures commission merchant, trading for their own account. This is consistent with the Commission's withdrawn rules and with Congress' inclusion in the statutory definition (under section 1a(11)(B)) of certain other specified liquidity providers.

<sup>14</sup> Again, the proposed rule provides for a review period that is substantially less than that permitted by the statute. See 7 U.S.C. 8(a).

<sup>10</sup> Section 5c(d) of the Act provides a mechanism for notifying contract markets (and other registered entities) that they are violating a core principle. The request for a demonstration of compliance operates independently of the section 5c(d) procedure. Indeed, the request for such a demonstration from a registered entity, and the Commission's consideration of the entity's response may constitute a useful alternative to the more formal procedures of section 5c(d) of the Act. It would be the Commission's intent to explore such informal methods of resolving issues of compliance with core principles by registered entities prior to invoking more formal mechanisms.

section 5a(c).<sup>15</sup> However, to maintain registration, DTFs must be in compliance with the core principles of section 5a(d) of the Act. Accordingly, the Commission is proposing that an applicant for DTF registration may, if it chooses, become registered without demonstrating its capacity to comply with the core principles for trading. A new DTF that chooses not to make such a demonstration, however, must certify to the Commission that it has the capacity to, and upon commencing operations will, operate in compliance with the core principles. This certification may be made separately or as part of the initial application.

As with the rules regarding contract markets, the Commission is proposing in an appendix general guidance regarding applications and acceptable practices for core principles. The proposed acceptable practices are not mandatory in nature, but rather provide a non-exclusive safe-harbor for compliance. Proposed rule 37.6(d) interprets application of certain of the core principles in the circumstances specified in the rule. For example, the Commission proposes that an electronic platform that is accessible for trading only by eligible commercial entities and that trades only tailored products may satisfy the requirement to monitor trading in a manner “appropriate to the market” by assuring compliance with its rules regarding access limitations.

In addition, the Commission is proposing in rule 37.1(b) to include within the definition of “eligible commercial entity” a registered floor broker or floor trader, trading for its own account, whose trading obligations are guaranteed by a futures commission merchant. This is consistent both with the Commission’s withdrawn rules and with the CFMA’s inclusion of certain types of liquidity providers within the statutory definition of “eligible commercial entity.” In this regard, it has been suggested that electronic markets may have functional counterparts to floor brokers and floor traders, and that these persons should also be included within the definition of eligible commercial entity. The Commission is requesting comment on how and by whom this market making function may be performed on electronic trading facilities, the similarities and differences in this market making function and its regulation when performed on an electronic platform

rather than in a physical trading environment, and whether such persons should be included within the definition of eligible commercial entity.

The Commission has proposed to interpret the core principle regarding disclosure of information relevant to market participants as including the principle of providing market participants information regarding prices, bids and offers on a fair, equitable and timely basis. Such transparency is key to protecting market participants from fraud and other types of abusive trading practices. Price transparency has been the hallmark of regulated markets and should be so recognized in the core principles. Finally, the Commission has proposed to interpret the core principle concerning fitness standards as including a DTF’s owners, defined as natural persons that directly or indirectly have greater than a ten percent interest in the facility. By this interpretation, the Commission is proposing to clarify the application of the core principle on fitness to proprietary trading facilities.

Like contract markets, DTFs may request that the Commission approve their trading rules, which may be trading protocols, and the products that they trade. The Commission has used its section 4(c) exemptive authority to permit DTFs to request such approval at any time, before or after the rule’s implementation or the product’s listing. Although this modification to the statutory scheme is modest, it may provide DTFs with far greater flexibility in bringing products to market.

Proposed section 37.7 includes several special call provisions. Under these provisions, the Commission may issue special calls to the DTF, its market intermediaries or participants upon a determination that the Commission needs certain information to conduct limited surveillance of trading in one or more products traded on the DTF. On occasion, it may need to examine trading activity for a specific period of time to ensure against excessive speculation, manipulation, controls, corners or squeezes.

### C. Exempt Markets

In addition to the types of markets subject to the regulatory oversight of the Commission—designated contract markets and DTFs—the Act as amended authorizes two categories of markets that are exempt from regulatory oversight by the Commission. They are: exempt commercial markets and exempt boards of trade. The Commission in part 36 has proposed rules necessary to implement these statutory exemptions.

### 1. Exempt Commercial Markets

Transactions by eligible commercial entities in exempt commodities traded on an electronic trading facility are exempt commercial markets under section 2(h)(3) of the Act. These markets that satisfy the initial and ongoing requirements of sections 2(h)(3) through (5) of the Act as amended are excluded from the Act’s other requirements.<sup>16</sup> The Commission is proposing rules for these markets that implement the qualifying conditions of the exemption.

Proposed rule 36.3(a) implements the notification requirements of section 2(h)(5)(A) of the Act. Proposed rule 36.3(b)(1) establishes information requirements for exempt commercial markets consistent with section 2(h)(5)(B) of the Act. In this regard, an exempt commercial market may satisfy reporting requirements by providing the Commission with electronic access to transactions conducted on the facility. Alternatively, an exempt commercial market may choose to satisfy its reporting requirements for such transactions by providing the Commission with information regarding such positions by large traders by an alternative means, the form and content of which the Commission may determine is acceptable pursuant to a petition to the Commission for such a determination. Such an alternative should provide the Commission with information comparable in coverage and frequency to that provided to the Commission by its large trader reporting system.

As required by section 2(h)(6) of the Act, proposed rule 36.3(b)(3) establishes procedures for a foreign person named in a subpoena issued by the Commission under section 2(h)(5)(C) to challenge the Commission’s action. In this regard, the Commission is proposing to use its existing hearing procedures found in rules 21.03(g) through (h) and to incorporate them by reference.

Although the Act as amended exempts these electronic markets from Commission regulatory oversight, the

<sup>16</sup> See Sections 2(e)(1) and 2(h)(3) of the Act, as added by sections 104 and 106 of the CFMA. The Act refers to electronic commercial markets as “excluded” from the Act’s regulatory requirements that are not qualifying conditions for the exemption. These qualifying conditions are found in paragraphs 2(h)(4) and (5). Moreover, it should be noted that among these qualifying conditions, the Commission is authorized to promulgate rules to ensure disclosure of prices and to specify procedures regarding redress by participants to an order denying them access in response to a determination that the participant did not comply with a subpoena issued by the Commission. See sections 2(h)(4)(D), 2(h)(5)(C)(ii) and 2(h)(6) of the Act as amended.

<sup>15</sup> Existing contract markets need not make such a demonstration. As proposed, they must simply notify the Commission of their intent to operate as a DTF, and file with the Commission the DTF’s rules and a certification that they meet all of the requirements for registration as a DTF.

Act at the same time affirmatively vests the Commission with comprehensive antimanipulation and antifraud enforcement authority over these trading facilities. Section 2(h)(4)(A) of the Act provides that an agreement, contract or transaction entered into on a qualifying exempt commercial market shall be subject to sections 6(c) and 9(a)(2) of the Act "to the extent such sections prohibit manipulation of the market price of any commodity in interstate commerce and to the extent the agreement, contract or transaction would otherwise be subject to such sections[.]" Section 2(h)(4)(B) of the Act provides that such transactions are subject to sections 4b and 4o, as well as regulations promulgated pursuant to 4c(b) proscribing fraudulent activity. Thus, the Commission is charged with monitoring these markets for manipulation and fraudulent conduct, and enforcing the antimanipulation and antifraud provisions of the Act. The informational requirements imposed by the Act and by these proposed rules are designed to ensure that the Commission can effectively perform these functions.

## 2. Exempt Boards of Trade

Section 5d of the Act, as added by section 114 of the CFMA, establishes a category of market exempt from Commission regulatory oversight referred to as an "exempt board of trade." The Commission in rule 36.2 is proposing implementing regulations for section 5d of the Act. First, the Commission is proposing to define those commodities that are eligible to trade on an exempt board of trade to include commodities defined in section 1a(13) of the Act as "excluded commodities," other than securities, and such other commodities as the Commission may define by rule, regulation or order. *See* proposed rule 36.2(a). The Commission believes that this definition provides legal certainty and further satisfies section 5d's requirements that the underlying commodity has "(A) a nearly inexhaustible deliverable supply; (B) a deliverable supply that is sufficiently large, and a cash market sufficiently liquid, to render any contract traded on the commodity highly unlikely to be susceptible to the threat of manipulation; or (C) no cash market[.]" In addition, proposed rule 36.2(b) implements the notification requirements of section 5d of the Act.

## 3. Additional Requirements

Consistent with sections 2(h)(5)(F) and 5d(g) of the Act, the proposed rules prohibit exempt boards of trade and exempt commercial markets from

representing that they are registered with, designated, recognized, licensed or approved by the Commission. The Commission invites comment on whether the rule also should require that such exempt entities affirmatively disclose to traders that the facility and trading on the facility are not so regulated or approved by the Commission.

## D. Anti-Fraud Provisions

One of the purposes for which the CFMA was enacted was "to clarify the jurisdiction of the Commodity Futures Trading Commission over certain retail foreign exchange transactions and bucket shops that may not be otherwise regulated." CFMA, section 2(5). The Commission is proposing rule 1.1, which applies in scope to such retail foreign exchange transactions not otherwise regulated, pursuant to its authority in sections 3 and 8a(5) of the Act. Congress recently amended section 3 of the Act through enactment of the CFMA. Section 3(a) expressly finds that the transactions subject to the Act are regularly entered into in interstate and international commerce and are affected with a "national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities." Section 3(b) provides, as pertinent here, that it is the purpose of the Act

to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this Act and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuse of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.

Section 8a(5) authorizes the Commission "to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this Act."

In the judgment of the Commission, proposed rule 1.1 is reasonably necessary to effectuate the express purpose of the Act to protect retail foreign exchange market participants from fraudulent or other abusive sales practices. It is the Commission's intention that proposed rule 1.1 not replace the applicability of any existing antifraud rule, including rules 32.9 (fraud in connection with commodity option transactions), and 33.10 (fraud in connection with domestic exchange-

traded option transactions), which were promulgated under section 4c(b) of the Act, rule 30.9 (fraud involving any foreign futures contract or foreign options transaction), rule 4.41 (fraudulent advertising by commodity pool operators, commodity trading advisors, and principals thereof) and rule 31.3 (fraud in connection with leverage transactions).

## E. Arbitration

Section 110 of the CFMA removed the Act's previous requirements for contract market designation, including former section 5a(11) of the Act, governing exchange arbitration proceedings. The Commission is therefore proposing to delete Part 180 of its rules, which was based, in part, on the provisions of former Section 5a(11) of the Act, and to repropose its withdrawn rule 166.5, incorporating certain amendments required by the new legislation. For example, the reproposed version provides that an FCM may require an eligible contract participant to sign an agreement waiving the right to reparations as a condition to using the FCM's services.<sup>17</sup> The CFMA is silent as to whether pre-dispute arbitration agreements must be entered into voluntarily. Compare former § 5a(11) of the Act with § 5(d)(13) of the Act, as amended. The proposed rule retains this requirement.

## IV. Section 4(c) Findings

Some of the proposals contained in this **Federal Register** notice are being proposed under section 4(c) of the Act, which grants the Commission broad exemptive authority. Section 4(c) of the Act provides that, in order to promote responsible economic or financial innovation and fair competition, the Commission may by rule, regulation or order exempt any class of agreements, contracts or transactions, either unconditionally or on stated terms or conditions, from any of the requirements of any provision of the Act (except certain provisions governing a group or index of securities and security futures products). As relevant here, when granting an exemption pursuant to section 4(c), the Commission must find that the exemption would be consistent with the public interest.

The Commission is proposing to use its section 4(c) exemptive authority here to provide registered entities with greater procedural flexibility than is contained in the Act. For instance, pursuant to proposed rule 38.4, designated contract markets may request

<sup>17</sup> This provision is consistent with section 118 of the CFMA.

approval of their contracts following certification of those contracts, notwithstanding the Act's limitation of the Commission's approval authority to "prior" approval. Furthermore, the Commission is proposing a less burdensome certification procedure than that provided in the Act. The Commission believes that providing this additional flexibility to registered entities is consistent with the public interest. The Commission invites public comment on this finding.

## V. Cost-Benefit Analysis

Section 15 of the Act, as amended by section 119 of the CFMA, requires the Commission to consider the costs and benefits of its action before issuing a new regulation under the Act. The Commission is applying the cost-benefit provisions of section 15 for the first time in this rulemaking and understands that, by its terms, section 15 as amended 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. Nor does it require that each proposed rule be analyzed in isolation when that rule is a component of a larger package of rules or rule revisions. Rather, section 15 simply requires the Commission to "consider the costs and benefits" of its action.

The amended section 15 further specifies that costs and benefits shall be evaluated 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. Accordingly, the Commission could in its discretion give greater weight to any one of the five enumerated areas of concern and could in its discretion determine that, notwithstanding its costs, a particular rule was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

The new regulatory framework constitutes a package of related rule provisions. The Commission has considered their costs and benefits as a totality. The rules impose reporting, recordkeeping and other informational requirements on trading facilities that are either mandated by or fully consistent with the new provisions of the CFMA. The Commission has considered the costs and benefits of this rule package in light of the specific areas of concern identified in the CFMA:

*1. Protection of market participants and the public.* In general, the proposed rules would be expected to cost little in terms of diminishing the protection of market participants and the public. The rules impose limited costs in terms of informational requirements. The countervailing benefit of these costs, however, is that the Commission will have the necessary information to perform its oversight functions and thus carry out its mandate of assuring the continued existence of competitive and efficient markets.

*2. Efficiency and competition.* The rules are expected to benefit competition and market efficiency broadly by providing more options for market structure and greater legal certainty for covered instruments. The rules do not impose a cost on market efficiency or competition.

*3. Financial integrity of futures markets.* The rules permit but do not require clearing for DTFs and contract markets. Nevertheless, the proposed rules require that such markets have and disclose their framework for financial integrity. Thus, consistent with the statute, the benefits of clearing are available but not mandated, and the facility may establish a financial integrity framework appropriate to its market.

*4. Price discovery.* Consistent with the statute, markets that serve a price discovery function are required to disseminate publicly certain market information. While such a requirement may impose a cost on markets required to disseminate such information, the cost would be expected to be minimal since such price discovery markets are likely to make available such information anyway in the interest of attracting additional liquidity to the market. Moreover, many markets use this price information as a source of revenue and would therefore make it available even in the absence of a requirement to do so. Nevertheless, this information provides a great benefit to the public in terms of ensuring the supply of economic guidance to commodity producers and users and is important to a market participant's ability to protect him or herself from fraudulent and other abusive practices.

*5. Sound risk management practices.* It is anticipated that the creation of the new regulatory structure will encourage better risk management practices by making available additional market outlets and more customized products for risk management purposes. The added competition for offering these products will tend to reduce the cost of risk management.

*6. Other public interest considerations.* The rules also include an antifraud rule for certain retail foreign exchange transactions and bucket shops that may not otherwise be regulated. The Commission believes that this provision will benefit market participants and the public and will further serve the public interest by deterring illegal behavior. The nonrepudiation provisions included in the rules benefit the public interest by furthering legal certainty.

After considering these factors, the Commission has determined to propose the revisions to its rules discussed above. The Commission invites public comment on its application of the new cost-benefit provision. Commenters also are invited to submit any data that they may have quantifying the costs and benefits of the proposed rules with their comment letters.

## VI. Related Rulemakings

As part of the final rules promulgating the new regulatory framework,<sup>18</sup> the Commission also issued final rules and rule amendments that would have applied to market intermediaries and to clearing organizations.<sup>19</sup> They too, for the most part, were withdrawn following the enactment of the CFMA.<sup>20</sup>

Upon further consideration, the Commission has determined that many of the withdrawn final rules and rule amendments relating to intermediaries are substantively unaffected by the CFMA's statutory revisions. Accordingly, the Commission intends, at a future date, to repropose and readopt those rules and rule amendments relating to intermediaries that are not implicated by the statutory revisions to the Act, with any necessary technical, conforming changes. These rules and rule amendments address, among other things, the definition of the

<sup>18</sup> Implementation of the CFMA requires the Commission to undertake a number of rulemakings in addition to those that were part of the Commission's new regulatory framework, such as rules relating to security futures products. Moreover, the initial rules of the new regulatory framework contemplated a number of subsequent rulemakings, such as permitting risk-based net capital requirements for intermediaries. Those rulemaking proceedings are separate from the rules that are referenced herein and also will be considered by the Commission within the coming year.

<sup>19</sup> See Rules Relating to Intermediaries of Commodity Interest Transactions, 65 FR 77993 (Dec. 13, 2000), and A New Regulatory Framework for Clearing Organizations, 65 FR 78020 (Dec. 13, 2000).

<sup>20</sup> With respect to those rules concerning the investment of customer funds, the Commission determined to move forward their effective date to December 28, 2000, as well as to make certain technical corrections to the rule amendments. See 65 FR 82270 (Dec. 28, 2000).

term "principal," the addition of a principal, certified financial reports, ethics training, disclosure, account opening procedures, trading standards, reporting requirements, and offsetting positions. The Commission also intends to repropose rules for clearing organizations shortly, with the intention of promulgating final rules for registered derivatives clearing organizations. The Commission encourages interested persons to review the **Federal Register** releases discussing the background and purpose of the rules and rule amendments mentioned above for further information.<sup>21</sup>

## VII. Implementation Issues; Comment Period and No-action

The amendments to the Act contained in the CFMA generally became effective on December 21, 2000, the date that the CFMA was enacted into law.<sup>22</sup> In light of the need to promulgate implementing regulations without delay, the Commission encourages commenters to submit their comments as early as possible during the comment period. The early filing of comments will assist the Commission in acting expeditiously to adopt the necessary implementing regulations. In any event, comments should be filed with the Commission by the end of the comment period. To the extent that the promulgation of implementing regulations is necessary to effectuate certain statutory provisions, any extension of the comment period likely would be contrary to the public interest and contrary to the intent of Congress that these statutory changes be made effective without delay.

In light of the Congressional intent to implement these statutory changes without delay, during this transition period between the effective date of the amendments to the Act and the adoption of final implementing regulations, the Commission will not bring any enforcement action against any person who complies with the rules proposed herein. Persons that do comply with the proposed rules, however, will be required to bring their conduct into compliance with the final rules to the extent that the final rules differ from the proposed rules.

<sup>21</sup> See 65 FR 77993 and 65 FR 78020. See also 65 FR 39008 and 65 FR 39027 (June 22, 2000) (proposing rules).

<sup>22</sup> Certain provisions of the CFMA, however, have a delayed effective date. The Commission will adopt implementing rules for those provisions of the CFMA at a later date.

## VIII. Related Matters

### A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.*, requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. The rules adopted herein would affect contract markets and other trading facilities. The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its rules on small entities in accordance with the RFA.<sup>23</sup> In its previous determinations, the Commission has concluded that contract markets are not small entities for the purpose of the RFA.<sup>24</sup> The Commission is proposing to determine that the other trading facilities covered by these rules, for reasons similar to those applicable to contract markets, are not small entities for purposes of the RFA. In any event, the rules being proposed today authorize these trading facilities to operate in a less regulated environment than may currently be the case; consequently, these rules should not have any, or result in only a de minimus, increase in the regulatory requirements that apply to contract markets and other trading facilities.

Accordingly, the Commission does not expect the rules, as proposed herein, to have a significant economic impact on a substantial number of small entities. Therefore, the Acting Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed amendments will not have a significant economic impact on a substantial number of small entities. The Commission invites the public to comment on this finding and on its proposed determination that the trading facilities covered by these rules would not be small entities for purposes of the RFA.

### B. Paperwork Reduction Act of 1995

This proposed rulemaking contains information collection requirements. As required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3504(h)), the Commission has submitted a copy of this section to the Office of Management and Budget (OMB) for its review.

**Collection of Information:** Rules Relating to Part 37, Establishing Procedures for Entities to be Registered as Derivatives Transaction Execution Facilities (DTFs), OMB Control Number 3038-0053. The proposed rules will not

<sup>23</sup> 47 FR 18618-21 (Apr. 30, 1982).

<sup>24</sup> 47 FR 18618, 18619 (discussing contract markets).

change the burden previously approved by OMB.

The estimated burden was calculated as follows:

*Estimated number of respondents:* 10.  
*Annual responses by each respondent:* 1.

*Total annual responses:* 10.  
*Estimated average hours per response:* 200.

*Annual reporting burden:* 2,000.  
**Collection of Information:** Rules Relating to Part 38, Establishing Procedures for Entities to become Designated as Contract Markets, OMB Control Number 3038-0052. The proposed rules will not change the burden previously approved by OMB.

The estimated burden was calculated as follows:

*Estimated number of respondents:* 10.  
*Annual responses by each respondent:* 1.

*Total annual responses:* 10.  
*Estimated average hours per response:* 300.

*Annual reporting burden:* 3,000.  
**Collection of Information:** Rules Pertaining to Large Trader Reports, OMB Control Number 3038-0009. The proposed rules will not change the burden previously approved by OMB.

*Estimated number of respondents:* 4,731.

*Annual responses by each respondent:* 14.67.

*Total annual responses:* 69,392.  
*Estimated average hours per response:* .35213.

*Annual reporting burden:* 24,435.  
**Collection of Information:** Rules Relating to Part 36, Establishing Procedures for Exempt Markets, OMB Control Number 3038-XXXX.

The estimated burden was calculated as follows:

*Estimated number of respondents:* 10.  
*Annual responses by each respondent:* 1.

*Total annual responses:* 10.  
*Estimated average hours per response:* 1.

*Annual reporting burden:* 10.  
Organizations and individuals desiring to submit comments on the information collection requirements should direct them to the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10202, New Executive Office Building, 725 17th Street, NW., Washington, DC 20503; Attention: Desk Officer for the Commodity Futures Trading Commission.

The Commission considers comments by the public on this proposed collection of information in:

- Evaluating whether the proposed collection of information is necessary



for the proper performance of the functions of the Commission, including whether the information will have a practical use;

- Evaluating the accuracy of the Commission's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of collecting information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques or other forms of information technology; e.g., permitting electronic submission of responses.

OMB is required to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the Commission on the proposed regulations.

Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street, NW., Washington DC 20581, (202) 418-5160.

#### List of Subjects

##### 17 CFR Part 1

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

##### 17 CFR Part 5

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

##### 17 CFR Part 15

Commodity futures, Contract markets, Reporting and recordkeeping requirements.

##### 17 CFR Part 36

Commodity futures, Commodity Futures Trading Commission.

##### 17 CFR Part 37

Commodity futures, Commodity Futures Trading Commission.

##### 17 CFR Part 38

Commodity futures, Commodity Futures Trading Commission.

##### 17 CFR Part 40

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

##### 17 CFR Part 41

Security Futures, Commodity Futures Trading Commission.

##### 17 CFR Part 100

Commodity futures, Commodity Futures Trading Commission.

##### 17 CFR Part 166

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

##### 17 CFR Part 170

Commodity futures, Reporting and recordkeeping requirements.

##### 17 CFR Part 180

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

In consideration of the foregoing, and pursuant to the authority contained in the Act, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106-554, 114 Stat. 2763 (2000), and in particular, sections 1a, 2, 3, 4, 4c, 4i, 5, 5a, 5b, 5c, 5d, 6 and 8a thereof, the Commission hereby proposes to amend Chapter I of Title 17 of the Code of Federal Regulations as follows:

#### PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for Part 1 is proposed to be amended to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 2a, 4, 4a, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000).

2. Section 1.1 is proposed to be revised to read follows:

##### § 1.1 Fraud in or in connection with transactions in foreign currency subject to the Commodity Exchange Act.

(a) *Scope.* The provisions of this subsection shall be applicable to accounts, agreements, or transactions described in section 2(c)(1) of the Act, to the extent that the Commission exercises jurisdiction over such accounts, agreements, or transactions as provided in section 2(c)(2)(B) of the Act (except that this section shall not be applicable to persons described in section 2(c)(2)(B)(ii)(II) or 2(c)(2)(B)(ii)(III) of the Act).

(b) *Fraudulent conduct prohibited.* It shall be unlawful for any person, directly or indirectly, in or in connection with any account, agreement, or transaction that is subject to paragraph (a) of this section:

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

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

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

3. Section 1.3 is proposed to be amended by revising the undesignated introductory paragraph to read as follows:

##### § 1.3 Definitions.

Words used in the singular form in the rules and regulations in this chapter shall be deemed to import the plural and vice versa, as the context may require. The following terms, as used in the Commodity Exchange Act, or in the rules and regulations in this chapter, shall have the meanings hereby assigned to them, unless the context otherwise requires:

\* \* \* \* \*

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

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

\* \* \* \* \*

(c) Each designated contract market shall keep a record in permanent form, which shall show the true name, address, and principal occupation or business of any foreign trader executing transactions on the facility or exchange. In addition, upon request, a designated contract market shall provide to the Commission information regarding the name of any person guaranteeing such transactions or exercising any control over the trading of such foreign trader.

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

5.-6. Sections 1.41, 1.41b, 1.43, 1.45, 1.50 and 1.51 are proposed to be removed and reserved.



## PART 15—REPORTS—GENERAL PROVISIONS

7. The authority citation for Part 15 is proposed to be revised to read as follows:

**Authority:** 7 U.S.C. 2, 4, 5, 6(c), 6a, 6c(a)–(d), 6f, 6g, 6i, 6k, 6m, 6n, 7, 9, 12a, 19 and 21, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000).

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

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

\* \* \* \* \*

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

(f) It shall be unlawful for any designated contract market or derivatives transaction execution facility to permit a foreign broker, any of its customers or a foreign trader to effect contracts, agreements or

transactions on the facility unless the designated contract market or derivatives transaction execution facility prior thereto informs the foreign broker, any of its customers or the foreign trader in any reasonable manner the facility deems to be appropriate, of the requirements of this section.

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

facility and the foreign broker, any of its customers or the foreign trader are subject to the provisions of paragraphs (e) and (f) of this section.

(h) The provisions of paragraphs (e), (f) and (g) of this section shall not apply to a designated contract market or derivatives transaction execution facility on which all transactions in futures or option contracts or other instruments subject to the Act pursuant to section 5a(g) of the Act of foreign brokers, their customers or foreign traders are executed through or the resulting transactions are maintained in accounts carried by a registered futures commission merchant or introduced by a registered introducing broker subject to the provisions of paragraphs (a), (b), (c) and (d) of this section.

9. Part 36 is proposed to be revised to read as follows:

## PART 36—EXEMPT MARKETS

Sec.

36.1 Scope.

36.2 Exempt boards of trade.

36.3 Exempt commercial markets.

**Authority:** 7 U.S.C. 2, 5, 6, 6c, and 12a, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000).

### § 36.1 Scope.

The provisions of this part apply to any board of trade or electronic trading facility eligible for exemption under sections 5d and 2(h)(3) through (5) of the Act, respectively.

### § 36.2 Exempt boards of trade.

(a) *Eligible commodities.*

Commodities eligible under section 5d(b)(1) of the Act to be traded by an exempt board of trade are:

(1) Commodities having—

(i) A nearly inexhaustible deliverable supply;

(ii) A deliverable supply that is sufficiently large, and a cash market sufficiently liquid, to render any contract traded on the commodity highly unlikely to be susceptible to the threat of manipulation; or

(iii) No cash market.

(2) The commodities that meet the criteria of paragraph (a)(1) of this section are:

(i) The commodities defined in section 1a(13) of the Act as “excluded commodities” (other than a security, including any group or index thereof or any interest in, or based on the value of, any security or group or index of securities); and

(ii) Such other commodity or commodities as the Commission may determine by rule, regulation or order.

(b) *Notification.* Boards of trade operating under section 5d of the Act as

exempt boards of trade shall so notify the Commission. This notification shall be filed with the Secretary of the Commission at its Washington, DC headquarters, in either electronic or hard copy form, shall be labeled as "Notification of Operation as Exempt Board of Trade," and shall include:

(1) The name and address of the exempt board of trade; and

(2) The name and telephone number of a contact person.

(c) *Additional requirements.* (1) A board of trade notifying the Commission that it meets the criteria of section 5d of the Act and elects to operate as an exempt board of trade shall not represent to any person that it is registered with, designated, recognized, licensed or approved by the Commission.

(2) If the Commission finds by order, after notice and an opportunity for a hearing through submission of written data, views and arguments, that the facility serves as a significant source for the discovery of prices in the cash market for the underlying commodity, the facility must on a daily basis disseminate publicly trading volume, opening and closing price ranges, open interest and other trading data to the extent appropriate to that market with respect to transactions executed in reliance on the exemption as specified in the order.

### § 36.3 Exempt commercial markets.

(a) *Notification.* An electronic trading facility relying upon the exemption in section 2(h)(3) of the Act shall notify the Commission of its intention to do so. This notification, and subsequent notification of any material changes in the information initially provided, shall be filed with the Secretary of the Commission at its Washington, DC headquarters, in either electronic or hard copy form, shall be labeled as "Notification of Operation as Exempt Commercial Market," and shall include the information and certifications specified in section 2(h)(5)(A) of the Act.

(b) *Required information.* (1) A facility operating in reliance on the exemption in section 2(h)(3) of the Act, initially and on an on-going basis, must provide the Commission with access to the facility's trading protocols and electronic access to transactions conducted on the facility in reliance on such exemption. Alternatively, the facility may attach its initial trading protocols and any amendments thereto in hard copy form to the notification required in paragraph (a) of this section and may provide in a form and manner acceptable to the Commission, as

determined by the Commission in response to a petition by the exempt market relying upon the exemption in section 2(h)(3) of the Act, information regarding transactions by large traders on the facility.

(2) *Special calls.* (i) All information required upon special call of the Commission under section 2(h)(5)(B)(iii) of the Act shall be prepared in the form and manner and in accordance with the instructions, and shall be transmitted at the time and to the office of the Commission, as may be specified in the call.

(ii) The Commission hereby delegates, until the Commission orders otherwise, the authority to make special calls as set forth in section 2(h)(5)(B)(iii) of the Act to the Director of the Division of Trading and Markets and to the Director of Economic Analysis to be exercised by either Director or by such other employee or employees as the Director may designate. The directors may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

(3) *Subpoenas to foreign persons.* A foreign person whose access to a trading facility is limited or denied at the direction of the Commission based on the Commission's belief that the foreign person has failed timely to comply with a subpoena as provided under section 2(h)(5)(C)(ii) of the Act shall have an opportunity for a prompt hearing under the procedures provided in § 21.03(g) and (h) of this chapter.

(c) *Additional requirements.* (1) An electronic trading facility relying upon the exemption in section 2(h)(3) of the Act shall not represent to any person that it is registered with, designated, recognized, licensed or approved by the Commission.

(2) If the Commission finds by order, after notice and an opportunity for a hearing through submission of written data, views and arguments, that the facility performs a significant price discovery function for transactions in the cash market for the underlying commodity, the facility must disseminate publicly price, trading volume and other trading data to the extent appropriate with respect to transactions executed in reliance on the exemption as specified in the order.

(3) The facility must require that each participant agree to comply with all applicable laws and the facility must have a reasonable basis for believing that authorized participants are "eligible

commercial entities" as defined in section 1a(11) of the Act.

10. Part 37 is proposed to be added to read as follows:

## PART 37—DERIVATIVES TRANSACTION EXECUTION FACILITIES

Sec.

37.1 Scope and definition.

37.2 Exemption.

37.3 Requirements for underlying commodities.

37.4 Election to trade excluded and exempt commodities.

37.5 Procedures for registration.

37.6 Compliance with core principles.

37.7 Additional requirements.

37.8 Information relating to transactions on derivative transaction execution facilities.

37.9 Enforceability.

Appendix A to Part 37—Application Guidance

Appendix B to Part 37—Guidance on Compliance with Core Principles

**Authority:** 7 U.S.C. 2, 5, 6, 6c, 6(c), 6(i), 7a and 12a, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106-554, 114 Stat. 2763 (2000).

### § 37.1 Scope and definition.

(a) *Scope.* The provisions of this part apply to any board of trade or trading facility operating as a registered derivatives transaction execution facility.

(b) *Definition.* As used in this part, the term "eligible commercial entity" means, and shall include, in addition to a party or entity so defined in section 1a(11) of the Act, a registered floor trader or floor broker trading for its own account, whose trading obligations are guaranteed by a registered futures commission merchant.

### § 37.2 Exemption.

Contracts, agreements or transactions traded on a derivatives transaction execution facility registered as such with the Commission under section 5a of the Act, the facility and the facility's operator are exempt from all Commission regulations for such activity, except for the requirements of this part 37 and §§ 1.3, 1.31, 15.05, 33.10, part 40 and part 190 of this chapter; and as applicable to the market, parts 15 through 21 of this chapter, which are applicable to a registered derivatives transaction execution facility as though they were set forth in this section and included specific reference to derivatives transaction execution facilities.

### § 37.3 Requirements for underlying commodities.

(a) *Trading facilities limited to eligible traders.* Trading facilities limited to eligible traders as defined by section 5a(b)(3) of the Act, may trade any contract of sale of a commodity for future delivery (or option on such a contract) on any of the following underlying commodities:

- (1) Commodities having—
  - (i) A nearly inexhaustible deliverable supply;
  - (ii) A deliverable supply that is sufficiently large that the contract is highly unlikely to be susceptible to the threat of manipulation; or
  - (iii) No cash market.
- (iv) The commodities defined in section 1a(13) of the Act as “excluded commodities,” meet the criteria of paragraphs (a)(1)(i) through (iii) of this section.

(2)(i) Commodities that are a security futures product, and

(ii) The registered derivatives transaction execution facility is a national securities exchange registered under the Securities Exchange Act of 1934;

(3)(i) Commodities for which the Commission has determined, based on the market characteristics, surveillance history, self-regulatory record, and capacity of the facility, that trading in the contract (or option) based on that commodity is highly unlikely to be susceptible to the threat of manipulation.

(ii) The Commission may make such a determination by rule, regulation or order, after notice and an opportunity for a hearing through submission of written data, views and arguments. A registered derivative transaction execution facility may request that the Commission make such an individualized determination by filing with the Commission at its Washington, DC headquarters a petition that includes:

(A) The terms and conditions of the product to be listed; and

(B) A demonstration, supported by data, that the underlying commodity has a sufficiently liquid and deep cash market and a surveillance history based on actual trading experience and in light of any self-regulatory undertakings of the facility, to provide assurance that the contract or product is highly unlikely to be manipulated. The demonstration should address the following specific factors to the extent that the factor is not self-evident:

- (1) A high level of cash-market liquidity;
- (2) Cash-market bid-ask spreads that are narrow relative to traded values;

(3) Relatively frequent cash market transactions involving participants that represent major segments of the industry;

(4) The absence of material impediments to participation in the cash market by commercial entities;

(5) Transfer of ownership of the cash commodity that is easily and readily accomplished at minimal cost;

(6) A pattern of cash market pricing that exhibits continuity and the absence of frequent, sharp price changes such that a person cannot readily move materially the price of the product in normal cash market channels;

(7) A history of actual trading experience that the contract or product's terms and conditions provide for a deliverable supply that is adequate to minimize the threat of market abuses such as price manipulation and distortions, congestion, and defaults; and

(8) Procedures to effectively oversee the market, including a large trader reporting system, as well as a history of active surveillance to prevent or mitigate market problems; or

(4) Commodities that are agricultural commodities enumerated in section 1a(4) of the Act that have been so approved by the Commission under the procedures of paragraph (c) of this section;

(b) *Trading facilities limited to eligible commercial entities.* Any commodity, other than the agricultural commodities enumerated in section 1a(4) of the Act, is eligible under section 5a(b)(2)(F) of the Act to be traded on a derivatives transaction execution facility that limits participants on the facility to eligible commercial entities as defined by § 37.1(b) trading for their own account. *Provided, however,* an agricultural commodity enumerated in section 1a(4) of the Act may be so approved by the Commission under the procedures of paragraph (c) of this section.

(c) *Enumerated agricultural commodities.* [Reserved]

### § 37.4 Election to trade excluded and exempt commodities.

A board of trade that is or elects to become a registered derivatives transaction execution facility may, pursuant to section 5a(g) of the Act, trade agreements, contracts, or transactions that are excluded or exempt from the Act pursuant to sections 2(c), 2(d), 2(g), or 2(h).

### § 37.5 Procedures for registration.

(a) *Notification by contract markets.* To operate as a derivatives transaction execution facility pursuant to section 5a of the Act, a board of trade, facility or

entity that is designated as a contract market, must:

(1) Comply with the core principles for operation under section 5a(d) of the Act and the provisions of this part 37; and

(2) Notify the Commission of its intent to so operate by filing with the Commission at its Washington, DC headquarters a copy of the facility's rules, which may be trading protocols, and a certification by the contract market that it meets:

- (i) The requirements for trading of section 5a(b) of the Act; and
- (ii) The criteria for registration under section 5a(c) of the Act.

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

(1) The application demonstrates that the applicant satisfies the requirements for trading and the criteria for registration of sections 5a(b) and 5a(c) of the Act, respectively;

(2) The submission is labeled, “Application for DTF Registration”;

(3) The submission includes:

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

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

(iii) To the extent that compliance with the requirements for trading or the criteria for recognition is not self-evident, a brief explanation of how the rules or trading protocols satisfy each of the conditions for registration;

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

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

(c) *Guidance for applicants.* Appendix A to this part provides guidance to applicants for registration as a derivatives transaction execution facility on how the conditions for registration in section 5a(b) and 5a(c) of the Act could be satisfied.

(d) *Termination of fast track review.* During the thirty-day period for review pursuant to paragraph (b) of this section, the Commission shall notify the applicant seeking registration that the Commission is terminating review under this section and will review the proposal under the time period and procedures of section 6 of the Act, if it appears that the application's form or substance fails to meet the requirements of this part. This termination notification will state the nature of the issues raised and the specific condition of registration that the applicant would violate, appears to violate, or the violation of which cannot be ascertained from the application. Within ten days of receipt of this termination notification, the applicant seeking registration may request that the Commission render a decision whether to register the derivatives transaction execution facility or to institute a proceeding to deny the proposed application under procedures specified in section 6 of the Act by notifying the Commission that the applicant seeking registration views its submission as complete and final as submitted.

(e) *Request for withdrawal of application for registration or withdrawal of registration.* An applicant to be registered, or a registered derivatives transaction execution facility may withdraw its application or its registration by filing with the Commission at its Washington, DC, headquarters such a request. Withdrawal from registration shall not affect any action taken or to be taken by the Commission based upon actions, activities or events occurring during the time that the application for registration was pending with, or that the facility was registered by, the Commission.

(f) *Delegation of authority.* (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Trading and Markets and separately to the Director of Economic Analysis or the Director's delegatee, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to exercise the functions provided under paragraph (b) of this section.

(2) The directors may submit to the Commission for its consideration any matter that has been delegated in this paragraph.

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

#### **§ 37.6 Compliance with core principles.**

(a) *In general.* To maintain registration as a derivatives transaction execution facility upon commencing operations by listing products for trading or otherwise and on a continuing basis thereafter, the derivatives transaction execution facility must have the capacity to be, and be, in compliance with the core principles of section 5a(d) of the Act.

(b) *New derivatives transaction execution facilities.* (1) *Certification of compliance.* Unless an applicant for registration has chosen to make a voluntary demonstration under paragraph (b)(2) of this section, a newly registered derivatives transaction execution facility at the time it commences operations must certify to the Commission that it has the capacity to, and will, operate in compliance with the core principles under section 5a(d) of the Act.

(2) *Voluntary demonstration of compliance.* An applicant for registration may choose to make a voluntary demonstration of its capacity to operate in compliance with the core principles as follows:

(i) At least thirty days prior to commencing operations, the applicant for registration must file with the Commission at its Washington, D.C. headquarters, either separately or with the application required by § 37.4, a submission that includes:

(A) The label, "Demonstration of Compliance with Core Principles for Operation;"

(B) The derivatives transaction execution facility's rules, which may be trading protocols, that enable or empower the facility to comply with the core principles;

(C) Any agreements entered into or to be entered into between or among the facility, its operator or its participants that enable or empower the facility to comply with the core principles, including where applicable, technical manuals and other guides or instructions for users of the facility; and

(D) To the extent that capacity to comply with a core principle is not self-evident, a brief explanation of how the facility has the capacity to meet the core principle.

(ii) Unless the applicant requests an extension of time, the applicant shall be deemed to have demonstrated its capacity to comply with the core principles thirty days after receipt by

the Commission, unless notified otherwise.

(iii) If it appears that the applicant has failed to make the requisite showing, the Commission will so notify the applicant at the end of that period. Upon commencement of operations by the derivatives transaction execution facility, such a notice may be considered by the Commission in a determination to issue a notice of violation of core principles under section 5c(d) of the Act.

(c) *Existing derivatives transaction execution facilities.* Upon request by the Commission, a registered derivatives transaction execution facility shall file with the Commission such data, documents and other information as the Commission may specify in its request that demonstrates that the registered derivatives transaction execution facility is in compliance with one or more core principles as specified in the request or that is requested by the Commission to enable the Commission to satisfy its obligations under the Act.

(d) *Guidance regarding compliance with core principles.* A derivatives transaction execution facility may meet the following core principles of section 5a(d) of the Act as specified in this paragraph:

(1) *Compliance with rules.* The core principle regarding compliance with rules under section 5a(d)(2) of the Act may be met, as appropriate to the facility, through the effective monitoring of limitations on access to the facility;

(2) *Monitoring of trading.* The core principle regarding monitoring of trading under section 5a(d)(3) of the Act may be met, as appropriate to the market and the products traded thereon, by providing information to the Commission as requested to satisfy the Commission's obligations under the Act;

(3) *Disclosure of general information.* The core principle regarding disclosure of general information relevant to participation in trading on the facility under section 5a(d)(4)(D) of the Act also includes providing to market participants on a fair, equitable and timely basis information regarding prices, bids and offers, and such other information that the Commission may determine by rule, regulation or order, after notice and an opportunity for a hearing through submission of written data, views and arguments;

(4) *Daily publication of trading information.* The Commission will determine by order, after notice and an opportunity for a hearing through submission of written data, views and arguments, whether the requirement of the core principle on publication of trading information under section

5a(d)(5) of the Act applies to a particular product or products traded on a facility;

(5) *Fitness.* Appropriate minimum standards for participants having direct access to the facility under the core principle on fitness pursuant to section 5a(d)(6) of the Act also includes natural persons that directly or indirectly have greater than a ten percent ownership interest in the facility; and

(6) *In general.* Appendix B to this part provides guidance to registered derivatives transaction execution facilities on how the core principles under section 5a(d) of the Act could be satisfied.

### **§ 37.7 Additional requirements.**

(a) *Products.* Notwithstanding the provisions of section 5c(c) of the Act and § 40.2 of this chapter, derivative transaction execution facilities need only notify the Commission of the listing of new products for trading, posting of new product descriptions, terms and conditions or trading protocols or providing for a new system product functionality, by filing with the Commission at its Washington, D.C. headquarters, a submission labeled “DTF Notice of Product Listing” that includes the text of the product’s terms or conditions, product description, trading protocol or description of the system functionality or by electronic notification of the foregoing at the time traders or participants in the market are notified, but in no event later than the close of business on the business day preceding initial listing, posting or implementation of the trading protocol or system functionality.

(b) *Material modifications.* Notwithstanding the provisions of section 5c(c) of the Act, registered derivative transaction execution facilities need not certify rules or rule amendments under § 40.6 of this chapter, and must only notify the Commission prior to placing into effect or amending such a rule, which includes trading protocols, by:

(1) Filing with the Commission at its Washington, D.C. headquarters at the time traders or participants in the market are notified, but (unless taken as an emergency action) in no event later than the close of business on the business day preceding implementation of the rule, a submission labeled, “DTF Rule Notice.” The submission shall include the text of the rule or rule amendment, (deletions and additions must be indicated); or

(2) By electronic notification to the Commission of the rule to be placed into effect or to be changed, in a format approved by the Secretary of the Commission, at the time traders or

participants in the market are notified, but (unless taken as an emergency action) in no event later than the close of business on the business day preceding implementation. *Provided, however,* the derivatives transaction execution facility need not notify the Commission of rules or rule amendments for which no certification is required under § 40.6(c) of this chapter.

(3) The derivatives transaction execution facility must maintain documentation regarding all changes to rules, terms and conditions or trading protocols.

(c) *Voluntary request for Commission approval of rules or products.* (1) A board of trade or trading facility seeking to be registered as, or registered as, a derivatives transaction execution facility, may request that the Commission approve under section 5c(c) of the Act, any or all of its rules and subsequent amendments thereto, including both operational rules and the terms or conditions of products listed for trading on the facility, prior to their implementation or, notwithstanding the provisions of section 5c(c)(2) of the Act, at anytime thereafter, under the procedures of §§ 40.5 or 40.3 of this chapter, as applicable. A derivatives transaction execution facility may label a product in its rules as, “Listed for trading pursuant to Commission approval,” if the product and its terms or conditions have been approved by the Commission and it may label as, “Approved by the Commission,” only those rules that have been so approved.

(2) An applicant for registration, or a registered derivatives transaction execution facility may request that the Commission consider under the provisions of section 15(b) of the Act any of the derivatives transaction execution facility’s rules or policies, including both operational rules and the terms or conditions of products listed for trading, at the time of registration or thereafter.

(d) *Identify participants.* Registered derivative transaction execution facilities must keep a record in permanent form, which shall show the true name, address, and principal occupation or business of any foreign trader executing transactions on the facility. In addition, upon request, a derivative transaction execution facility shall provide to the Commission information regarding the name of any person exercising control over the trading of such foreign trader. *Provided, however,* this paragraph shall not apply to a derivatives transaction execution facility insofar as transactions in futures or option contracts of foreign traders are

executed through and the resulting transactions are maintained in accounts carried by a registered futures commission merchant or introducing broker subject to § 1.37 of this chapter.

(e) *Identify persons subject to fitness requirement.* Upon request by the Commission, a registered derivatives transaction execution facility shall furnish to the Commission a current list of persons subject to the fitness requirements of section 5a(d)(6) of the Act.

### **§ 37.8 Information relating to transactions on derivatives transaction execution facilities.**

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

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

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

(d) *Delegation of authority.* The Commission hereby delegates, until the Commission orders otherwise, the authority set forth in paragraphs (a) through (c) of this section to the Directors of the Division of Trading and Markets and separately to the Director of Economic Analysis or such other employee or employees as the Directors may designate from time to time. The Directors may submit to the

Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

### § 37.9 Enforceability.

An agreement, contract or transaction entered into on, or pursuant to, the rules of a registered derivatives transaction execution facility shall not be void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable as a result of:

(a) A violation by the registered derivatives transaction execution facility of the provisions of section 5a of the Act or this part 37; or

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

### Appendix A to Part 37—Application Guidance

This appendix provides guidance to applicants for registration as derivatives transaction execution facilities under section 5a(c) of the Act and § 37.5. The guidance following each registration criterion is illustrative only of the types of matters an applicant may address, as applicable, and is not intended to be a mandatory checklist. Addressing the issues and questions set forth in this appendix would help the Commission in its consideration of whether the application has met the criteria for registration. To the extent that compliance with, or satisfaction of, a criterion for registration is not self-explanatory from the face of the derivatives transaction execution facility's rules, which may be terms and conditions or trading protocols, the application should include an explanation or other form of documentation demonstrating that the applicant meets the registration criteria of section 5a(c) of the Act and § 37.5.

Registration Criterion 1 of section 5a(c) of the Act: *IN GENERAL—To be registered as a registered derivatives transaction execution facility, the board of trade shall be required to demonstrate to the Commission only that the board of trade meets the criteria specified in subsection (b) and this subsection.*

A board of trade preparing to submit to the Commission an application to operate as a registered derivatives transaction execution facility is encouraged to contact Commission staff for guidance and assistance in preparing its application. Applicants may submit a draft application for review prior to the submission of an actual application without triggering the application review procedures of § 37.5.

Registration Criterion 2 of section 5a(c) of the Act: *DETERRENCE OF ABUSES—The board of trade shall establish and enforce trading and participation rules that will deter abuses and has the capacity to detect, investigate, and enforce those rules, including means to—(A) obtain information necessary to perform the functions required under this section; or (B) use technological means to—(i) provide market participants with impartial access to the market; and (ii) capture information that may be used in establishing whether rule violations have occurred.*

An application of a board of trade to operate as a registered derivatives transaction execution facility should include arrangements and resources for effective and affirmative rule enforcement, including documentation of the facility's authority to do so. The submission should include documentation on the ability of the facility either to obtain necessary information or to provide participants with impartial access and capture information for use in establishing possible rule violations.

Registration Criterion 3 of section 5a(c) of the Act: *TRADING PROCEDURES—The board of trade shall establish and enforce rules or terms and conditions defining, or specifications detailing, trading procedures to be used in entering and executing orders traded on the facilities of the board of trade. 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 futures commission merchant, 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 registered derivatives transaction execution facility or a derivatives clearing organization.*

(a) A submission of a board of trade to operate as an electronic registered derivatives transaction execution facility should include the system's trade-matching algorithm and order entry procedures. A submission 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 board of trade'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 submission. The Commission believes that the guidelines issued by the International Organization of Securities Commissions (IOSCO) in 1990 (which have been referred to as the "Principles for Screen-Based Trading Systems"), and subsequently adopted by the Commission on November 21, 1990 (55 FR 48670), 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.

(c) A registered derivatives transaction execution facility 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. Block trading rules should ensure that the block trading does not operate in a manner that compromises the integrity of the prices or price discovery on the relevant market.

Registration Criterion 4 of section 5a(c) of the Act: *FINANCIAL INTEGRITY OF TRANSACTIONS—The board of trade shall establish and enforce rules or terms and conditions providing for the financial integrity of transactions entered on or through the facilities of the board of trade, and rules or terms and conditions to ensure the financial integrity of any futures commission merchants and introducing brokers and the protection of customer funds.*

(a) A board of trade operating as a registered derivatives transaction execution facility should provide for the financial integrity of transactions by setting appropriate minimum financial standards for users and/or members, appropriate margin forms and levels, and appropriate default rules and procedures. If cleared, transactions executed on the facility must be cleared through a derivatives clearing organization. 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 facility's minimum financial standards. In order to monitor for minimum financial requirements, a facility should routinely receive and promptly review financial and related information.

(b) A registered derivatives transaction execution facility that allows customers that qualify as "eligible traders" under the definition found in section 5a(b)(3) of the Act only by trading through a futures commission merchant pursuant to section 5a(b)(3)(B), 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.

### Appendix B to Part 37—Guidance on Compliance With Core Principles

1. This appendix provides guidance concerning the core principles with which a registered derivatives transaction execution facility must comply to maintain registration under section 5a(d) of the Act and § 37.5(a). This guidance is illustrative only and is not intended to be a mandatory checklist.

2. If a registered derivatives transaction execution facility chooses to certify that it has the capacity to, and upon initiation will, operate in compliance with the core principles under section 5a(d) of the Act and § 37.6, it should consider the issues set forth in this appendix prior to certification.

3. Alternatively, if a registered derivatives transaction execution facility chooses pursuant to § 37.6(b)(2) to provide the

Commission with a demonstration of its compliance with core principles, addressing the issues set forth in this appendix would help the Commission in its consideration of such compliance. To the extent that compliance with, or satisfaction of, the core principles is not self-explanatory from the face of the derivatives transaction execution facility's rules, which may be terms and conditions or trading protocols, a submission under § 37.6(b)(2) should include an explanation or other form of documentation demonstrating that the derivatives transaction execution facility complies with the core principles.

Core Principle 1 of section 5a(d) of the Act: *IN GENERAL—To maintain the registration of a board of trade as a derivatives transaction execution facility, a board of trade shall comply with the core principles specified in this subsection. The board of trade shall have reasonable discretion in establishing the manner in which the board of trade complies with the core principles.*

A board of trade newly registered to operate as a derivatives transaction execution facility must certify or satisfactorily demonstrate its capacity to operate in compliance with the core principles under section 5a(d) of the Act prior to the commencement of its operations. The Commission also may require that a board of trade operating as a registered derivatives transaction execution facility demonstrate to the Commission that it is operating in compliance with one or more core principles.

Core Principle 2 of section 5a(d) of the Act: *COMPLIANCE WITH RULES—The board of trade shall monitor and enforce the rules of the facility, including any terms and conditions of any contracts traded on or through the facility and any limitations on access to the facility.*

(a) A board of trade operating as a registered derivatives transaction execution facility should have arrangements, resources and authority for effectively and affirmatively enforcing its rules (which, in the case of a facility that restricts traders to eligible commercial entities, may be the effective monitoring of limitations on access to the facility), including the authority and ability to collect or capture information and documents on both a routine and non-routine basis and to investigate effectively possible rule violations.

(b) This should include the authority and ability to discipline, limit or suspend, and terminate a member/participant's activities or access or, in the case of a derivatives transaction execution facility restricting its traders to eligible commercial entities, the authority and ability to terminate a member/participant's activities or access. In either case, any termination should be carried out pursuant to clear and fair standards.

Core Principle 3 of section 5a(d) of the Act: *MONITORING OF TRADING—The board of trade shall monitor trading in the contracts of the facility to ensure orderly trading in the contract and to maintain an orderly market while providing any necessary trading information to the Commission to allow the Commission to discharge the responsibilities of the Commission under the Act.*

(a) Arrangements and resources for effective trade monitoring programs should

facilitate, on both a routine and nonroutine basis, direct supervision of the market. Appropriate objective testing and review of any automated systems should occur initially and periodically to ensure proper system functioning, adequate capacity and security. The analysis of data collected should be suitable for the type of information collected and should occur in a timely fashion. A board of trade operating as a registered derivatives transaction execution facility should have the authority to collect the information and documents necessary to reconstruct trading for appropriate market analysis as it carries out its programs to ensure orderly trading and to maintain an orderly market. The facility also should have the authority to intervene as necessary to maintain an orderly market.

(b) Alternatively, if a board of trade operating as a registered derivatives transaction execution facility restricts contracts traded pursuant to those under §§ 37.3(a)(1) and 37.3(b), it may choose to satisfy this core principle by providing information to the Commission as requested by the Commission to satisfy its obligations under the Act. The facility should have the authority to collect or capture and retrieve all necessary information.

Core Principle 4 of section 5a(d) of the Act: *DISCLOSURE OF GENERAL INFORMATION—The board of trade shall disclose publicly and to the Commission information concerning—(A) contract terms and conditions; (B) trading conventions, mechanisms, and practices; (C) financial integrity protections; and (D) other information relevant to participation in trading on the facility.*

A board of trade operating as a registered derivatives transaction execution facility should have arrangements and resources for the disclosure and explanation of contract terms and conditions, trading conventions, trading mechanisms, trading practices, system functioning, system capacity, system security, system testing and review, and financial integrity protections, including whether eligible contract participants will have the right to opt out of segregation of customer funds. The facility must also disclose any limitations of liability (which may not include limitations of liability for violations of the Act or Commission regulations by fraud, or wanton or willful misconduct). Such information may be made publicly available through the derivatives transaction execution facility's website. The facility should also make information regarding prices, bids and offers, or other information as determined by the Commission, readily available to market participants on a fair, equitable and timely basis. Furthermore, the facility should make available information concerning steps taken by the facility in response to an emergency.

Core Principle 5 of section 5a(d) of the Act: *DAILY PUBLICATION OF TRADING INFORMATION—The board of trade shall make public daily information on settlement prices, volume, open interest, and opening and closing ranges for contracts traded on the facility if the Commission determines that the contracts perform a significant price discovery function for transactions in the*

*cash market for the commodity underlying the contracts.*

A board of trade operating as a registered derivatives transaction execution facility should provide to the public information regarding settlement prices, price range, trading volume, open interest and other related market information for all applicable contracts, as determined by the Commission. The Commission will determine by order, after notice and an opportunity for a hearing through submission of written data, views and arguments, whether the requirement of the core principle on publication of trading information under section 5a(d)(5) of the Act applies to a particular product or products traded on a facility. Provision of information for any applicable contract could be through such means as providing the information to a financial information service or by timely placing the information on a facility's website.

Core Principle 6 of section 5a(d): *FITNESS STANDARDS—The board of trade shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members, and any other persons with direct access to the facility, including any parties affiliated with any of the persons described in this paragraph.*

A derivatives transaction execution facility should have appropriate eligibility criteria for the categories of persons set forth in the core principle that would include standards for fitness and for the collection and verification of information supporting compliance with such standards. Minimum standards of fitness for persons who have member voting privileges, governing obligations or responsibilities, or who exercise disciplinary authority are those bases for refusal to register a person under section 8a(2) of the Act, or a history of serious disciplinary offenses, such as those which would be disqualifying under § 1.63 of this chapter. Eligible contract participants or eligible commercial entities who have direct access but do not have these privileges, obligations, responsibilities or disciplinary authority could satisfy minimum fitness standards by meeting the standards that they must meet to qualify under the Act's respective definitions of eligible contract participants or eligible commercial entities. Natural persons who directly or indirectly have greater than a ten percent interest in a facility should meet the fitness standards applicable to members with voting rights. A demonstration of the fitness of the applicant's directors, members, or natural persons who directly or indirectly have a greater than ten percent interest in a facility may include providing the Commission with registration information for such persons, certification to the fitness of such persons, an affidavit of such persons' fitness by the facility's Counsel or other information substantiating the fitness of such persons.

Core Principle 7 of section 5a(d) of the Act: *CONFLICTS OF INTEREST—The board of trade shall establish and enforce rules to minimize conflicts of interest in the decision making process of the derivatives transaction execution facility and establish a process for resolving such conflicts of interest.*



The means to address conflicts of interest in decision-making of a board of trade operating as a registered derivatives transaction execution facility should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict. The Commission also believes that a board of trade operating as a registered derivatives transaction execution facility 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 facility employees or gained through an ownership interest in the facility.

Core Principle 8 of section 5a(d) of the Act: *RECORDKEEPING—The board of trade shall maintain records of all activities related to the business of the derivatives transaction execution facility in a form and manner acceptable to the Commission for a period of 5 years.*

Section 1.31 of this chapter governs recordkeeping obligations under the Act and the Commission's regulations thereunder. In order to provide broad flexible performance standards for recordkeeping, § 1.31 was updated and amended by the Commission in 1999. Accordingly, § 1.31 itself establishes the guidance regarding the form and manner for keeping records.

Core Principle 9 of section 5a(d) of the Act: *ANTITRUST CONSIDERATIONS—Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall endeavor to avoid—(A) adopting any rules or taking any actions that result in any unreasonable restraint of trade; or (B) imposing any material anticompetitive burden on trading on the derivatives transaction execution facility.*

A board of trade seeking to operate as a registered derivatives transaction execution facility may request that the Commission consider under the provisions of section 15(b) of the Act any of the board of trade's rules, which may be trading protocols or policies, and including both operational rules and the terms or conditions of products listed for trading, at the time it submits its registration application or thereafter. The Commission intends to apply section 15(b) of the Act to its consideration of issues under this core principle in a manner consistent with that previously applied to contract markets.

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

## **PART 38—DESIGNATED CONTRACT MARKETS**

Sec.	
38.1	Scope.
38.2	Exemption.
38.3	Procedures for designation by application.
38.4	Procedures for listing products and implementing contract market rules.
38.5	Information relating to contract market compliance.
38.6	Enforceability.
Appendix A to Part 38—Application	Guidance

Appendix B to Part 38—Guidance on, and Acceptable Practices in, Compliance with Core Principles

**Authority:** 7 U.S.C. 2, 5, 6, 6c, 7 and 12a, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000).

### **§ 38.1 Scope.**

The provisions of this part 38 shall apply to every board of trade or trading facility that has been designated as a contract market in a commodity under section 6 of the Act. *Provided, however,* nothing in this provision affects the eligibility of designated contract markets to operate under the provisions of parts 36 or 37 of this chapter.

### **§ 38.2 Exemption.**

Agreements, contracts, or transactions traded on a designated contract market under section 6 of the Act, the contract market and the contract market's operator are exempt from all Commission regulations for such activity, except for the requirements of this part 38 and §§ 1.3, 1.31, 1.38, 33.10, part 9, parts 15 through 21, part 40, and part 190 of this chapter.

### **§ 38.3 Procedures for designation by application.**

(a) *Application.* A board of trade or trading facility shall be deemed to be designated as a contract market sixty days after receipt by the Commission of an application for designation unless notified otherwise during that period, or, as determined by Commission order, designated upon conditions, if:

(1) The application demonstrates that the applicant satisfies the criteria for designation of section 5(b) of the Act, the core principles for operation under section 5(d) of the Act and the provisions of this part 38;

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

(3) The application includes a copy of the applicant's rules and, to the extent that compliance with the conditions for designation is not self-evident, a brief explanation of how the rules satisfy each of the conditions for designation;

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

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

(b) *Guidance regarding application for designation.* An applicant for contract market designation may meet the

following conditions for designation as specified in this paragraph:

(1) *Prevention of market manipulation.* The designation criterion to prevent market manipulation under section 5(b)(2) of the Act also includes the requirement that the designated contract market have a dedicated regulatory department, or delegation of that function;

(2) *Fair and equitable trading.* The designation criterion requiring fair and equitable trading rules under section 5(b)(3) of the Act also includes fair, equitable and timely availability to market participants of information regarding prices, bids and offers;

(3) *Disciplinary procedures.* The designation criterion to enforce disciplinary procedures under section 5(b)(6) of the Act may be satisfied by an organized exchange or a trading facility with respect to non-member participants of the contract market by expelling or by denying future access to such a person found to have violated the contract market's rules;

(4) *Governance fitness standards.* The requirement to establish appropriate minimum fitness standards for participants in a facility having direct access to the facility under the core principle on fitness pursuant to section 5(d)(14) of the Act includes natural persons that directly or indirectly have greater than a ten percent ownership interest in the facility; and

(5) *In general.* Appendix A to this part provides guidance to applicants for designation as contract markets on how the criteria for designation under section 5(b) of the Act can be satisfied and Appendix B to this part provides guidance to applicants for designation and designated contract markets on how the core principles of section 5(d) of the Act can be satisfied;

(c) *Termination of fast track review.* During the sixty-day period for review pursuant to paragraph (a) of this section, the Commission shall notify the applicant seeking designation that the Commission is terminating review under this section and will review the proposal under the time period and procedures of section 6 of the Act, if it appears that the application's form or substance fails to meet the requirements of this part. This termination notification will state the nature of the issues raised and the specific condition of designation that the applicant would violate, appears to violate, or the violation of which cannot be ascertained from the application. Within ten days of receipt of this termination notification, the applicant seeking designation may request that the Commission render a decision whether to designate the

contract market or to institute a proceeding to deny the proposed application under procedures specified in section 6 of the Act by notifying the Commission that the applicant views its submission as complete and final as submitted.

(d) *Request for withdrawal of application for designation or vacation of designation.* An applicant to be designated, or a designated contract market, may withdraw its application or vacate its designation under section 7 of the Act by filing with the Commission at its Washington, D.C., headquarters such a request. Withdrawal from registration or vacation of designation shall not affect any action taken or to be taken by the Commission based upon actions, activities or events occurring during the time that the application for designation was pending with, or that the facility was designated by, the Commission.

(e) *Delegation of authority.* (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Trading and Markets and separately to the Director of Economic Analysis or the Directors' delegatee, with the concurrence of the General Counsel or the General Counsel's delegatee, authority to notify the entity seeking designation under paragraph (a) of this section that review under those procedures is being terminated or to designate the entity as a contract market upon conditions.

(2) The Directors may submit to the Commission for its consideration any matter that has been delegated in this paragraph.

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

#### **§ 38.4 Procedures for listing products and implementing contract market rules.**

(a) *Request for Commission approval of rules and products.* An applicant for designation, or a designated contract market, may request that the Commission approve under section 5c(c) of the Act, any or all of its rules and subsequent amendments thereto, including both operational rules and the terms or conditions of products listed for trading on the facility, prior to their implementation or, notwithstanding the provisions of section 5c(c)(2) of the Act, at anytime thereafter, under the procedures of §§ 40.5 or 40.3 of this chapter, as applicable. A designated contract market may label a product in its rules as, "Listed for trading pursuant to Commission approval," if the product and its terms or conditions have been

approved by the Commission and it may label as, "Approved by the Commission," only those rules that have been so approved.

(b) *Self-certification of rules and products.* Rules of a designated contract market and subsequent amendments thereto, including both operational rules and the terms or conditions of products listed for trading on the facility, not voluntarily submitted for prior Commission approval pursuant to paragraph (a) of this section must be submitted to the Commission with a certification that the rule, rule amendment or product complies with the Act or rules thereunder pursuant to the procedures of §§ 40.6 and 40.2 of this chapter, as applicable. Provided, however, any rule or rule amendment that would, for a delivery month having open interest, materially change a term or condition of a contract for future delivery in an agricultural commodity enumerated in section 1a(4) of the Act, or of an option on such a contract or commodity, must be submitted to the Commission prior to its implementation for review and approval under § 40.4 of this chapter.

(c) An applicant for designation, or a designated contract market, may request that the Commission consider under the provisions of section 15(b) of the Act any of the contract market's rules or policies, including both operational rules and the terms or conditions of products listed for trading.

#### **§ 38.5 Information relating to contract market compliance.**

(a) Upon request by the Commission, a designated contract market shall file with the Commission such information related to its business as a contract market, including information relating to data entry and trade details, in the form and manner and within the time as specified by the Commission in the request.

(b) Upon request by the Commission, a designated contract market shall file with the Commission a written demonstration, containing such supporting data, information and documents, in the form and manner and within such time as the Commission may specify, that the designated contract market is in compliance with one or more core principles as specified in the request.

#### **§ 38.6 Enforceability.**

An agreement, contract or transaction entered into on, or pursuant to the rules of a designated contract market shall not be void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable as a result of:

(a) A violation by the designated contract market of the provisions of section 5 of the Act or this part 38; or

(b) Any Commission proceeding to alter or supplement a rule, term or condition under section 8a(7) of the Act, to declare an emergency under section 8a(9) of the Act, or any other proceeding the effect of which is to alter, supplement, or require a designated contract market to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

#### **Appendix A to Part 38—Application Guidance**

This appendix provides guidance for applicants for designation as a contract market under section 5(b) of the Act and § 38.3. The guidance following each designation criterion is illustrative only of the types of matters an applicant may address, as applicable, and is not intended to be a mandatory checklist. Addressing the issues and questions set forth in this appendix would help the Commission in its consideration of whether the application has met the criteria for designation. To the extent that compliance with, or satisfaction of, a criterion for designation is not self-explanatory from the face of the contract market's rules, which may be trading protocols or terms and conditions, the application should include an explanation or other form of documentation demonstrating that the applicant meets the designation criteria of section 5(b) of the Act.

Designation Criterion 1 of section 5(b) of the Act: *IN GENERAL—To be designated as a contract market, the board of trade shall demonstrate to the Commission that the board of trade meets the criteria specified in this subsection.*

A board of trade preparing to submit to the Commission an application for designation as a contract market is encouraged to contact Commission staff for guidance and assistance in preparing an application. Applicants may submit a draft application for review and feedback prior to the submission of an actual application without triggering the application review procedures of § 38.3.

Designation Criterion 2 of section 5(b) of the Act: *PREVENTION OF MARKET MANIPULATION—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.*

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 3 of section 5(b) of the Act: *FAIR AND EQUITABLE TRADING—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 futures commission merchant, 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.*

(a) Ensuring fair and equitable trading on a contract market, among other things, includes:

(1) Providing to market participants, on a fair, equitable and timely basis, information regarding prices, bids and offers; and

(2) Limitations of contract market liability (or of any of its officers, directors, employees, licensors, contractors and/or affiliates) only if such limitations of liability do not arise from a person's violation of the Act or Commission regulations by fraud, or wanton or willful misconduct.

(b) 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.

Designation Criterion 4 of section 5(b) of the Act: *TRADE EXECUTION FACILITY—The board of trade shall—(A) establish and enforce rules defining, or specifications detailing, the manner of operation of the trade execution facility maintained by the board of trade, including rules or specifications describing the operation of any electronic matching platform; and (B) demonstrate that the trade execution facility operates in accordance with the rules or specifications.*

(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 designated contract market'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 (which have been referred to as the "Principles for Screen-Based Trading Systems"), subsequently adopted by the Commission on November 21, 1990 (55 FR 48670), are appropriate guidelines for 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.

Designation Criterion 5 of section 5(b) of the Act: *FINANCIAL INTEGRITY OF TRANSACTIONS—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.*

(a) A designated contract market should provide for the financial integrity of transactions by setting appropriate minimum financial standards for users and/or members, appropriate margin forms and levels, and appropriate default rules and procedures. Clearing of transactions executed on the contract market should be provided through a derivatives clearing organization. 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 designated contract market 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 Act: *DISCIPLINARY PROCEDURES—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.*

The disciplinary procedures established by a designated contract market 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 a member or participant's activities could be found in a contract market's rules, user agreements or other means. An organized exchange or a trading facility could satisfy this criterion for non-members by expelling or denying future access to such persons upon a finding that such a person has violated the board of trade's rules.

Designation Criterion 7 of section 5(b) of the Act: *PUBLIC ACCESS—The board of trade shall provide the public with access to the rules, regulations, and contract specifications of the board of trade.*

A board of trade operating as a contract market may provide information to the public by placing the information on its web site.

Designation Criterion 8 of section 5(b) of the Act: *ABILITY TO OBTAIN INFORMATION—The board of trade shall 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.*

A designated contract market should have the authority to collect information and documents on both a routine and non-routine basis including the examination of books and records kept by members/participants of the contract market. Appropriate information-sharing agreements could be established with other boards of trade or the Commission could act in conjunction with the contract market to carry out such information sharing.

## Appendix B to Part 38—Guidance on, and Acceptable Practices in, Compliance with Core Principles

1. This appendix provides guidance concerning the core principles with which a board of trade must comply to maintain designation under section 5(d) of the Act and §§ 38.3 and 38.5. The guidance is provided in subsection (a) following each core principle and it can be used to demonstrate to the Commission core principle compliance, under §§ 38.3(a) and 38.5. The guidance for each core principle is illustrative only of the types of matters a board of trade may address, as applicable, and is not intended to be a mandatory checklist. Addressing the issues and questions set forth in this appendix would help the Commission in its consideration of whether the board of trade is in compliance with the core principles. To the extent that compliance with, or satisfaction of, a core principle is not self-explanatory from the face of the board of trade's rules, which may be terms and conditions or trading protocols, an application pursuant to § 38.3, or a submission pursuant to § 38.5 should include an explanation or other form of documentation demonstrating that the board of trade complies with the core principles.

2. Acceptable practices meeting the requirements of the core principles are set forth in subsection (b) following each core principle. Boards of trade that follow the specific practices outlined under subsection (b) for any core principle in this appendix will meet the applicable core principle. Subsection (b) is for illustrative purposes only, and does not state the exclusive means for satisfying a core principle.

Core Principle 1 of section 5(d) of the Act: *IN GENERAL—To maintain the designation of a board of trade as a contract market, the board of trade shall comply with the core principles specified in this subsection. The board of trade shall have reasonable discretion in establishing the manner in which it complies with the core principles.*

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 Act and § 38.3. The Commission may require that a board of trade

operating as a contract market demonstrate to the Commission that it is in compliance with one or more core principles.

Core Principle 2 of section 5(d) of the Act: **COMPLIANCE WITH RULES**—*The board of trade shall monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market.*

(a) *Application Guidance.* (1) A designated contract market should have arrangements and resources for effective trade practice surveillance programs, with the authority to collect information and documents on both a routine and non-routine basis including the examination of books and records kept by members/participants of the contract market. The arrangements and resources should facilitate the direct supervision of the market and the analysis of data collected. Trade practice surveillance programs could be carried out by the contract market itself or through delegation to a third party. If the contract market out-sources its trade practice surveillance program to a third party, such third party should have the capacity and authority to carry out such program, and the contract market should retain appropriate supervisory authority over the third party.

(2) A designated contract market should have arrangements, resources and authority for effective rule enforcement. The Commission believes that this should include the authority and ability to discipline and limit, or suspend, a member/participant's activities as well as the authority and ability to terminate a member/participant's activities pursuant to clear and fair standards. An organized exchange or a trading facility could satisfy this criterion for non-members by expelling or denying such persons future access upon a finding that such a person has violated the board of trade's rules.

(b) *Acceptable Practices.* An acceptable trade practice surveillance program generally would include:

(1) Maintenance of data reflecting the details of each transaction executed on the contract market;

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

(3) Appropriate and thorough investigative analysis of these and other potential trading violations brought to the contract market's attention; and

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

Core Principle 3 of section 5(d) of the Act: **CONTRACTS NOT READILY SUBJECT TO MANIPULATION**—*The board of trade shall list on the contract market only contracts that are not readily susceptible to manipulation.*

(a) *Application Guidance.* Contract markets may list new products for trading by self-certification under § 40.2 of this chapter or may submit products for Commission approval under § 40.3 and part 40, Appendix A, of this chapter.

(b) *Acceptable Practices.* Guideline No. 1, 17 CFR Part 40, Appendix A may be used as guidance in meeting this core principle for both new product listings and existing listed contracts.

Core Principle 4 of section 5(d) of the Act: **MONITORING OF TRADING**—*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 designated contract market 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 (1) to the size and ownership of deliverable supplies—the existing supply and the future or potential supply, and (2) 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 done by the members of its clearing facility. 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). The Commission operates an industry-wide LTRS. As an alternative to having its own LTRS or contracting out for such a system, contract markets may find it more efficient to use information available from the Commission's LTRS data for position monitoring.

Core Principle 5 of section 5(d) of the Act: **POSITION LIMITATIONS OR ACCOUNTABILITY**—*To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the board of trade shall adopt position limitations or position accountability for speculators, where necessary and appropriate.*

(a) *Application Guidance.* [Reserved]

(b) *Acceptable Practices.*

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

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

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

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

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

(6) Contract markets should establish a program for effective monitoring and

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

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

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

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

Core Principle 6 of section 5(d) of the Act: *EMERGENCY AUTHORITY—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 designated contract market should have clear procedures and guidelines for contract market decision-making regarding emergency intervention in the market, including procedures and guidelines to carry out such decision-making without conflicts of interest. 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, preventing conflicts of interest, 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 under § 40.6 of this chapter and any related submissions for

rule approval pursuant to § 40.5 of this chapter, when carried out pursuant to a contract market's emergency 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 of the contract market to another, or alter the delivery terms or conditions.

Core Principle 7 of section 5(d) of the Act: *AVAILABILITY OF GENERAL INFORMATION—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.*

(a) *Application Guidance.* A designated contract market should have arrangements and resources for the disclosure of contract terms and conditions and trading mechanisms to the Commission, users and the public. Procedures should also include providing information on listing new products, rule amendments or other changes to previously disclosed information to the Commission, users and the public.

(b) *Acceptable Practices.* [Reserved]

Core Principle 8 of section 5(d) of the Act: *DAILY PUBLICATION OF TRADING INFORMATION—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.*

(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.* [Reserved]

Core Principle 9 of section 5(d) of the Act: *EXECUTION OF TRANSACTIONS—The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions.*

(a) *Application Guidance.* (1) Appropriate objective testing and review of any automated systems should occur initially and periodically to ensure proper system functioning, adequate capacity and security. A designated contract market's analysis of its

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

(2) A designated contract market 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 Informational 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.

Core Principle 10 of section 5(d) of the Act: *TRADE INFORMATION—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.*

(a) *Application Guidance.* A designated contract market should have arrangements and resources for recording of full data entry and trade details and the safe storage of audit trail data. A designated contract market 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. The contract market must create and maintain an electronic transaction history database that contains information

with respect to transactions effected on the designated contract market.

(2) An acceptable audit trail, therefore, 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 9.

(i) *Original Source Documents.* Original source documents include unalterable, sequentially identified records on which trade execution information is originally recorded, whether recorded manually or electronically. For each customer order (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) whether the trade was for a customer or proprietary account; (c) timing and sequencing data adequate to reconstruct trading; and (d) the identification of each account to which fills are allocated.

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

(iv) *Safe Storage Capability.* Safe storage capability provides for a method of storing the data included in the transaction history in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss. Data should be retained in accordance with the recordkeeping standards of Core Principle 17.

Core Principle 11 of section 5(d) of the Act: *FINANCIAL INTEGRITY OF CONTRACTS—The board of trade shall establish and enforce rules providing for the financial integrity of any contracts traded on the contract market (including the clearance and settlement of the transactions with a derivatives clearing organization), and rules to ensure the financial integrity of any futures commission merchants and introducing brokers and the protection of customer funds.*

(a) *Application Guidance.* Clearing of transactions executed on a designated contract market should be provided through a Commission-designated clearing facility. In addition, a designated contract market should maintain the financial integrity of its transactions by maintaining minimum financial standards for its members and having default rules and procedures. The minimum financial standards should be monitored for compliance purposes. The Commission believes that in order to monitor for minimum financial requirements, a designated contract market should routinely receive and promptly review financial and related information. Rules concerning the

protection of customer funds should address the segregation of customer and proprietary funds, the custody of customer funds, the investment standards for customer funds, related recordkeeping and related intermediary default procedures.

(b) *Acceptable Practices.* [Reserved]

Core Principle 12 of section 5(d) of the Act: *PROTECTION OF MARKET PARTICIPANTS—The board of trade shall establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants.*

(a) *Application Guidance.* A designated contract market 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.

(b) *Acceptable Practices.* [Reserved]

Core Principle 13 of section 5(d) of the Act: *DISPUTE RESOLUTION—The board of trade shall establish and enforce rules regarding and provide facilities for alternative dispute resolution as appropriate for market participants and any market intermediaries.*

(a) *Application Guidance.* A designated contract market should provide customer dispute resolution procedures that are fair and equitable and that are made available to the customer on a voluntary basis, either directly or through another self-regulatory organization.

(b) *Acceptable Practices.* (1) Under Core Principle 13, a designated contract market is required to provide for dispute resolution mechanisms that are appropriate to the nature of the market.

(2) In order to satisfy acceptable standards, a designated contract market should provide a customer dispute resolution mechanism that is fundamentally fair and is equitable. An acceptable customer dispute resolution mechanism would provide:

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

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

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

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

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

(3) The procedure employed also should be voluntary, and could permit counterclaims as provided in § 166.5 of this chapter.

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

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

Core Principle 14 of section 5(d) of the Act: *GOVERNANCE FITNESS STANDARDS—The board of trade shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other persons with direct access to the facility (including any parties affiliated with any of the persons described in this paragraph).*

(a) *Application Guidance.* (1) A designated contract market should have appropriate eligibility criteria for the categories of persons set forth in the Core Principle that should include standards for fitness and for the collection and verification of information supporting compliance with such standards. Minimum standards of fitness for persons who have member voting privileges, governing obligations or responsibilities, or who exercise disciplinary authority are those bases for refusal to register a person under section 8a(2) of the Act or a history of serious disciplinary offenses, such as those that would be disqualifying under § 1.63 of this chapter. Participants who have direct access to trade on the contract market, but do not have these privileges, obligations, responsibilities or disciplinary authority could satisfy minimum fitness standards by meeting the standards that they must meet to qualify as a "participant." Natural persons who directly or indirectly have greater than a ten percent interest in a designated contract market should meet the fitness standards applicable to members with voting rights.

(2) The Commission believes that such standards should include providing the Commission with fitness information for such persons, whether registration information, certification to the fitness of such persons, an affidavit of such persons' fitness by the contract market's counsel or other information substantiating the fitness of such persons. If a contract market provided certification of the fitness of such a person, the Commission believes that such certification should be based on verified information that the person is fit to be in his or her position.

(b) *Acceptable Practices.* [Reserved]

Core Principle 15 of section 5(d) of the Act: *CONFLICTS OF INTEREST—The board of trade shall establish and enforce rules to minimize conflicts of interest in the decision making process of the contract market and establish a process for resolving such conflicts of interest.*

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.

Core Principle 16 of section 5(d) of the Act: *COMPOSITION OF BOARDS OF MUTUALLY OWNED CONTRACT MARKETS—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.*

The composition of a mutually-owned contract market should fairly represent the diversity of interests of the contract market's market participants.

Core Principle 17 of section 5(d) of the Act: *RECORDKEEPING—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.*

(a) *Application Guidance.* [Reserved]

(b) *Acceptable Practices.* Section 1.31 of this chapter governs recordkeeping obligations under the Act and the Commission's regulations thereunder. In order to provide broad flexible performance standards for recordkeeping, § 1.31 was updated and amended by the Commission in 1999. Accordingly, § 1.31 itself establishes the guidance regarding the form and manner for keeping records.

Core Principle 18 of section 5(d) of the Act: *ANTITRUST CONSIDERATIONS—Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall endeavor to avoid—(A) adopting any rules or taking any actions that result in any unreasonable restraints of trade; or (B) imposing any material anticompetitive burden on trading on the contract market.*

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

(b) *Acceptable Practices.* [Reserved]

12. Chapter I of 17 CFR is proposed to be amended by adding new Part 40 as follows:

#### **PART 40—PROVISIONS COMMON TO CONTRACT MARKETS, DERIVATIVES TRANSACTION EXECUTION FACILITIES AND DERIVATIVES CLEARING ORGANIZATIONS**

Sec.

40.1 Definitions.

40.2 Listing products for trading by certification.

40.3 Voluntary submission of new products for Commission review and approval.

40.4 Amendments to terms or conditions of enumerated agricultural contracts.

40.5 Voluntary submission of rules for Commission review and approval.

40.6 Self-certification of rules by designated contract markets and registered derivatives clearing organizations.

40.7 Delegations.

Appendix A to Part 40—Guideline No. 1.

Appendix B—Schedule of fees.

Appendix C—Information that a foreign board of trade should submit when seeking no-action relief to offer and sell, to persons located in the United States, a futures contract on a foreign securities index traded on that foreign board of trade.

**Authority:** 7 U.S.C. 1a, 2, 2a, 5, 6, 6c, 7, 7a, 8 and 12a, as amended by the Commodity Futures Modernization Act of 2000, Appendix \_\_\_\_ of Pub. L. No. 106–554, 114 Stat. 2763 (2000).

#### **§ 40.1 Definitions.**

As used in this part:

*Contract market* includes a clearing organization that clears trades for the contract market, unless reference also is made within the same section of the Code of Federal Regulations to derivatives clearing organization, as defined in § 39.1 of this chapter.

*Dormant contract* means any commodity futures or option contract or other instrument in which no trading has occurred in any future or option expiration for a period of six complete calendar months; *provided, however*, no contract or instrument shall be considered to be dormant until the end of 60 complete calendar months following initial listing.

*Emergency* means any occurrence or circumstance which, in the opinion of the governing board of the contract market or derivatives transaction execution facility, requires immediate action and threatens or may threaten such things as the fair and orderly trading in, or the liquidation of or delivery pursuant to, any agreements, contracts or transactions on such a trading facility, including any manipulative or attempted manipulative activity; any actual, attempted, or threatened corner, squeeze, congestion, or undue concentration of positions; any circumstances which may materially affect the performance of agreements, contracts or transactions traded on the trading facility, including failure of the payment system or the bankruptcy or insolvency of any participant; any action taken by any governmental body, or any other board of trade, market or facility which may have a direct impact on trading on the trading facility; and any other circumstance which may have a severe, adverse effect upon the functioning of a designated contract

market or derivatives transaction execution facility.

*Rule* means any constitutional provision, article of incorporation, bylaw, rule, regulation, resolution, interpretation, stated policy, term and condition, trading protocol, agreement or instrument corresponding thereto, in whatever form adopted, and any amendment or addition thereto or repeal thereof, made or issued by a contract market, derivatives transaction execution facility or derivatives clearing organization or by the governing board thereof or any committee thereof.

*Terms and conditions* mean any definition of the trading unit or the specific commodity underlying a contract for the future delivery of a commodity or commodity option contract, specification of settlement or delivery standards and procedures, and establishment of buyers' and sellers' rights and obligations under the contract. Terms and conditions include provisions relating to the following:

(1) Quality or quantity standards for a commodity and any applicable premiums or discounts;

(2) Trading hours, trading months and the listing of contracts;

(3) Minimum and maximum price limits and the establishment of settlement prices;

(4) Position limits and position reporting requirements;

(5) Delivery points and locational price differentials;

(6) Delivery standards and procedures, including alternatives to delivery and applicable penalties or sanctions for failure to perform;

(7) Settlement of the contract; and

(8) Payment or collection of commodity option premiums or margins.

#### **§ 40.2 Listing products for trading by certification.**

To list a new product for trading, to list a product for trading that has become dormant, or to accept for clearing a product (not traded on a designated contract market or a derivatives transaction execution facility), a registered entity must file with the Commission at its Washington, D.C., headquarters no later than the close of business of the business day preceding the product's listing or acceptance for clearing, either in electronic or hard-copy form, a copy of the product's rules, including its terms and conditions, and a certification by the registered entity that the trading product or other instrument complies with the Act and rules thereunder.



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

(a) *Request for approval.* A designated contract market or registered derivatives transaction execution facility may request under section 5c(c)(2) of the Act that the Commission approve new products under the following procedures:

(1) The submitting entity labels the request as "Request for Commission Product Approval";

(2) The request for product approval is for a commodity other than a security future or a security futures product as defined in sections 1a(31) or 1a(32) of the Act, respectively;

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

(4) The submission includes the fee required under Appendix B to this part.

(b) *Forty-five day review.* All products submitted for Commission approval under this paragraph shall be deemed approved by the Commission forty-five days after receipt by the Commission, or at the conclusion of such extended period as provided under paragraph (c) of this section, unless notified otherwise within the applicable period, if:

(1) The submission complies with the requirements of paragraphs (a)(1) of this section; and

(2) The submitting entity does not amend the terms or conditions of the proposed product or supplement the request for approval, except as requested by the Commission or for correction of typographical errors, renumbering or other such nonsubstantive revisions, during that period. Any voluntary, substantive amendment by the requestor will be treated as a new submission under this section.

(c) *Extension of time.* The Commission may extend the forty-five day review period in paragraph (b) of this section for:

(1) An additional forty-five days, if within the initial forty-five day review period, the Commission notifies the submitting entity that the proposed rule raises novel or complex issues that require additional time for review or is of major economic significance. This notification shall briefly describe the nature of the specific issues for which additional time for review is required; or

(2) Such period as the submitting entity so instructs the Commission in writing.

(d) *Notice of non-approval.* The Commission at any time during its review under this section may notify the submitting entity that it will not, or is

unable to, approve the product or instrument. This notification will briefly specify the nature of the issues raised and the specific provision of the Act or regulations, including the form or content requirements of paragraph (a) of this section, that the proposed rule would violate, appears to violate or the violation of which cannot be ascertained from the submission.

(e) *Effect of non-approval.* (1) Notification to a submitting entity under paragraph (d) of this section of the Commission's refusal to approve a proposed product or instrument does not prejudice the entity from subsequently submitting a revised version of the product or instrument for Commission approval or from submitting the product or instrument as initially proposed pursuant to a supplemented submission.

(2) Notification to a submitting entity under paragraph (d) of this section of the Commission's refusal to approve a proposed rule or rule amendment shall be presumptive evidence that the entity may not truthfully certify under § 40.2 that the same, or substantially the same, product does not violate the Act or rules thereunder.

### § 40.4 Amendments to terms or conditions of enumerated agricultural contracts.

Designated contract markets and registered derivatives transaction execution facilities must submit for Commission approval under the procedures of § 40.5, prior to its implementation, any rule or rule amendment that would, for a delivery month having open interest, materially change a term or condition as defined in § 40.1(f), of a contract for future delivery in an agricultural commodity enumerated in section 1a(4) of the Act, or of an option on such a contract or commodity. *Provided, however,* the following rules or rule amendments would not be material changes:

- (a) Changes in trading hours;
- (b) Changes in lists of approved delivery facilities pursuant to previously set standards or criteria;
- (c) Changes to terms and conditions of options on futures other than those relating to last trading day, expiration date, option strike price delistings, and speculative position limits; and
- (d) Reductions in the minimum price fluctuation (or "tick").

### § 40.5 Voluntary submission of rules for Commission review and approval.

(a) *Request for approval of rules.* A registered entity may request pursuant to section 5c(c) of the Act that the Commission approve any rule or proposed rule or rule amendment under the following procedures:

(1) Three copies of each rule or rule amendment submission under this section shall be furnished in hard copy form to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581 or electronically in a format specified by the Secretary of the Commission. Each request for approval under this section shall be in the following order and shall:

(i) Label the submission as "Request for Commission rule approval";

(ii) Set forth the text of the rule or proposed rule (in the case of a rule amendment, deletions and additions must be indicated);

(iii) 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 registered entity or by its governing board or by any committee thereof, and cite the rules of the entity that authorize the adoption of the proposed rule;

(iv) 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 registered entity's framework of self-regulation, and any other information which may be beneficial to the Commission in analyzing the proposed rule. If a proposed rule affects, directly or indirectly, the application of any other rule of the submitting entity, set forth the pertinent text of any such rule and describe the anticipated effect;

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

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

(2) [Reserved]

(b) *Forty-five day review.* All rules submitted for Commission approval under paragraph (a) of this section shall be deemed approved by the Commission under section 5c(c) of the Act, forty-five days after receipt by the Commission, or at the conclusion of such extended period as provided under paragraph (c)

of this section, unless notified otherwise within the applicable period, if:

(1) The submission complies with the requirements of paragraphs (a)(1)(i) through (vi) of this section, and

(2) The submitting entity does not amend the proposed rule or supplement the submission, except as requested by the Commission, during the pendency of the review period. Any amendment or supplementation not requested by the Commission will be treated as the submission of a new filing under this section.

(c) *Extensions of time.* The Commission may extend the review period in paragraph (b) of this section for:

(1) An additional forty-five days, if the Commission, within the initial forty-five day review period, notifies the submitting entity that the proposed rule raises novel or complex issues that require additional time for review or is of major economic significance. This notification shall briefly describe the nature of the specific issues for which additional time for review is required; or

(2) Such additional period as the submitting entity has so instructed the Commission in writing.

(d) *Notice of non-approval.* The Commission at any time during its review under this section may notify the submitting entity 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 Act 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.

(e) *Effect of non-approval.* (1) Notification to a registered entity under paragraph (d) of this section of the Commission's refusal to approve a proposed rule or rule amendment of a registered entity does not prejudice the entity from subsequently submitting a revised version of the proposed rule or rule amendment for Commission approval or from submitting the rule or rule amendment as initially proposed pursuant to a supplemented submission.

(2) Notification to a registered entity under paragraph (d) of this section of the Commission's refusal to approve a proposed rule or rule amendment of a registered entity shall be presumptive evidence that the entity may not truthfully certify that the same, or substantially the same, proposed rule or rule amendment does not violate the Act or rules thereunder.

(f) *Expedited approval.*

Notwithstanding the provisions of paragraph (b) of this section, changes to terms and conditions of a product that are consistent with the Act and Commission regulations and with standards approved or established by the Commission in a written notification to the registered entity of the applicability of this paragraph (f) shall be deemed approved by the Commission at such time and under such conditions as the Commission shall specify in the notice, provided, however, that the Commission may, at any time, alter or revoke the applicability of such a notice to any particular product.

#### **§ 40.6 Self-certification of rules by designated contract markets and registered derivatives clearing organizations.**

(a) *Required certification.* A designated contract market or a registered derivatives clearing organization may implement any new rule or rule amendment only if:

(1) The rule or rule amendment does not materially change a term or condition of a contract for future delivery of an agricultural commodity enumerated in section 1a(4) of the Act or an option on such a contract or commodity in a delivery month having open interest;

(2) The designated contract market or registered derivatives clearing organization has filed a submission for the rule or rule amendment, and the Commission has received the submission at its Washington, D.C. headquarters by close of business on the business day preceding implementation of the rule; provided, *however*, rules or rule amendments implemented under procedures of the governing board to respond to an emergency as defined in § 40.1(d), must be filed with the Commission at the time of implementation of the rule or rule amendment, if implementation is sooner than the next business day; and

(3) The rule submission includes:

(i) The label, "Rule Certification" or, in the case of a rule or rule amendment that responds to an emergency, "Emergency Rule Certification";

(ii) The text of the rule (in the case of a rule amendment, deletions and additions must be indicated);

(iii) The date of implementation;

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

(v) A certification by the entity that the rule complies with the Act and regulations thereunder.

(b) *Stay.* The Commission may stay the effectiveness of a rule implemented pursuant to paragraph (a) of this section

during the pendency of Commission proceedings for filing a false certification or to alter or amend the rule pursuant to section 8a(7) of the Act. The decision to stay the effectiveness of a rule in such circumstances shall not be delegable to any employee of the Commission.

(c) *Notification of rule amendments.* Notwithstanding the rule certification requirement of section 5c(c)(1) of the Act, and paragraphs (a)(2) and (a)(3) of this section, a designated contract market or a registered derivatives clearing organization may place the following rules or rule amendments into effect without certification to the Commission if the following conditions are met:

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

(2) The rule governs:

(i) *Nonmaterial revisions.* Corrections of typographical errors, renumbering, periodic routine updates to identifying information about approved entities and other such nonsubstantive revisions of a product's terms and conditions that have no effect on the economic characteristics of the product;

(ii) *Delivery standards set by third parties.* Changes to grades or standards of commodities deliverable on a product that are established by an independent third party and that are incorporated by reference as product terms, provided that the grade or standard is not established, selected or calculated solely for use in connection with futures or option trading and such changes do not affect deliverable supplies or the pricing basis for the product;

(iii) *Index products.* Routine changes in the composition, computation, or method of selection of component entities of an index (other than a stock index) referenced and defined in the product's terms, that do not affect the pricing basis of the index, which are made by an independent third party whose business relates to the collection or dissemination of price information and that was not formed solely for the

purpose of compiling an index for use in connection with a futures or option product; or

(iv) *Option contract terms.* Changes to option contract rules relating to the strike price listing procedures, strike price intervals, and the listing of strike prices on a discretionary basis.

(3) *Notification of rule amendments not required.* Notwithstanding the rule certification requirements of section 5c(c)(1) of the Act and of paragraphs (a)(2) and (a)(3) of this section, designated contract markets and registered derivatives clearing organizations may place the following rules or rule amendments into effect without certification or notice to the Commission if the following conditions are met:

(i) The designated contract market or registered derivatives clearing organization maintains documentation regarding all changes to rules; and

(ii) The rule governs:

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

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

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

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

#### **§ 40.7 Delegations.**

(a) *Procedural matters.* (1) *Review of products or rules.* The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Trading and Markets and separately to the Director of Economic Analysis or to the Director's delegatee with the concurrence of the General Counsel or the General Counsel's delegatee, authority to request under

§ 40.3(b)(2) or § 40.5(b)(2) that the entity requesting approval amend the proposed product, rule or rule amendment or supplement the submission, to notify a submitting entity under § 40.3(c) or § 40.5(c) that the time for review has been extended, and to notify the submitting entity under § 40.3(d) or § 40.5(d) that the Commission is not approving, or is unable to approve, the proposed product, rule or rule amendment.

(2) *Emergency rules.* The Commission hereby delegates authority to the Director of the Division of Trading and Markets, or the delegatees of the Director, authority to receive notification and the required certification of emergency rules under § 40.6(a)(2).

(b) *Approval authority.* The Commission hereby delegates, until the Commission orders otherwise, to the Director of the Division of Trading and Markets and separately to the Director of Economic Analysis, with the concurrence of the General Counsel or the General Counsel's delegatee, to be exercised by either of such Directors or by such other employee or employees of the Commission under the supervision of such Directors as may be designated from time to time by the Directors, the authority to approve, pursuant to section 5c(c)(3) of the Act and § 40.5, rules or rule amendments of a designated contract market, registered derivatives transaction execution facility or registered derivatives clearing organization that:

(1) Relate to, but do not materially change, the quantity, quality, or other delivery specifications, procedures, or obligations for delivery, cash settlement, or exercise under an agreement, contract or transaction approved for trading by the Commission; daily settlement prices; clearing position limits; requirements or procedures for governance of a registered entity; procedures for transfer trades; trading hours; minimum price fluctuations; and maximum price limit and trading suspension provisions;

(2) Reflect routine modifications that are required or anticipated by the terms of the rule of a registered entity;

(3) [Reserved].

(4) Are in substance the same as a rule of the same or another registered entity which has been approved previously by the Commission pursuant to section 5c(c)(3) of the Act;

(5) Are consistent with a specific, stated policy or interpretation of the Commission; or

(6) Relate to the listing of additional trading months of approved contracts.

(c) The Directors may submit to the Commission for its consideration any matter that has been delegated pursuant to paragraph (a) or (b) of this section.

(d) Nothing in this section shall be deemed to prohibit the Commission, at its election, from exercising the authority delegated in paragraph (a) or (b) of this section to the Directors.

\* \* \* \* \*

#### **Appendix B—Schedule of fees**

(a) *Applications for product approval.* Each application for product approval under § 40.3 must be accompanied by a check or money order made payable to the Commodity Futures Trading Commission in an amount to be determined annually by the Commission and published in the **Federal Register**.

(b) Checks and applications should be sent to the attention of the Office of the Secretariat, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581. No checks or money orders may be accepted by personnel other than those in the Office of the Secretariat.

(c) Failure to submit the fee with an application for product approval will result in return of the application. Fees will not be returned after receipt.

\* \* \* \* \*

12-a. Appendix A to Part 5 is redesignated as Appendix A to Part 40 and the heading is revised; Appendix E to Part 5 is redesignated as Appendix C to Part 40; and Part 5 is removed and reserved. The revised heading reads as follows:

#### **Appendix A to Part 40—Guideline No. 1**

13. Chapter I of 17 CFR is proposed to be amended by adding new Part 41 as follows:

#### **PART 41—SECURITY FUTURES**

Sec.

41.1 [Reserved]

#### **PART 166—CUSTOMER PROTECTION RULES**

14. The authority citation for Part 166 is proposed to be revised to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 4, 6b, 6c, 6d, 6g, 6h, 6k, 6l, 6o, 7, 12a, 21, and 23, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106-554, 114 Stat. 2763 (2000).

15. § Section 166.5 is proposed to be added to read as follows:

#### **§ 166.5 Dispute settlement procedures.**

(a) *Definitions.* (1) The term *claim or grievance* as used in this section shall mean any dispute that:

(i) Arises out of any transaction executed on or subject to the rules of a designated contract market,

(ii) Is executed or effected through a member of such facility, a participant transacting on or through such facility or an employee of such facility, and

(iii) Does not require for adjudication the presence of essential witnesses or third parties over whom the facility does not have jurisdiction and who are not otherwise available.

(iv) The term claim or grievance does not include disputes arising from cash market transactions that are not a part of or directly connected with any transaction for the purchase or sale of any commodity for future delivery or commodity option.

(2) The term *customer* as used in this section includes an option customer (as defined in § 1.3(jj) of this chapter) and any person for or on behalf of whom a member of a designated contract market, or a participant transacting on or through such designated contract market, except another member of or participant in such designated contract market. *Provided, however*, a person who is an "eligible contract participant" as defined in section 1a(12) of the Act shall not be deemed to be a customer within the meaning of this section.

(3) The term *Commission registrant* as used in this section means a person registered under the Act as a futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor, or associated person.

(b) *Voluntariness*. The use by customers and eligible contract participants of dispute settlement procedures shall be voluntary as provided in paragraphs (c) and (g) of this section.

(c) *Customers*. No Commission registrant shall enter into any agreement or understanding with a customer in which the customer agrees, prior to the time a claim or grievance arises, to submit such claim or grievance to any settlement procedure except as follows:

(1) Signing the agreement must not be made a condition for the customer to utilize the services offered by the Commission registrant.

(2) If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the cautionary language and provisions specified in this section. A futures commission merchant or introducing broker may obtain such endorsement as provided in § 1.55(d) of this chapter for the following classes of customers only:

(i) A plan defined as a government plan or church plan in section 3(32) or section 3(33) of title I of the Employee Retirement Income Security Act of 1974

or a foreign person performing a similar role or function subject as such to comparable foreign regulation; and

(ii) A person who is a "qualified eligible participant" or a "qualified eligible client" as defined in § 4.7 of this chapter.

(3) The agreement may not require any customer to waive the right to seek reparations under section 14 of the Act and part 12 of this chapter. Accordingly, such customer must be advised in writing that he or she may seek reparations under section 14 of the Act by an election made within 45 days after the Commission registrant notifies the customer that arbitration will be demanded under the agreement. This notice must be given at the time when the Commission registrant notifies the customer of an intention to arbitrate. The customer must also be advised that if he or she seeks reparations under section 14 of the Act and the Commission declines to institute reparations proceedings, the claim or grievance will be subject to the pre-existing arbitration agreement and must also be advised that aspects of the claim or grievance that are not subject to the reparations procedure (*i.e.*, do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the pre-existing arbitration agreement.

(4) The agreement must advise the customer that, at such time as he or she may notify the Commission registrant that he or she intends to submit a claim to arbitration, or at such time as such person notifies the customer of its intent to submit a claim to arbitration, the customer will have the opportunity to elect a qualified forum for conducting the proceeding.

(5) *Election of forum*. (i) Within ten business days after receipt of notice from the customer that he or she intends to submit a claim to arbitration, or at the time a Commission registrant notifies the customer of its intent to submit a claim to arbitration, the Commission registrant must provide the customer with a list of organizations whose procedures meet Acceptable Practices established by the Commission for dispute resolution, together with a copy of the rules of each forum listed. The list must include:

(A) The designated contract market, if available, upon which the transaction giving rise to the dispute was executed or could have been executed;

(B) A registered futures association; and

(C) At least one other organization that will provide the customer with the

opportunity to select the location of the arbitration proceeding from among several major cities in diverse geographic regions and that will provide the customer with the choice of a panel or other decision-maker composed of at least one or more persons, of which at least a majority are not members or associated with a member of the designated contract market or employee thereof, and that are not otherwise associated with the designated contract market (mixed panel): *Provided, however*, that the list of qualified organizations provided by a Commission registrant that is a floor broker need not include a registered futures association unless a registered futures association has been authorized to act as a decision-maker in such matters.

(ii) The customer shall, within forty-five days after receipt of such list, notify the opposing party of the organization selected. A customer's failure to provide such notice shall give the opposing party the right to select an organization from the list.

(6) *Fees*. The agreement must acknowledge that the Commission registrant will pay any incremental fees that may be assessed by a qualified forum for provision of a mixed panel, unless the arbitrators in a particular proceeding determine that the customer has acted in bad faith in initiating or conducting that proceeding.

(7) *Cautionary Language*. The agreement must include the following language printed in large boldface type:

Three Forums Exist for the Resolution of Commodity Disputes: Civil Court litigation, reparations at the Commodity Futures Trading Commission (CFTC) and arbitration conducted by a self-regulatory or other private organization.

The CFTC recognizes that the opportunity to settle disputes by arbitration may in some cases provide many benefits to customers, including the ability to obtain an expeditious and final resolution of disputes without incurring substantial costs. The CFTC requires, however, that each customer individually examine the relative merits of arbitration and that your consent to this arbitration agreement be voluntary.

By signing this agreement, you: (1) May be waiving your right to sue in a court of law; and (2) are agreeing to be bound by arbitration of any claims or counterclaims which you or [name] may submit to arbitration under this agreement. You are not, however, waiving your right to elect instead to petition the CFTC to institute reparations proceedings under Section 14 of the Commodity Exchange Act with respect to any dispute that may be arbitrated pursuant to this agreement. In the event a dispute arises, you will be notified if [name] intends to submit the dispute to arbitration. If you believe a violation of the Commodity

Exchange Act is involved and if you prefer to request a section 14 "Reparations" proceeding before the CFTC, you will have 45 days from the date of such notice in which to make that election.

You need not sign this agreement to open or maintain an account with [name]. See 17 CFR 166.5.

(d) *Enforceability.* A dispute settlement procedure may require parties utilizing such procedure to agree, under applicable state law, submission agreement or otherwise, to be bound by an award rendered in the procedure, provided that the agreement to submit the claim or grievance to the procedure was made in accordance with paragraph (c) or (g) of this section or that the agreement to submit the claim or grievance was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(e) *Time limits for submission of claims.* The dispute settlement procedure established by a designated contract market shall not include any unreasonably short limitation period foreclosing submission of customers' claims or grievances or counterclaims.

(f) *Counterclaims.* A procedure established by a designated contract market under the Act for the settlement of customers' claims or grievances against a member or employee thereof may permit the submission of a counterclaim in the procedure by a person against whom a claim or grievance is brought. The designated contract market may permit such a counterclaim where the counterclaim arises out of the transaction or occurrence that is the subject of the customer's claim or grievance and does not require for adjudication the presence of essential witnesses, parties, or third persons over whom the designated contract market does not have jurisdiction. Other counterclaims arising out of a transaction subject to the Act and rules promulgated thereunder for which the customer utilizes the services of the registrant may be permissible where the customer and the registrant have agreed in advance to require that all such submissions be included in the proceeding, and if the aggregate monetary value of the counterclaims is capable of calculation.

(g) *Eligible contract participants.* (1) A person who is an "eligible contract participant" as defined in section 1a(12) of the Act may negotiate any term of an agreement or understanding with a Commission registrant in which the eligible contract participant agrees, prior to the time a claim or grievance arises, to submit such claim or grievance to any settlement procedure, except that

signing the agreement must not be made a condition for the eligible contract participant to use the services offered by the registrant.

(2) The agreement may require an eligible contract participant, to waive the right to seek reparations under section 14 of the Act and part 12 of this chapter.

(3) If the agreement is contained as a clause or clauses of a broader agreement, the eligible contract participant must separately endorse the clause or clauses containing the agreement; *Provided, however,* a futures commission merchant may obtain such endorsement as provided in § 1.55(d) of this chapter.

## **PART 170—REGISTERED FUTURES ASSOCIATIONS**

### **Subpart A—Standards Governing Commission Review of Applications for Registration as a Futures Association Under Section 17 of the Act**

16. The authority citation for Part 170 is proposed to be revised to read as follows:

**Authority:** 7 U.S.C. 6p, 12a, and 21, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000).

17. Section 170.8 is proposed to be revised to read as follows:

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

A futures association must be able to demonstrate its capacity to promulgate rules and to conduct proceedings 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 of the association or any employee of a member of the association. Such rules shall conform to and be consistent with section 17(b)(10) of the Act and be consistent with the guidelines and acceptable practices for dispute resolution found within Appendix A and Appendix B to Part 38 of this chapter.

## **PART 180—ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES**

18. Part 180 is proposed to be removed.

Issued in Washington, D.C., this 2nd day of March, 2001, by the Commission.

**Jean A. Webb,**

*Secretary of the Commission.*

**Concurring Statement of Commissioner Thomas J. Erickson**

### **A New Regulatory Framework for Trading Facilities, Intermediaries, and Clearing Organizations**

I concur with the release of these proposed rules. First, the Commodity Futures Modernization Act of 2000 ("CFMA")<sup>1</sup> is now law, and it is imperative that the Commission provide some regulatory structure and guidance so that the intent behind the CFMA might be fully effectuated. Second, the CFMA represents profound change for the derivatives industry, and I therefore believe that it is important to solicit as much comment as is possible from as broad a cross-section of the public as is possible. This brings me to my primary concern.

Over the past year, this Commission has devoted a tremendous amount of time and resources to devising a new regulatory framework,<sup>2</sup> working with Congress on the CFMA, and drafting today's proposed rules which implement the CFMA. Throughout this process, the Commission has provided draft rules to certain interested parties for their review and comment—at times, prior to their publication in the **Federal Register** for general comment. Certainly, discussion and dialogue with the industry is to be encouraged, and I am pleased that the Commission has reached out to the industry and made every effort to accommodate its views. However, I fear that this process has given great weight to the views of a select few, depriving the Commission of an opportunity to hear from the broader community of interests on a broader range of issues. In particular, I believe the Commission would benefit from input on two additional issues: disclosure and fraud.

#### *Disclosure*

The CFMA is based largely on a regulatory reform package initially proposed by the Commission. From the very inception of this reform effort, the Commission has referred to its new regulatory framework as a

<sup>1</sup> See Consolidated Appropriations Act 2001, Appendix E, Pub. L. No. 106–554, 114 Stat. 2763 (2000).

<sup>2</sup> See A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations (final rulemaking), 65 FR 77961 (Dec. 13, 2000); A New Regulatory Framework for Clearing Organizations (final rulemaking), 65 FR 78020 (Dec. 13, 2000); Exemption for Bilateral Transactions (final rules), 65 FR 78030 (Dec. 13, 2000); and Rules Relating to Intermediaries of Commodity Interest Transactions (final rules), 65 FR 77993 (Dec. 13, 2000). The final rules were subsequently withdrawn following the passage of the CFMA. See A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations; Rules Relating to Intermediaries of Commodity Interest Transactions; A New Regulatory Framework for Clearing Organizations; Exemption for Bilateral Transactions (final rules; partial withdrawal), 65 FR 82272 (Dec. 28, 2000).

“disclosure-based” system.<sup>3</sup> The Commission today rightly asks whether, in the case of exempt markets, it should require that exempt entities affirmatively disclose to traders that the facility and trading on the facility are not regulated or approved by the Commission. It seems self-evident to me that rules implementing such a disclosure-based system ought to require disclosure. I would further suggest that it may be appropriate for the Commission to consider requiring all trading facilities at each of the tiers of regulation to disclose to their participants the type of regulation to which they are subject (if any). I am interested in hearing comment regarding the merits of a disclosure obligation. In the absence of such an obligation, should the Commission publish a listing of exchange markets identifying their regulatory status?

#### Fraud

One of the points about which there has been a great deal of discussion from the

earliest days of the reform effort involves the Commission’s antifraud authority. In the past, the Commission has had difficulty applying the antifraud provisions of the Act in some novel situations. In particular, the Commission’s efforts to address fraud against retail customers has been hamstrung by some courts’ interpretation of Section 4b of the Commodity Exchange Act.<sup>4</sup> Given the inevitability of new market structures and classes of participants, the Commission has been wise to consider how its antifraud authority might be clarified through rulemaking. Nevertheless, throughout the reform process, the Commission has repeatedly heard from industry representatives that this would be a bad idea.

With the passage of the CFMA, members of Congress acknowledged the problems faced by the Commission in enforcing its antifraud provisions and stated their understanding that Section 4b was intended to be read broadly so as to give the Commission maximum enforcement authority.<sup>5</sup> This

intent is reflected in the “Findings and Purpose” section of the CFMA. That provision explicitly provides that, among other things, it is the purpose of the Act “to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets \* \* \*.”<sup>6</sup>

Today, the Commission proposes rules that include a free-standing fraud provision. But the proposed rule, Rule 1.1, applies only to forex bucket shops because of expressed concerns about a broader rule of application. I believe it is in the public interest to propose a more comprehensive antifraud rule. While I concur generally with the publication of these proposed rules and certainly support the Commission asserting its authority under the CFMA to address forex bucket shops, I would like to hear precisely why adoption of such a comprehensive fraud rule in any way violates the public interest, overrides the intent of Congress, or oversteps the Commission’s authority.

Dated: March 2, 2001.

**Thomas J. Erickson,**  
*Commissioner.*

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<sup>3</sup> See A New Regulatory Framework: Report of the Commodity Futures Trading Commission Task Force, Feb. 2000, p. 2 (describing the taskforce’s mission as providing recommendations regarding, among other things, “moving the Commission \* \* \* from merit to disclosure-based regulation”); A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations (proposed rulemaking), 65 FR 38985, 38986 (June 22, 2000) (“the proposed framework to a large degree relies more heavily on disclosure rather than merit regulation”); A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations (final rulemaking), 65 FR 77961, 77962 (Dec. 13, 2000) (“the new framework relies more heavily on disclosure rather than merit regulation”); see also *id.* at 77974.

<sup>4</sup> See *Commodity Trend Service, Inc. v. Commodity Futures Trading Comm’n*, 233 F.3d 981 (7th Cir. 2000) (Section 4b held not to apply to a financial publisher because the prohibition on fraud in connection with certain contracts of sale of a commodity for future delivery made for or on behalf of any other person applies only to brokers or others who have an agency relationship with their clients).

<sup>5</sup> “It is the intent of Congress in retaining Section 4b in this bill that the provision not be limited to fiduciary, broker-client or other agency-like relationships. Section 4b provides the Commission with broad authority to police fraudulent conduct within its jurisdiction, whether occurring in boiler rooms and bucket shops, or in the e-commerce and other markets that will develop under this new statutory framework.” 146 Cong. Rec. S11924 at

S11926 (daily ed. Dec. 15, 2000) (statement of Sen. Lugar). See also 146 Cong. Rec. H12488 at H12489 (daily ed. Dec. 15, 2000) (statement of Rep. Ewing) (same).

<sup>6</sup> Consolidated Appropriations Act 2001, Appendix \_\_\_, Pub. L. No. 106-554 § 108, 114 Stat. 2763 (2000) (amending Section 3 of the Commodity Exchange Act (7 U.S.C. 5)).