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Jean A. Webb, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

COMMENT

Re: Self-Regulation and Self-Regulatory Organizations

Dear Ms. Webb:

Board of Trade of the City of New York, Inc. ("NYBOT®") hereby submits its response to the Request for Additional Comments appearing in 70 Fed. Reg. 71090 et. seq. (November 25, 2005) (the "RFAC"). NYBOT previously submitted written comments in a submission dated September 30, 2004 in response to the Commission's June 9, 2004 notice in the Federal Register concerning the agency's study of self-regulatory organizations ("SROs"). NYBOT's 2004 comment letter is referred to herein as the "Initial Comment".

NYBOT is a designated contract market ("DCM") that is the successor to, and operates the former markets of, the Coffee, Sugar & Cocoa Exchange and the New York Cotton Exchange. Products traded on NYBOT encompass agricultural commodities, foreign currencies and index contracts. The members of NYBOT represent a diverse range of market users including floor brokers, commercial hedgers, futures commission merchants, commodity trading advisors, hedge funds and broker-dealers.

NYBOT is a mutually owned exchange organized under the Not-for-Profit Corporation Law of the State of New York. As such, some of the questions posed by the RFAC have more direct relevance to those exchanges that are owned by publicly traded corporations than to NYBOT. Consequently, NYBOT's further comments address those areas in which it has the most experience, and we refer the Commission to our Initial Comment as to any matters not addressed herein. Question numbers used in this letter correspond to the question numbers as they appear in the RFAC.

1. Is the present system of self-regulation an effective regulatory model for the futures industry?

The concept of self-regulation, long embodied in the Commodity Exchange Act, was strongly reinforced and expanded by the Commodity Futures Modernization Act of 2000 (the "CFMA"). Among the declared purposes of that Act were the following goals, as specified in Section 2 thereof: "(2) to streamline and eliminate unnecessary regulation for the commodity futures exchanges and other entities regulated under the Commodity Exchange Act; [and] (3) to transform the role of the Commodity Futures Trading Commission to oversight of the futures markets." It would be contrary to these stated purposes for the Commission to mandate changes in the way SROs govern or how they carry out their SRO responsibilities.

There is a strong history of self-regulation working effectively in the futures markets for many decades. It is inherent in the concept of self-regulation that SROs should determine for themselves the appropriate way to address such matters as conflicts of interests and to determine what systems of governance and discipline are appropriate for each of them, respectively, based on its culture, philosophy and particular circumstances. The Commission's strong oversight role has served to assure that the public interest has been protected within this structure. Unless there is a compelling need to do so, based on concrete experience and not generalized allegations or mere philosophical theorizing, the Commission should not mandate changes or specify the methods by which SROs fulfill their responsibilities.

4. What is the appropriate composition of SRO's boards of directors to ensure the fairness and effectiveness of their self-regulatory programs?

As a threshold matter, we point out that as a matter of general corporate law, the fiduciary duty of a director is to the corporation and not to any particular constituency. Therefore questions of "fairness" when speaking of board composition are inapposite. Nevertheless, in NYBOT's view board diversification does have beneficial effects and NYBOT's By-Laws provide for representation from a variety of communities, including members who represent

the trades associated with its products, members who trade for themselves or others on the trading floor, and clearing members and other members trading for their own accounts or for non-members. Such diversification of board membership serves the economic self-interest of an SRO by providing it with the expertise that can best be derived from those actively engaged in the trading activities of each community, by making the activities of the SRO transparent to the members of those communities and by giving each community a voice in the conduct of the trading in which they engage. However, whether to have such diversification, and how representation should be allocated among various communities, are matters for each SRO to determine for itself in light of its own particular circumstances.

5. Should SRO boards include independent directors, and, if so, what level of representation should they have? What factors are relevant to determining a director's independence?

The NYBOT Board consists of 25 voting governors and one non-voting governor. Five of the voting governors (20%) are denominated as "Public Governors," who are individuals that are not NYBOT members or affiliated with NYBOT member firms. These Public Governors are appointed by the Board, rather than elected by the membership. When selecting its Public Governors the NYBOT Board considers the expertise, independence, reputation and public sector awareness of the candidate. The current Public Governors include a faculty member of a prestigious school of business administration, a principal in a merger and acquisition firm, a consultant on legislative affairs, a senior official at a bank and a commodity trading advisor. We believe that the level of representation of independent directors on a governing board is a determination that each SRO should make for itself.

With respect to determining a director's independence, the standards articulated in the New York Stock Exchange Constitution, as quoted in the Commission's initial Request for Comments, strike us as relevant and appropriate to consider, and all of our Public Governors meet that standard. This has been as a result of the way in which the Board has filled those positions and not because of an express provision in our By-Laws or other legal requirement.

6. Should self-regulation be overseen by an independent entity within an SRO?

(i) If so, what functions and authority should be vested in such an entity?

(ii) At least two futures exchanges have implemented board-level regulatory oversight committees ("ROCs") to oversee their regulatory functions in an advisory capacity. Comments are invited to address any strengths or weaknesses in this approach.

In its Initial Comment NYBOT noted that it did not see a compelling need for its SRO regulatory functions to be overseen by an independent body internal to the exchange, in light of the regulatory oversight supplied by the Commission, although the establishment of such a body would not be inappropriate. NYBOT has always enlisted its Public Governors in a variety of matters and, specifically in the context of its disciplinary program, some of its Public Governors fulfill the NYBOT requirement that a non-member participate as a member of each disciplinary panel reviewing investigative reports or adjudicating contested cases. NYBOT Public Governors also comprise a majority of the Audit Committee and play an active role as members of the Executive Committee and others. As such, all of the Public Directors have developed a level of familiarity with the exchange regulatory environment which, when coupled with their own business experience, provides the Board with a professional, independent viewpoint on many important issues.

Based on this strong foundation, NYBOT recently created a standing committee of the Board comprised of its Public Governors, to serve as an advisory committee on compliance regulatory matters.¹ The Committee's

¹ Rule 340 provides that :

(a) The Regulatory Oversight Committee shall be a Standing Committee and shall consist of the Public Governors.

(b) The Committee shall oversee fulfillment of the Exchange's compliance self-regulatory obligations and advise the Board on all such matters.

(c) In furtherance of its responsibility to oversee the fulfillment of the Exchange's self-regulatory function, the Regulatory Oversight Committee shall, among other things:

mandate extends to the market regulation activities (compliance and market surveillance functions) but not to other regulated activities of the Exchange, such as the adoption and submission of rules. In addition, as set forth in its charter, the Committee is not charged with any role in the day-to-day oversight of the operations of the market regulation function, but rather is there to support that function. This is accomplished by, among other things, confirming that the resources needed to effectively carry out the Exchange's program are available to the staff and that nothing interferes with the staff's fulfillment of the program. In order to do so, the Committee members will have a level of rapport with the officials managing the market regulation program that the Board, as a whole, would not otherwise have. The Committee periodically will report its findings to the Board, and thereby provide a gauge of the Exchange's performance that supplements the Commission's Market Surveillance and Rule Enforcement reviews of the Exchange.

We do not believe that the SRO functions of exchanges need to be overseen, in the operational sense, by an independent entity within the SRO any more than do the regulatory functions of FCMs, which have a more direct connection to the trading public than do the exchanges. Indeed, if the existence or appearance of conflicts of interest were to be a black-line test, every FCM would have established an independent entity within its organization to carry out its regulatory functions, or would have contracted with an unaffiliated third party to do so. However, many, if not most, FCMs continue to maintain a compliance division, usually within the Legal Department, with the reporting chain ultimately extending to the CEO—a person who also has ultimate

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- (i) review and make recommendation with respect to the responsibilities, budget and staffing of the Market Regulation Department so that it is able to fulfill its self-regulatory responsibilities;
 - (ii) review the functioning of the Market Regulation Department to determine whether it is able to implement self-regulatory responsibilities independent of any improper influence, interference or other factors that could interfere with the ability to fulfill its responsibilities;
 - (iii) review the Exchange's compliance with its self-regulatory responsibilities as prescribed by law and the Rules; and
 - (iv) review changes and proposed changes, as appropriate, to the Rules to the extent that such Rules are likely to impact significantly the self-regulatory functions of the Exchange.

responsibility for the business success of the company. There is no evidence that SROs are any less able to handle their regulatory obligations than are FCMs, or that the Commission's oversight is less effective than that of the SEC and NASD. Accordingly, the Commission should not require any specific mode of operation or structure with respect to the manner in which an SRO fulfills its SRO responsibilities.

8. What is the appropriate composition of SRO's disciplinary committees to ensure both expertise and impartiality in decision-making?

(i) Should a majority of committee members be independent? Should the composition of SRO's disciplinary committees reflect the diversity of the constituency? Should similar safeguards apply to other key committees and, if so, which committees?

(ii) Should SRO disciplinary committees report to the board of directors, an independent internal body, or an outside body?

The Business Conduct Committee ("BCC"), which is the only committee with authority to discipline NYBOT members (other than by the issuance of summary fines), reflects the diversity of NYBOT's constituents and includes non-members. The BCC operates through two panels of eight members, with each panel having four members from the floor interest, three members from the trade and FCM communities, and one non-member. Thus, half of each panel is drawn from the floor trading community and the other half from persons who are not floor traders, with each panel including a non-member. All final decisions are reported to the Commission and the disciplined member has a right to Commission review in accordance with the Commodity Exchange Act and the regulations thereunder.

This system has worked successfully for years, and we believe it would be a serious mistake to require that a majority of the BCC members be "independent". Most cases presented to the BCC are very technical in nature and require a strong knowledge of our rules and understanding of trading practices. To change this system by requiring a majority of the BCC members to be non-members would deprive the system of needed expertise. Moreover, it could result in some of the non-members deferring to the members in a particular case with respect to questions about trading practices. This would have the effect of vesting decision-making in the hands of just a few individuals,

and would undercut the benefit of having diverse interests represented on the BCC. It is counter-intuitive to conclude that a disciplinary committee comprised of a majority of non-members with no industry experience could reach better decisions than one comprised of a majority of knowledgeable members. Therefore, we urge the Commission to leave such composition issues in the hands of the SROs. If a problem were to arise, the Commission has adequate means to address it either through the existing procedures for the review and appeal of disciplinary decisions or the routine Rule Enforcement review program.

With respect to the reporting chain for disciplinary committees, the NYBOT rules provide that the decision of the BCC constitutes the final Exchange action, except that where the sanction being meted out includes expulsion a right of appeal to the full Board exists with respect to the expulsion. We see no reason for the routine review of BCC decisions by anyone other than the Commission. Indeed, NYBOT's predecessor exchanges eliminated the existence of a general "appeals" committee, concluding that it was not beneficial to have decisions second-guessed by committees whose members had not heard the evidence presented at trial and could not make informed credibility and other determinations. Statistics indicate that very few, if any, SRO disciplinary actions are reversed by the Commission on appeal. This would tend to suggest that the decisions of the SRO disciplinary committees are supported by the record evidence presented to them, and therefore no manifest problems need to be cured by imposing specific composition requirements on these committees.

While the NYBOT system has worked successfully for many years, undoubtedly other systems might be employed at other SROs to equally good effect, and it should be the decision of each SRO as to what system to employ. There is no demonstrated need to mandate otherwise.

9. What information should SROs make available to the public to increase transparency (e.g., governance, compensation structure, regulatory programs and other related matters)? Are the disclosure requirements applicable to publicly traded companies adequate for SROs?

Information regarding the staffing and budget for the various NYBOT regulatory functions is provided to and is available to the Commission. We have never been asked for such information by members of the public, and we do not see why it would be relevant to them. Other information, such as

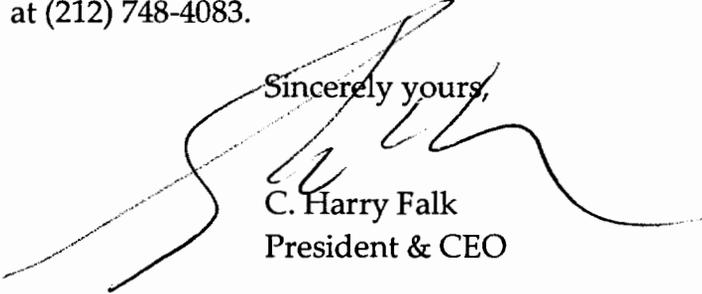
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Board member affiliations and disciplinary committee membership and affiliations is available to the public on the NYBOT web site and in the materials published by the Commerce Clearing House service containing the NYBOT Rule Book and other information.

Whether additional information should be made public is a matter to be decided by each SRO for itself, according to its structure. The disclosure requirements applicable to publicly-traded companies do not apply to NYBOT and we therefore reserve comment as to them.

NYBOT appreciates the opportunity to submit these additional comments regarding SROs and looks forward to participating in the roundtable discussion scheduled for February 15, 2006. If the Commission has any questions concerning the comments in this letter, please contact NYBOT's General Counsel, Audrey R. Hirschfeld, at (212) 748-4083.

Sincerely yours,



C. Harry Falk
President & CEO

Cc: Chairman Reuben Jeffery, III
Commissioner Sharon Brown-Hruska
Commissioner Michael V. Dunn
Commissioner Fred Hatfield
Commissioner Walter L. Lukken