

COMMODITY FUTURES
TRADING COMMISSION
RECEIVED FOR
PUBLIC RECORD

THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK
42 WEST 44TH STREET
NEW YORK, NY 10036-6690

98-2
4
COMMODITY FUTURES
TRADING COMMISSION
RECEIVED FOR
PUBLIC RECORD

MAR 18 12 13 PM '98 COMMITTEE ON FUTURES REGULATION

EMILY M. ZEIGLER
CHAIR
CITICORP CENTER
153 EAST 53RD STREET
NEW YORK, NY 10022
(212) 821-8284
FAX # (212) 821-8111

March 13, 1998

MAR 18 10 43 AM '98
RITA M. MOLESWORTH
SECRETARY
CITICORP CENTER
153 EAST 53RD STREET
NEW YORK, NY 10022
(212) 821-8727
FAX: (212) 821-8111

COMMENT

Ms. Jean A. Webb
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: FCM Early Warning Reporting Requirements

Dear Ms. Webb:

The Committee on Futures Regulation of this Association (the "Committee") respectfully submits this comment letter to the Commission in response to the Commission's request for comments in its notice published on January 14, 1998 in the Federal Register (63 Fed. Reg. 2188) (the "Release") regarding early warning reporting requirements applicable to futures commission merchants ("FCMs").

The Association of the Bar is an organization of 21,000 lawyers. While most of the members practice in the New York area, the Association has members in 48 states and 51 countries. The Committee, which is comprised of attorneys knowledgeable in the field of futures and derivative instrument regulation, has a long history of publishing reports carefully analyzing critical regulatory issues which affect the futures and derivatives industry.

While the Committee supports the Commission's efforts to strengthen market safeguards, we believe that the Release raises two significant legal issues which should be addressed:

1. Constant Compliance. The notion that an FCM knows at every moment of the day the size of receivables due to or from a clearing organization or a clearing broker assumes that those payment obligations arise immediately, ignores the effects of netting under the various clearing systems, and assumes away the substantial legal issue of when such payments are "due" to be made by the respective parties.¹ In addition, given the international scope of many major FCMs' activities, it is not realistic to believe that the information which the Commission staff seems to

¹ For example, the money settlement arrangements utilized by the clearing houses may be vulnerable to weakness because of a lack of clarity regarding the obligations of the various participants in the settlement process, and how these obligations would be affected by the failure of a clearing member or a settlement bank. See Bank for International Settlements, Clearing Arrangements for Exchange-Traded Derivatives (March 1997) at page 32.

believe "should be" within the easy grasp of an FCM could be collected, assembled, and digested in enough time to satisfy the "real-time" standards set forth in the Proposal.

2. "Should Know" Standard. The standard of when an FCM "should know" that it has failed to maintain sufficient funds in segregation or secured accounts introduces dangerous elements of subjectivity and "after the fact" determinations into what should be a mechanical and objective accounting calculation. Given the vicarious liability provisions of the Commodity Exchange Act and various interpretations of Regulation 166.3 on supervision standards, this subjective "should know" standard interjects undue risk and uncertainty into what should be a straight-forward calculation.

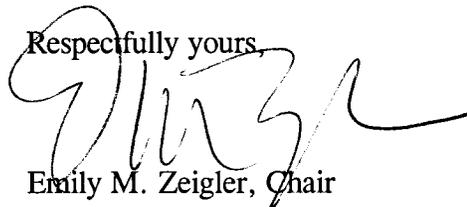
In this regard, we note that the "should know" standard has not been the subject of litigation or addressed by any staff interpretations. We believe that the uncertain nature of this standard may encourage the premature reporting of events, particularly those involving segregation. Should these reports become public, even inadvertently, various firms could become the victims of customer runs. The proposed amendments to Rule 1.12 ironically could end up creating the very market emergencies which it is purportedly designed to avoid. We further note that in situations such as Barings, the calming influence of the Commission and the exchanges avoided panic on the part of market participants. Similarly, we believe that Rule 1.12. should be designed to encourage dialogue between FCMs and the Commission staff rather than instigate a domino-type effect. The use of a subjective standard will lead to "after the fact" determinations which can be harmful to this full disclosure and open discourse necessary among an FCM, the exchanges and the Commission staff.

* * *

In sum, the Committee believes that the proposals set forth in the Release should be refined. Most FCMs would not object to an early warning requirement with respect to undersegregation or secured amounts. This early warning requirement could be tied to an earlier time in Rule 1.32 for the preparation of the daily segregation calculation and could be immediate in nature. However, in no event should Rule 1.12 be revised to (a) incorporate a notion of "constant" compliance or (b) establish a subjective "should know" standard.

The Committee appreciates this opportunity to present its views regarding this important proposed amendment of Rule 1.12.

Respectfully yours,



Emily M. Zeigler, Chair

**Association of the Bar the City of New York
Committee on Futures Regulations**

**Emily M. Zeigler,* Chair
Rita M. Molesworth, Secretary**

Samuel F. Abernethy
Ruth Ainslie
Conrad G. Bahlke
Armando Belly
J.P. Bruynes
Joseph P. Collins**
Marcy Engel
Edward H. Fleischman
Suellen Galish
Alison M. Gregory
Joyce M. Hansen (adjunct)
Andrew Herrmann*
Lenel Hickson, Jr.# (adjunct)
Philip Karasyk
Bernard J. Karol
Steven J. Keltz*
Dennis Klejna
David Kozak
Robert G. Lendino
Norma B. Levy
Barry Loyal

William F. McCoy*
Richard A. Miller
David Mitchell
Richard E. Nathan
Steven Olgin
John W. Osborn
C. Robert Paul*
Michael Schmidtberger
Howard Schneider
Rebecca Simmons
Lore C. Steinhauer
Rita McCloy Stephanz
Gary Stumpp
Scott G. Van Hatten
Steven P. Vincent
Barbara Wierzynski
Mark Woodall*

Lan Cao (intern)

-
- * Members of Subcommittee on FCMs who drafted this letter of comments.
** Chair of Subcommittee.
Mr. Hickson did not participate in the comment letter.