



Division of
Market Oversight

U.S. COMMODITY FUTURES TRADING COMMISSION

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DESIGNATION MEMORANDUM

TO: The Commission

FROM: Division of Market Oversight

DATE: May 18, 2009

SUBJECT: Application of ELX Futures, L.P. for Designation as a Contract Market pursuant to Sections 5 and 6(a) of the Commodity Exchange Act and Part 38 of the Commission's regulations.

RECOMMENDATION: That the Commission: (1) designate ELX as a contract market; (2) approve the following ELX Rules: I-1 through I-4; II-1 through II-12; III-1 through III-14; IV-1 through IV-33; V-1 through V-8; VI-1 through VI-14; VII-1 through VII-20; VIII-1 through VIII-5; IX-1 through IX-3; X-1 through X-5; (3) approve the Amended and Restated Limited Liability Partnership Agreement of ELX Futures L.P.¹; and (4) issue the attached Order of Designation and Letter.

RESPONSIBLE STAFF: Nancy Markowitz x5453

CONCURRING DIVISIONS: Division of Enforcement
Office of the General Counsel
Division of Clearing and Intermediary Oversight

I. Background and Summary

By submissions filed November 28, 2008 through May 18, 2009, ELX Futures, L.P. ("Electronic Liquidity Exchange" or "ELX" and formerly ESX Futures, L.P.) submitted an Application for Designation as a Contract Market ("Application"), pursuant to the provisions of

¹ On May 15, 2008, a Certificate of Amendment to the Certificate of Limited Partnership of ESX Futures, L.P. was filed with the Secretary of the State of Delaware, changing the name of the Partnership from ESX Futures, L.P. to ELX Futures, L.P.

Section 5(b) of the Commodity Exchange Act (“Act”) and Part 38 of the Commodity Futures Trading Commission’s (“Commission”) regulations. ELX originally requested expedited treatment, pursuant to Section 38.3 (a)(2) of the Commission’s regulations, where, based upon the date of receipt, the 90-day review period would have ended on February 26, 2009. On February 4, 2009, ELX submitted a request to extend the review of its Application on an expedited basis for an additional 45 days, with the review period to end on April 15, 2009. On February 20, 2009, staff notified ELX that its Application was materially incomplete and thus pursuant to 17 C.F.R. § 38.3 (b), the Commission was compelled to terminate the expedited review of the Application. The letter noted that, to date, the material submitted was incomplete so that the Commission staff could not determine compliance with many of the Designation Criteria and Core Principles required under Part 38 of the Commission’s regulations including, but not limited to, Designation Criteria 2 (Prevention of Market Manipulation), 3 (Fair and Equitable Trading) and 4 (Trade Execution Facility); and Core Principles 2 (Compliance with Rules), 4 (Monitoring of Trading), 8 (Daily Publication of Trading Information), 10 (Trade Information), 12 (Protection of Market Participants) and 16 (Composition of Boards of Mutually Owned Contract Markets). The Application was thereafter processed under the statutory 180-day time period and procedures of Section 6(a) of the Commodity Exchange Act, with a designation date of May 27, 2009.

ELX is a Delaware limited partnership formed in December 2007 initially consisting of 11 investors², including dealers, trading firms, a voice broker and a technology provider. ELX Futures Holdings, LLC (“Holdings”) is a Delaware limited liability company and the sole general partner of ELX. 99.75% of ELX is owned directly by the individual members of Holdings, in the form of limited partnership interests. The remaining 0.25% of the equity interests of ELX is owned indirectly by the members through Holdings, in the form of a general partnership interest.

ELX initially intends to list for trading U.S. Treasury futures products that are identical to those currently traded on the Chicago Board of Trade. (“CBOT”) including the U.S. Treasury Bond Futures Contract, the Long Term (6 1/2 to 10 years), U.S. Treasury Note Futures Contract, the Medium Term (5 year) U.S. Treasury Note Futures Contract and the Short Term (2 years) U.S. Treasury Note Futures Contract.³ Pursuant to its Market Supervision Policies and Procedures, ELX’s Control Desk is responsible for the Exchange’s market operations, real-time market monitoring, customer support and real-time market surveillance. Pursuant to a Technical Services Agreement with ELX, BGC Partners, Inc. (“BGC,” formally eSpeed Technology Services, L.P.) is ELX’s technology services provider and will provide technology support to the Control Desk. Further, ELX entered into a contract with the National Futures Association (“NFA”), pursuant to which the NFA will provide T +1 surveillance and compliance services for ELX. Clearing services for ELX will be provided by the Options Clearing Corporation (“OCC”).

² The investors include the following: Banc of America Strategic Investments Corporation; Barclays Electronic Commerce Holdings Inc.; Citadel Tactical Investments LLC; Citigroup Financial Products Inc.; Credit Suisse NEXT II Investors, L.P.; DBAH Capital LLC; Getco LLC, LabMorgan Corporation; Merrill Lynch L.P. Holdings Inc.; PEAK6 Investments, L.P.; Random Properties Acquisition Corp. I and eSpeed ESX Holdings, L.P.

³ Under ELX Rules, trading privileges are given to “Participants”, “Authorized Customers” and “Authorized Traders”.

An interdivisional Commission team was assembled to review the ELX application for contract market designation.⁴ As noted in Sections II-III of this memorandum, the interdivisional team concludes that the ELX Application has provided a showing that it complies with the Act’s Section 5(b) Designation Criteria, Section 5(d) Core Principles, Section 5c(b) Delegation of Functions Under Core Principles, Section 6(a) Application for Designation – Hearing, and Part 38 of the Commission’s regulations.

Accordingly, the Division recommends that the Commission issue the attached order designating ELX as a contract market and simultaneously approve the following ELX Rules: I-1 through I-4; II-1 through II-12; III-1 through III-14; IV-1 through IV-33; V-1 through V-8; VI-1 through VI-14; VII-1 through VII-20; VIII-1 through VIII-5; IX-1 through IX-3; X-1 through X-5; and the Amended and Restated Limited Liability Partnership Agreement of ELX Futures, L.P.

II. Analysis of ELX’s Contract Market Application, Outsourcing Agreement with NFA and BGC and its Proposed Rules, for Compliance with the Act’s Criteria for Designation as a Contract Market

CONTRACT MARKET CRITERIA FOR DESIGNATION	ELX PROPOSAL	STAFF ANALYSIS
<p>Sec. 5(a) Applications – “A board of trade applying to the Commission for designation as a contract market shall submit an application to the Commission that includes any relevant materials and records the Commission may require consistent with this Act.”</p>		<p>Acceptable.</p> <p><i>See Attachments.</i></p>
<p>Sec. 5(b) CRITERIA FOR DESIGNATION</p>		
<p>Designation Criterion 1 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.”</p>		<p>Acceptable.</p> <p><i>See generally below.</i></p>

⁴ The ELX review team members include: Steve Benton, Industry Economist, Division of Market Oversight (“DMO” or “Division”); Susan Berkowitz, Deputy Chief Counsel – Division of Enforcement (“Enforcement”); Gloria Clement, Assistant General Counsel – Office of the General Counsel (“OGC”); Patricia Collins, Futures Trading Specialist-DMO; Brian Conlon, Futures Trading Specialist-DMO; William McKinley, Industry Economist-DMO; Melissa Mitchell, Attorney Advisor- DMO; Chul Park, Senior Economist – DMO; Nancy Schnabel, Attorney-Advisor - Division of Clearing and Intermediary Oversight (“DCIO”); Sebastian Pujol Schott, Special Counsel – DMO; Gail Scott, Attorney –OGC; Harvey Theberge, Information Technology Contractor-DMO.

CONTRACT MARKET CRITERIA FOR DESIGNATION	ELX PROPOSAL	STAFF ANALYSIS
<p>Designation Criterion 2 <i>Prevention of Market Manipulation</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 1-2; Attachment C-2 (ELX Rulebook): Rule II-5 (Regulatory Oversight Committee), Rule II-12 (Regulatory Services Agreement with the RSP), Chapter VII (Discipline and Enforcement); Regulatory Services Agreement between ELX and NFA; ELX Market Supervision Policies and Procedures; ELX System Demonstration- April 20, 2009</p>	<p>Acceptable.</p> <p>The Compliance Director and Deputy Compliance Director will be responsible for the day-to-day self-regulatory functions of ELX. They will supervise staff of the ELX Control Desk, which will be responsible for market operations, real-time market monitoring, customer support and surveillance. The Compliance Director will be the Exchange liaison with the NFA, who is the Regulatory Service Provider (RSP) under contract for ELX. NFA will be responsible for ELX’s trading and market surveillance, audit and investigatory functions. The Compliance Director will report to the Regulatory Oversight Committee (ROC) which will oversee the ELX regulatory program on behalf of the Board and will consist only of public directors.</p> <p>The ELX Control Desk and NFA will work together and integrate the Control Desk’s real-time monitoring with NFA’s surveillance functions and each will exchange information with the other.</p> <p>Based on its review of the joint responsibilities of the ELX Compliance Director, Deputy Compliance Director, ELX Control Desk and NFA trade practice and market surveillance duties (including ELX’s System Demonstration-April 20, 2009), Commission staff has determined that ELX adequately demonstrates compliance with Designation Criterion 2.</p>

CONTRACT MARKET CRITERIA FOR DESIGNATION	ELX PROPOSAL	STAFF ANALYSIS
<p>Designation Criterion 3 <i>Fair and Equitable Trading</i> – “The board of trade shall establish and enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and [sic] 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 futures – (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 principle 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”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 5-6; Attachment C-2 (ELX Rulebook): Chapter IV (Trading Standards), Chapter VI (Business Conduct), Chapter VII (Discipline and Enforcement); Regulatory Services Agreement between ELX and NFA; ELX Market Supervision Policies and Procedures; ELX’s response to CFTC Technology Questionnaire; eSpeedC/C++ Application Program Interface – Reference Guide; External Application Certification Process</p>	<p>Acceptable.</p> <p>ELX has established and will enforce trading rules to ensure fair and equitable trading. All Participants and their Authorized Traders and Authorized Customers will have equal access to the ELX trading platform, including information regarding prices, bids and offers and system alerts. Orders will be executed impartially by the ELX system (using the eSpeed trading platform), utilizing a trade matching algorithm in accordance with the principles set forth in Chapter IV of the ELX Rulebook and procedures described in the ELX response to the CFTC Technology Questionnaire. ELX has established trading rules prohibiting trading abuses and requiring adherence to the law, including the CEA, in Chapter VI of ELX’s Rulebook.</p> <p>The NFA, under the terms of its regulatory services agreement with ELX, will maintain procedures to detect and investigate abuses such as trading ahead, wash trading, money passes, accommodation trades, market manipulation, fraud and other types of abuses. NFA has provided similar regulatory services for the Chicago Climate Exchange, HedgeStreet and NYSE Liffe. ELX’s Chapter VII Rules contain a mechanism for enforcing its Rules and disciplining those participants within its jurisdiction.</p> <p>Based on its review of the ELX rules, its trading system and NFA procedures, Commission staff has determined that ELX adequately demonstrates compliance with Designation Criterion 3.</p>
<p>Designation Criterion 4 <i>Trade Execution Facility</i> – “The board of</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance</p>	<p>Acceptable.</p>

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<p>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.”</p>	<p>with Designation Criteria and Core Principles) at 6-7; Attachment C-2 (ELX Rulebook): Chapter IV (Trading Standards); Technology Services Agreement between BGC and ELX; ELX response to CFTC Technology Questionnaire; Test Plan and Matrix, Test Scenarios; ELX System Demonstration- April 20, 2009</p>	<p>ELX Rule IV-4 describes the order entry process and required information. Rule IV-5 describes the types of orders that may be entered into the system. Orders that do not comply will be rejected. Rule IV-6 describes the procedures for modification and cancellation of orders. Rule IV-7 describes the trade-matching algorithm.</p> <p>On April 20, 2009, ELX presented a comprehensive demonstration of the ELX trading system, including all order and trade matching scenarios described in its rulebook. All functions operated as described.</p> <p><i>See also</i> Core Principle 9, below.</p> <p>Based upon its review of the ELX technical and operational information, Commission staff has determined that ELX adequately demonstrates compliance with Designation Criterion 4.</p>
<p>Designation Criterion 5 <i>Financial Integrity of Transactions</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 7-8; Attachment C-2 (ELX Rulebook): Rule III-1 (Jurisdiction), Rule III-6 (Eligibility), Rule III-13 (Direct Access by Customers), Rule IV-10 (Position Limits), Rule IV-19 (Emergencies), Rule IV-23 (Primary Clearing Privilege Holder Authorization), Rule V-8 (Customer Margin), Rule VI-8 (Adherence to Law), Rule VII-18 (Summary Suspensions and Other Summary Actions), Rule VII-19 (Rights and Responsibilities After Suspension or Termination), Rule IX-3 (Contract Rules) and Rule X-1 (Settlement by Clearance); Regulatory Services Agreement between ELX and NFA; ELX</p>	<p>Acceptable.</p> <p>ELX provides for the financial integrity of transactions by arranging for OCC (an existing DCO) to clear ELX transactions.</p> <p>ELX has established rules and procedures for ensuring the financial integrity of transactions.</p> <p>ELX Rules III-1, IV-23 and X-1 require each ELX participant (i) to be an OCC member or to have a written agreement with an OCC member, whereby the OCC member guarantees the transactions of such participant on ELX (ii) to adhere to all applicable OCC Rules and (iii) that each ELX contract be subject to OCC Rules.</p>

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	<p>Participant Application Form and Agreement; ELX Access Procedures; Agreement for Clearing and Settlement Services, dated as of December 5, 2008, between ELX and The Options Clearing Corporation (“OCC”); Development Agreement, dated as of December 5, 2008, between ELX and OCC; ELX Market Supervision Policies and Procedures; ELX Response to March 10, 2009 Questions from DCIO; ELX Response to March 30, 2009 Questions from DCIO; ELX Response to April 14, 2009 Questions from DCIO; ELX Representations, dated as of April 17, 2009; Attachment C-5 (ELX Representations to the Commission).</p>	<p>ELX Rule VI-8 requires all ELX participants that are futures commission merchants (“FCMs”) to comply with: (i) applicable capital requirements under Commission Regulations and under the rules of the relevant designated self-regulatory organization (“DSRO”) and (ii) applicable law regarding the treatment of customer funds (including Commission Regulations on segregation, custody, and permitted investments).</p> <p>ELX Rule V-8 states that: (i) ELX will be responsible for publishing minimum performance bond requirements for each ELX contract or combination of contracts, (ii) an ELX participant may not effect a transaction on behalf of a customer, or carry an account for such customer, unless such participant obtains a performance bond at the times, in the amounts, and in the forms required by ELX, (iii) an ELX participant must calculate minimum performance bond requirements for each customer account using a risk-based portfolio margining system acceptable to ELX and (iv) an ELX participant may only accept performance bonds in the forms set forth in ELX Rule V-8 (<i>e.g.</i>, cash, Treasuries).</p> <p>ELX Rules III-6, VII-18 and VII-19(d), collectively, provide ELX with the authority: (i) upon default or probable default, to revoke, suspend, or condition the trading privileges of an ELX participant or Authorized Customer (<i>i.e.</i>, a customer with direct access to ELX), and (ii) upon the revocation or suspension of the trading privileges of an ELX participant, to transfer positions (and associated collateral) of customers of such ELX participant to a non-defaulting ELX participant.</p>

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		<p>ELX Rule III-14 mandates that each ELX Participant that is an FCM must deliver to ELX, in a timely manner, a copy of any financial information (including accountant certifications) that it files with the Commission or a DSRO pursuant to Commission Regulation 1.10. Pursuant to ELX's Market Supervision Policies and Procedures, the ELX Compliance Department will review such financial information for accuracy and completeness within 2 business days of ELX receipt.</p> <p>In addition to the above, ELX has agreed to undertake certain financial surveillance activities. ELX agrees to implement a financial surveillance program that will, on a daily basis under normal market conditions and on an intra-day basis during periods of market volatility: (i) ascertain the positions in ELX contracts held by each customer of an ELX participant, provided that such customer is a large trader, (ii) determine whether such positions are large relative to the adjusted net capital and excess net capital of the relevant ELX participant, and (iii) cause ELX to take appropriate action to address the results of its determinations in subparts (i) and (ii) (including calling the relevant ELX participant or taking formal action under the ELX Rules).</p> <p>In addition, pursuant to ELX's Market Supervision Policies and Procedures, ELX will undertake additional surveillance activities, such as monitoring large intra-day positions and comparing the pay-and- collect information for an ELX participant to the adjusted net capital and excess net capital of such ELX participant.</p>

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		Based on its review of the specified documents, Commission staff has determined that ELX adequately demonstrates compliance with Designation Criterion 5.
<p>Designation Criterion 6 <i>Disciplinary Procedures</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 8 -9; Attachment C-2 (ELX Rulebook): Rule II-5 (Regulatory Oversight Committee), Rule III-6 (Eligibility), Chapter VII (Discipline and Enforcement); Regulatory Services Agreement between ELX and NFA.</p>	<p>Acceptable.</p> <p>ELX has established disciplinary procedures which will be implemented with the assistance of NFA that are consistent with Commission regulations and interpretive guidance regarding core principles.</p> <p>All market participants, including Participants, Authorized Traders, Authorized Customers and each of their directors, officers, agents, or employees (as defined in the Rules and collectively referred to as “Subject Persons”), are subject to the Exchange’s jurisdiction and to disciplinary action for violating the ELX’s Rules, Commission Regulations or provisions of the CEA. The procedures provide due process, as discussed below.</p> <p>The NFA will conduct all investigations and ELX’s Compliance Director will promptly review each completed investigation report to determine whether a reasonable basis exists to believe that a violation within ELX’s jurisdiction has occurred or is about to occur. A Disciplinary Panel will conduct hearings in connection with any disciplinary proceeding, make findings and impose sanctions. The Disciplinary Panel is selected by the ROC from the NFA’s Hearing Panel Committee and is made up of 5 members. If charges are brought and a rule violation is found by the Disciplinary Panel, the respondent may appeal to the Appeals Panel</p>

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		<p>within 20 days. The Appeals Panel is selected by the Compliance Director and is comprised of 3 individuals who are ROC members. ELX's definition of Appeals Panel states that "[n]o Person serving on a Disciplinary Panel for any disciplinary proceeding may also serve on an Appeals Panel relating to such disciplinary proceedings."</p> <p>If the Compliance Director authorizes disciplinary proceedings, the Compliance Department will prepare and serve a notice of charges, stating the acts that the respondent is alleged to have engaged in, the Exchange Rule(s) alleged to have been violated, the proposed sanctions and advise the respondent of its right to a hearing. A Respondent's failure to timely answer a notice of charges or to expressly deny an allegation will be deemed an admission.</p> <p>ELX's Compliance Department may delegate any of its disciplinary powers and responsibilities to the NFA, but ELX retains responsibilities and supervisory authority over the exercise of those powers and responsibilities.</p> <p>During a hearing, the Compliance Department and all respondents may present evidence and facts, call and examine witnesses, and cross examine all witness called by other parties.</p> <p>Throughout the disciplinary process, respondents may be represented by counsel.</p> <p>The Exchange may impose one or more of the following sanctions or remedies: censure; limitation on the Subject Person's trading privileges; suspension of trading privileges; fine of up to \$500,000 for each rule</p>

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		<p>violation; restitution or disgorgement; expulsion or termination of trading privileges; any other sanction or remedy deemed appropriate.</p> <p>Finally, a respondent may propose an offer of settlement to disciplinary proceedings. Settlement offers should contain proposed findings and sanctions and be signed by the Respondent and submitted to the Compliance Department. Settlement offers that are accepted become final after 20 days, and Respondent's submission of an offer is deemed to constitute a waiver of the right to appeal.</p> <p>The ROC oversees the Exchange's disciplinary program, including supervising the Compliance Director who will report to the ROC.</p> <p>Based on its review of the ELX Rules, Commission staff has determined that ELX adequately demonstrates compliance with Designation Criterion 6.</p>
<p>Designation Criterion 7 <i>Public Access</i> – “The board of trade shall provide the public with access to the rules, regulations, and contract specifications of the board of trade.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 7; Attachment C-2 (ELX Rulebook): Rule III-11 (Notices to Participants), Rule IV-3 (Publication of Trading Information), and Rule IV-20 (Information regarding Nominal Prices and Settlement Prices).</p>	<p>Acceptable.</p> <p>ELX represents that the Rulebook, all amendments, notices and policies as well as specifications for all contracts will be publicly available on ELX's website. In addition, ELX will notify participants of any new or modified rules of ELX and any other relevant information.</p> <p>Based on its review, Commission staff has determined that ELX adequately demonstrates compliance with Designation Criterion 7.</p>
<p>Designation Criterion 8 <i>Ability to Obtain Information</i> – “The board of trade shall establish and enforce rules that will allow the board of</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 9; Attachment C-2</p>	<p>Acceptable.</p> <p>ELX's Rule V-1 requires each Participant and Supervised Person to</p>

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<p>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.”</p>	<p>(ELX Rulebook): Rule II-12 (Regulatory Cooperation), Rule V-1 (Books and Records; Cooperation in Proceedings), Rule V-2 (Cooperation with the RSP), Rule VII-2 (Inquiries and Investigation).</p>	<p>prepare and keep current all books, ledgers and other similar records required to be kept under the CEA, Commission Regulations and the Rules of the Exchange, and to prepare books and records as the Exchange may require. The books and records must be made available to the Exchange, the Commission, the Department of Justice (DOJ) and their respective authorized representatives upon request.</p> <p>ELX Rule VII-2 also provides that each Participant, Authorized Trader, or Supervised Person under ELX’s jurisdiction must respond to discovery requests (<i>e.g.</i>, interrogatories and document requests) propounded during ELX disciplinary proceedings.</p> <p>Under ELX Rule II-11, the Exchange may enter into agreements with self-regulatory organizations, associations and boards of trade that provide for the exchange of information and other forms of mutual assistance for financial surveillance, routine audits, market surveillance, investigative, enforcement and other regulatory purposes as the Exchange may consider necessary or appropriate or as the CFTC and its regulations may require.</p> <p>ELX represents that it has become a signatory to the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations (known as the “Boca Declaration”).</p> <p>Based on its review, Commission staff has determined that ELX adequately demonstrates compliance with Designation Criterion 8.</p>

III. Analysis of ELX’s Contract Market Application, Outsourcing Agreements with NFA and BGC and Proposed Rules, for Compliance with the Act’s Core Principles for Designation as a Contract Market.

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<p>Sec. 5c(b) Common Provisions Applicable to Registered Entities (1) In General – “A contract market or derivatives transaction execution facility may comply with any applicable core principle through delegation of any relevant function to a registered futures association or another registered entity.” (2) Responsibility – “A contract market or derivatives transaction execution facility that delegates a function under paragraph (1) shall remain responsible for carrying out the function.”</p>		<p>Acceptable</p> <p>ELX has submitted and staff has reviewed the service agreements between ELX and other parties, such as the NFA, as part of the designation process. The Division is not recommending approval of these agreements. Rather, staff has considered these agreements to ensure that ELX is satisfying its obligations to meet certain core principles, such as maintaining an appropriate dispute-resolution process. To eliminate any misunderstanding, the Division recommends that the Commission specifically remind ELX that the Commission’s designation is not an approval of any third-party service agreements.</p> <p>Although ELX has contracted out for certain regulatory services, ELX remains responsible for compliance with those designation criteria and core principles for which relevant functions are contracted out.</p>
<p>SEC. 5c(c) NEW CONTRACTS, NEW RULES, AND RULE AMENDMENTS – (1) In General – Subject to paragraph (2), a registered entity may elect to list for trading or accept for clearing any new contract or other instrument, or may elect to approve and implement any new rule or rule amendment, by providing to the Commission (and the Secretary of the Treasury, in case of a contract for sale of a government security for future delivery (or an option on such a contract) or a rule or rule amendment specifically related to</p>		<p>Acceptable.</p> <p>ELX has requested that the Commission approve its proposed rules in connection with its designation as a contract market. The Division recommends such approval pursuant to Section 5c(c)(3) of the Act, since no provision of the Rulebook appears to violate any provision of the Act or the Commission’s regulations.</p>

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<p>such a contract) a written certification that the new contract or instrument or clearing of the new contract or instrument, new rule, or rule amendment complies with this Act (including regulations under this Act).</p> <p>(2) Prior Approval – (A) In General – A registered entity may request that the Commission grant prior approval to any new contract or other instrument, new rule, or rule amendment.</p>		
<p>Core Principle 1 <i>In General</i> – “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.”</p>		<p>Acceptable.</p> <p><i>See generally</i> below</p>
<p>Core Principle 2 <i>Compliance with Rules</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 12-13; Attachment C-2 (ELX Rulebook): Rule II-5 (Regulatory Oversight Committee); Rule III-6 (Eligibility); Rule IV-15 (Exchange for Futures for Related Positions); Rule IV-16 (Block Trades); Chapter VII (Discipline and Enforcement); Regulatory Services Agreement between ELX and NFA; ELX Market Supervision Policies and Procedures; C-5 (ELX Representations to the Commission); ELX’s Response to DMO’s 04/16/09 Additional Questions on ELX Futures, L.P.’s Application for Designation as a Contract Market.</p>	<p>Acceptable.</p> <p>As previously noted, pursuant to the RSA, NFA will be primarily responsible for performing most of the investigative work relating to trade practice inquiries and investigations. NFA will utilize an automated system to perform trade practice surveillance for ELX on a T+1 basis. NFA will review ELX’s trades on a daily basis to determine whether suspicious activity relating to the Exchange’s trading standards exists. Also, if applicable, NFA will review all exchange-for- physicals, exchange-for-risk-transactions, exchange-for-swaps, exchange-for-futures, transfer trades, block trades, and error trades.</p> <p>Based on the Exchange Rules, the following transactions are allowable: exchange-for-physicals, exchange-for-swaps, exchange-for-futures,</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
		<p>transfer trades, block trades, and error trades. According to the RSA, NFA is responsible for reviewing interim orders provided by ELX and trade files during the trading day, exchange-for-physicals, exchange-for-swaps, exchange-for-futures, transfer trades, block trades and error trades. NFA will review the Exchange's trades on a routine basis to determine whether suspicious activity, based on ELX's trading standards, exists. NFA shall rely solely upon data for orders entered and trades matched and cleared on behalf of the Exchange in performing trade practice surveillance.</p> <p>NFA's system produces exception reports designed to detect various types of potential trading abuses and other anomalous trading activity for further investigation. The system is able to detect potential trade practice violations including trading ahead, cross trades, wash trading, money passing, prearranged trading, marking the close, off-exchange large block trades, and to generate reports that identify patterns and uncover new relationships. NFA also will conduct customized queries of the audit trail data.</p> <p>The Compliance Director will act as the NFA liaison and will receive direction from the ROC. The Compliance Director will supervise the collection and transmission of all trading data submitted to NFA. The Compliance Director and the ROC will retain supervisory authority regarding the functions delegated to NFA.</p> <p>If a potential violation is discovered, NFA will explain to the Compliance Director the results of its preliminary inquiry and make an appropriate recommendation. If the Compliance Director authorizes further</p>

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		<p>investigation, NFA has the authority to make factual inquiries, request documents, and take statements from the Exchange’s Subject Persons (defined as “any Participant, Authorized Trader, Authorized Customer or Supervised Person.”) to evaluate the likelihood that a rule violation has occurred.</p> <p>NFA will prepare a written report summarizing results of its investigation for the Compliance Director, along with a recommendation. The Compliance Director will then decide whether charges should be issued. In the event, the Compliance Director determines not to follow the NFA’s recommendation, the Compliance Director will notify NFA of this decision and provide a written explanation as to why the Compliance Director disagrees with NFA’s recommendation. In addition to communicating as necessary on the matters under investigation, NFA will consult with the Compliance Director on a monthly basis to discuss the status of all inquiries and investigations. This procedure is consistent with the manner in which other exchanges conduct investigations. <i>See also</i> Designation Criterion 6 for specifics about disciplinary process.</p> <p>Based on ELX Representations to the Commission, prior to commencement of ELX’s operations as a Designated Contract Market approved by the Commission, ELX will hire four new employees, each having appropriate experience in exchange or futures commission merchant control functions (i.e., compliance, operations or risk management), to staff its Control Desk and to conduct regulatory surveillance of the ELX System at all times during which the System is</p>

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		<p>open for trading. The Control Desk will be supervised at all times during which the System is open for trading by a Control Desk Supervisor with Contract Market experience, including compliance-related experience.</p> <p>Based on its review, Commission staff has determined that ELX adequately demonstrates compliance with Core Principle 2.</p>
<p>Core Principle 3 <i>Contracts Not Readily Subject to Manipulation</i> – “The board of trade shall list on the contract market only contracts that are not readily susceptible to manipulation.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 11; Attachment C-2 (ELX Rulebook): Chapter IX (Contracts), Rule IV-10 (Position Limits), Rule IV-11 (Position Accountability) and Rule VI-5 (Market Manipulation).</p>	<p>Acceptable.</p> <p>The contracts that ELX intends to list for trading are contracts that are identical to those traded on CBOT, an established DCM. According to the draft contract specifications, ELX plans to maintain the same contract terms and conditions as those contracts listed on the CBOT. That includes the Position Limit and Position Accountability rules currently in effect for the CBOT listed futures contracts.</p> <p>Specifically, ELX intends to list for trading futures contracts on the U.S. Treasury Bond, Long-Term (6-1/2 to 10-Year) U.S. Treasury Note, Medium-Term (5-Year) U.S. Treasury Note, and Short-Term 92-Year U.S. Treasury Note.</p> <p>Based on its review, Commission staff has determined that with respect to the Contracts, in general, ELX adequately demonstrates compliance with Core Principle 3.</p>

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<p>Core Principle 4 <i>Monitoring of Trading</i> – “The board of trade shall monitor trading to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 13; Attachment C-2 (ELX Rulebook): Rule II-5 (Regulatory Oversight Committee), Rule II-13 (Regulatory Services Agreement with the RSP), Chapter VI (Business Conduct), Chapter VII (Discipline and Enforcement); Regulatory Services Agreement between ELX and NFA; and ELX Market Supervision Policies and Procedures; NFA Procedures for Deliverable Products on ELX; ELX System Demonstration-April 20, 2009</p>	<p>Acceptable.</p> <p>ELX has rules in place to prevent manipulation and, as herein noted, has contracted with NFA to monitor market activity and prices. ELX Control Desk services will be responsible for the real-time monitoring of market transactions, and NFA primarily will be responsible for reviewing transactions and large trader data on a next-day (T+1) basis to detect or flag for any suspicious or unusual trading activity by using its market surveillance system. Both the duties of the Control Desk and NFA will be supervised by ELX’s Compliance Director. The real-time market surveillance conducted by the Control Desk will be in the form of an automated market-alert system.</p> <p>NFA’s Market Surveillance Program relies primarily on an alert system that flags any unusual price or trading activity. Alerts are generated through its Trade Analysis and Profiling System (TAPS), which are then reviewed by NFA staff. Using the market data that it collects, NFA uses TAPS to produce exceptions reports whenever certain price, volume, or open interest movements exceed preset parameter limits. The TAPS system is also integrated with large trader data to conduct large trader analysis. NFA staff will have monthly meetings with the ELX Compliance Director to discuss any new investigation and to provide any update on any existing investigation.</p> <p>NFA also will be primarily responsible for the monitoring of deliverable supplies. NFA will monitor and ensure that deliverable supplies are adequate as contracts enter into the delivery period. NFA will examine market data to assess market conditions and large trader</p>

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		<p>data to determine which large traders may be involved in the delivery process. Specifically, NFA will monitor activity to protect against the possibility of congestion, corners, squeezes or any potential manipulation of futures and underlying cash market. NFA will also, on an as- needed basis, contact traders to verify whether or not they intend to make or take delivery of the underlying cash instrument.</p> <p>Based on the coordinated market surveillance of the ELX Control Desk and NFA, Commission staff has determined that ELX adequately demonstrates compliance with Core Principle 4.</p>
<p>Core Principle 5 <i>Position Limitations or Accountability</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 11; Attachment C-2 (ELX Rulebook): Rule IV-10 (Position Limits), Rule IV-11 (Position Accountability) and Chapter IX (Contracts).</p>	<p>Acceptable.</p> <p>As noted above, ELX intends to list for trading futures contract for U.S. Treasury Bonds, Long-Term (6 ½ to 10-Year) U.S. Treasury Notes, Medium Term (5-Year) U.S. Treasury Notes and Short-Term (2-Year) U.S. Treasury Notes. The draft contract terms and conditions are identical to those specified for the Treasury contracts currently trading on the CBOT.</p> <p>Each of the futures contracts will have an all-months-combined Position Accountability trigger level and a Position Limit that is in effect for the last 10 trading days of the expiring futures contract. Specifically, the U.S. Treasury Bond futures will have Position Accountability of 10,000 contracts, and a Position Limit of 25,000 contracts; the Long-Term (6 ½ to 10-Year) U.S. Treasury Note futures will have Position Accountability of 7,500 contracts and a Position Limit of 60,000 contracts; the Medium Term (5-Year) U.S. Treasury Note futures will have Position</p>

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		<p>Accountability of 7,500 contracts and a Position Limit 45,000 contracts; and the Short-Term (2-Year) U.S. Treasury Note futures will have Position Accountability of 7,500 contracts and a Position Limit of 25,000 contracts.</p> <p>Based on its review Division staff has determined that ELX adequately demonstrates compliance with Core Principle 5.</p>
<p>Core Principle 6 <i>Emergency Authority</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 14-15; Attachment C-2 (ELX Rulebook) Rules II-10 (Conflict of Interest), Rule IV-19 (Emergencies); ELX Response to CFTC Technology Questionnaire; ELX Business Continuity Plan; ELX Market Supervision Policies and Procedures; OCC Agreement for Clearing and Settlement Services; Regulatory Services Agreement between NFA and ELX; Technology Services Agreement between BGC and ELX.</p>	<p>Acceptable.</p> <p>ELX rules provide details regarding who, in the event of an emergency, may place into immediate effect a temporary emergency rule that may provide for actions necessary or appropriate to respond to the emergency. Rule IV-19 provides that in the event of an emergency, the Chief Executive Officer, the Compliance Director or any other individual designated by the CEO and approved by the Board may place into effect a temporary emergency rule which may provide for, or may authorize the board or any committee to undertake, actions necessary or appropriate to respond to the emergency.</p> <p>The measures available to ELX in the case of an emergency are listed in the rule and include each of the items listed in Appendix B to Part 38 of the Commission Regulations. Such actions include changing margin requirements, fixing settlement prices, changing the delivery month or extending or shortening the term of any contract, extending, limiting or changing the hours of trading, modifying or suspending any provision of the rules of the exchange or the rules of the clearinghouse.</p> <p>Rule IV-19 (b) addresses physical</p>

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		<p>emergencies and allows the CEO or any individual designated by the CEO and approved by the Board to take such action to respond to the physical emergency, including closing the exchange, delaying the opening of trading or suspending trading or extending trading hours.</p> <p>The Exchange will notify the CFTC of any action taken or proposed to be taken in accordance with the rule and Commission Regulation 40.6. The decision-making process with respect to, and the reasons for, any such action will be recorded in writing.</p> <p>Conflicts of interest provisions set forth in Rule II-10 and the related documentation requirements set forth in Rule II-10 will apply, with any such modifications or adaptations as may be necessary or appropriate under the circumstances, to the taking of any action under the Rule IV-19.</p> <p>Based on its review, Commission staff has determined that ELX's emergency procedures adequately demonstrate compliance with Core Principle 6.</p>
<p>Core Principle 7 <i>Availability of General Information</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 15; Attachment C-2 (ELX Rulebook): Rule III-11 (Notices to Participants), Chapter IV (Trading Standards) and Chapter IX (Contracts).</p>	<p>Acceptable.</p> <p>ELX states that the Rulebook, all amendments and notices and policies, as well as the specifications for all contracts traded on ELX will be publicly available on ELX's website. Information concerning deliverable supplies of cheapest-to-deliver Treasury securities will be determined by NFA and provided on the ELX website.</p> <p>Based on its review, Commission staff has determined that ELX adequately demonstrates compliance with Core Principle 7.</p>

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<p>Core Principle 8 <i>Daily Publication of Trading Information</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 15; Attachment C-2 (ELX Rulebook): Rule IV-3 (Publication of Trading Information) and Rule IV-20 (Information Regarding Nominal Prices and Settlement Prices).</p>	<p>Acceptable.</p> <p>ELX states that it will publish information regarding settlement prices, volume, open interest and opening and closing ranges for actively traded contracts on a timely basis on its website.</p> <p>Based on its review, Commission staff has determined that ELX adequately demonstrates compliance with Core Principle 8.</p>
<p>Core Principle 9 <i>Execution of Transactions</i> – “The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 15-16; Response to IOSCO questionnaire; System Description; Network Environment; Physical/Logical Infrastructure; Physical Security; Security Architecture; Secure Build Guidelines; Server, Firewall, and Switch Configurations; Audits of Physical Security, Operations, Change Management, and Data Management; Vulnerability Assessment Reports; Access Procedures; Backup and Retention Ops Guide; API Documents; Application Certification Process; Business Continuity Plan; SAS 70 for Backup Data Center; Control Desk Guidance; Test Plans and Results; Technology Services Agreement between BGC and ELX; Attachment C-2 (ELX Rulebook): Rule IV-7 (Execution of Orders by the ELX System), Rule V-6 (System Security), Rule IV-9 (Trade Cancellations and Price Adjustments), Rule IV-9(b) (Review of Trades), Rule IV-15 (Exchange of Futures for Related Positions) and Rule IV-16 (Block Trades); ELX Market Supervision Policies and Procedures; ELX System Demonstration- April 20, 2009.</p>	<p>Acceptable.</p> <p>ELX has provided sufficient documentation and a demonstration of the system in operation to enable Commission staff to conclude that ELX’s electronic trading system should provide for open, competitive and efficient trading.</p> <p><u>Matching Engine & Algorithm:</u> ELX has a technology agreement with BGC to use its eSpeed (matching engine) platform. eSpeed has been modified for futures execution and enhanced. Users will be required to connect to the eSpeed platform.</p> <p>The ELX matching algorithm gives first priority to Orders at the best price and priority to Orders entered at the same price based on a combination of size and time priority. Based on ELX Rules, the algorithm to match Orders entered in the ELX System is based upon the following principles: Rule IV-7 (a) an Order at a better price will always have priority over Orders at inferior prices, and (b) as among resting Orders at the same price, the algorithm will allocate a percentage of each matching Order to be filled with such resting Orders as follows: (i) first, if a portion of a resting Order creates a “new best price</p>

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		<p>above or below” the market, the best market price will prevail; (ii) next, with a portion of all such resting Orders on a pro rata basis in proportion to their relative size (resulting in resting Orders of greater size being executed in greater proportion than resting Orders of lesser size) and (iii) finally, with a portion of certain of such resting Orders based on their respective time of entry into the ELX System. Accordingly, under the Rules, “resting Orders entered with time priority may not necessarily be executed in full prior to, or in greater proportion than, the execution of other resting Orders at the same price and of greater size.” The Commission previously has approved a pro-rata algorithm in the designation of Nasdaq LIFFE (also known as NQLX) in 2001.</p> <p>As represented to staff by ELX, under the algorithm, an Order at a better price will always have priority over Orders at inferior prices. With regard to resting Orders at the same price, in practice, each contract executed on the ELX system will be configured to match orders based on a pro-rata, FIFO or split pro-rata algorithm: outright the 5-year, 10-year, and 30-year Treasury contracts will be matched based on the FIFO algorithm; the 2-year Treasury contract will be matched with a split pro-rata and FIFO distribution; and all calendar spreads will operate pro-rata.</p> <p>The pro-rata distribution will be rounded down to the nearest whole number. This may cause a portion of the order to remain unallocated. At the conclusion of the pro-rata matching sequence, any quantity remaining will be distributed to the remaining resting Orders based on FIFO.</p>

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		<p><u>Permissible Off-Centralized Market Transactions</u>: ELX Rules state that the following Exchanges of Futures for Related Positions (or EFPs, EFSs, and EFRs) transactions may be executed outside of the ELX System: (1) Exchanges of Futures for (or in connection with) cash commodities (“Exchange for Physical Transactions”); (2) Exchanges of Futures for (or in connection with) swap transactions (“Exchange for Swap Transactions”), and (3) Exchanges of Futures for (or in connection with) over-the-counter derivatives (“OTC”) transactions (“Exchange for Risk Transactions”). The OTC component of an Exchange of Futures for Related Position must comply with any applicable regulatory requirements prescribed by the CFTC.</p> <p>ELX Rules state that the Related Position (cash, swap, or OTC derivative) must involve the commodity underlying the Future, or must be a derivative, by-product or related product of the commodity that has a reasonable degree of price correlation or other significant price relationship to the underlying Future. An Exchange of Futures for a Related Position consists of two discrete but related simultaneous transactions. One party must be the buyer of (or have the long market exposure associated with) the Related Position and the seller of the corresponding Future. The other party must be the seller of (or have the short market exposure associated with) the Related Position and the buyer of the corresponding Future.</p> <p>With regard to block trades, each Block Trade “must be cleared through Clearing Privilege Holders”. Information regarding the relevant Contract, Contract month, price,</p>

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		<p>quantity, time of execution, and counterparty Clearing Privilege Holder will be made public. Participants, Authorized Traders and Authorized Customers may enter into Block Trades outside of the ELX System at mutually agreed upon prices that have been designated by the Exchange. ELX will take into consideration the size of transactions and the size distribution of the transactions in the related cash or over-the-counter markets. ELX has determined that the allowable block trade size of 1,000 contracts for 2-year, 5-Year, and 10-year Notes, and 500 contracts for the 30-year Bond Futures. Each Block Trade will be reported by the seller to the Exchange within 5 minutes following execution.</p> <p><u>System Functionality/Operations:</u> ELX submitted numerous technical documents, responded to all follow-up questions and conducted a comprehensive demonstration of the system's functionality. In addition, Commission staff participated in tours of the primary and backup data centers in conjunction with a contemporaneous review for an applicant who will use the same two data centers.</p> <p>The information provided addressed the following areas of technical interest: 1) equitable and timely availability of trade and quotation information; 2) prioritization and execution rules of the trading algorithm; 3) operational equality for all participants; 4) conduct of independent risk assessments; 5) planning for and implementing controls to mitigate vulnerabilities associated with the physical environment and communications and computing equipment; 6) creation and maintenance of essential technical documentation; 7)</p>

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		<p>adherence to IT governance programs such as software change management, hardware configuration management, and problem tracking and reporting; 8) capacity planning; 9) testing of functionality, security, and capacity; and 10) contingency planning, including disaster recovery.</p> <p>As to testing, for example, ELX performed penetration and vulnerability tests. For changes required to support new interfaces or functionality, sufficient tests are being run to validate success in implementation. Projected system capacity and performance goals have been accommodated in the sizing of the system. Because of the extensible system architecture, adding additional capacity would be relatively easy.</p> <p>The applicant's testing methodology shows a high level of maturity as evidenced by its use of best practices such as, requirements documentation, written test plans, automated testing, automated support for configuration management and issue tracking, and multiple stages of quality assurance reviews.</p> <p><u>Conclusion:</u> Based on its review of the ELX technical and operational information, its discussions with ELX staff and the site tours, Commission staff has determined that ELX's proposed electronic trading system adequately demonstrates compliance with Core Principle 9, including the IOSCO principles for screen-based trading as noted in the Commission's guidance on compliance with Core Principle 9.</p>

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<p>Core Principle 10 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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 16-17; Attachment C-2 (ELX Rulebook): Chapter IV, (Trading Standards); Attachment C-5 (ELX Representations to the Commission).</p>	<p>Acceptable.</p> <p>The ELX audit trail includes a complete electronic record of all entries into the ELX System and includes the details of every trade, allowing for the effective reconstruction of trade entries. Additionally, ELX Rules provide that any Order that has been entered into the ELX System may be modified or cancelled unless and until it has been executed or has otherwise expired.</p> <p>Each Order submitted to the ELX System will be submitted under the applicable User ID and Source ID, and will indicate the Clearing Account Number for the Clearing Privilege Holder that has agreed to guarantee the trade.</p> <p>To qualify to receive one or more User IDs, the Person must be a Participant, Authorized Trader or Authorized Customer, and such Person will meet all Exchange mandated fitness standards and other requirements under the Rules. Each Participant and Authorized Customer will be responsible for granting and/or authorizing the use of any Source ID for Orders that are submitted using that Participant’s or Authorized Customer’s User ID and will be responsible for all Orders entered, or other actions taken, through the use of its User IDs.</p> <p>No Person may use a User ID or Source ID to place any Order except as permitted by Exchange Rules, nor may any Person knowingly permit or assist the unauthorized use of a User ID or Source ID. Each Participant and Authorized Customer on behalf of itself and each of its Supervised Persons and Customers will ensure that no User ID or Source ID is used</p>

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		<p>by any Person not authorized by the Exchange Rules.</p> <p>The ELX System will not accept Orders which do not include all of the Order terms required under Exchange Rules.</p> <p>All Orders must contain the following information: (i) the instrument description including commodity, Contract month, and for any Option on Futures, strike price, type of option (put or call) and expiration month; (ii) whether such Order is a buy or sell Order, (iii) Order type, (iv) price (if required); (v) quantity; (vi) account type; (vii) account designation (the number assigned by a Participant to each of its accounts); (viii) the User ID of the Person entering the Order; (ix) the Source ID of the individual entering the Order; (x) the Account Type Indicator; (xi) the Clearing Privilege Holder ID of the Clearing Privilege Holder that will clear any resultant Contracts; and (xii) such additional information as may be prescribed from time to time by the Exchange.</p> <p>Orders must be entered by electronic transmission to the ELX System, and the Exchange will maintain an electronic record of those entries. Each Participant will be responsible for any and all Orders entered by the Participant's Authorized Traders and Customers.</p> <p>The system will capture the time of each order, (time stamped to the nearest minute when the Order was received), all order cancellations or modifications and trades.</p> <p>A system user who entered an Order which is resting in the system can cancel or modify its terms. The ELX System records the cancellation or</p>

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		<p>modification without deleting the original order, and also records the User ID and Source ID, (if a Source ID is applicable in the situation), of the system user making the cancellation or modification.</p> <p>Any such modification or cancellation requires that a Cancel Replace Order or Cancel Order, as the case may be, with respect to the original Order be entered into the ELX System. Such modification or cancellation will become effective upon receipt by the ELX System of the Cancel Order or Cancel Replace Order, as the case may be.</p> <p>Although, ELX will have a complete audit trail on day one and meet recordkeeping requirements, ELX is still in the process of developing its enforcement program. ELX has represented to the Commission that within one year following the commencement of ELX's operations as a Designated Contract Market approved by the Commission, it will have an appropriate audit trail and recordkeeping <u>enforcement program</u> in place. This delay does not relieve ELX from full compliance with Core Principle 10, and, in fact, based on the information provided and demonstrations received, staff believes that ELX complies with this Core Principle. <i>See infra</i> further discussion in Section V.3 of this memorandum.</p> <p>ELX represents that it will provide to the Commission trade data on a T+1 basis, either directly or through its agent, in a form, content, and manner acceptable to the Commission. ELX will use new FIXML standard within 60 days of formal written request by Commission staff.</p> <p>Based on its review, Commission</p>

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		staff has determined that the audit trail captured by the ELX System adequately demonstrates compliance with Core Principle 10.
<p>Core Principle 11 <i>Financial Integrity of Contracts</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 17; <i>See</i> Designation Criterion 5 above.</p>	<p>Acceptable.</p> <p><i>See</i> Designation Criterion 5, above.</p> <p>As noted above, ELX contracts will be cleared by the OCC.</p> <p>Based on its review of the specified documents, Commission staff has determined that ELX adequately demonstrates compliance with Core Principle 11.</p>
<p>Core Principle 12 <i>Protection of Market Participants</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 17-18; Attachment C-2 (ELX Rulebook): Rule IV-27, (Compliance), Rule VII-1 (a), (Discipline and Enforcement), Chapter VI (Business Conduct), Chapter IV (Trading Standards); Regulatory Services Agreement between ELX and NFA; ELX Market Supervision Policies and Procedures</p>	<p>Acceptable.</p> <p>ELX Rule IV-27 provides that each ELX Participant, Authorized Trader and Authorized Customer shall, by making application for a User ID, or by placing any Order, be deemed to have agreed to be bound by the Rules of the Exchange, be subject to the jurisdiction of the Exchange, comply with all applicable Rules of the Exchange and comply with Applicable Law.</p> <p>ELX Rules provide that all Subject Persons (any Participant, Authorized Trader, Authorized Customer or Supervised Person) will be subject to the Exchange’s jurisdiction.</p> <p>ELX Rules prohibit trading ahead of or against Customer Orders, address potential abuses related to withholding, modifying or cancelling, misallocating or disclosing Orders and contain broad prohibitions against fraudulent acts and market manipulation.</p> <p>Separately, the Rulebook prohibits any fraudulent or misleading communications relating to the</p>

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		<p data-bbox="1029 317 1414 432">purchase or sale of any contract and establishes a due diligence standard with respect to handling and execution of Customer Orders.</p> <p data-bbox="1029 470 1430 615">As previously noted, ELX contracted with the NFA to assist in carrying out self-regulatory responsibilities with respect to trade practice surveillance.</p> <p data-bbox="1029 653 1425 1104">The NFA will use an automated system to provide such surveillance. The NFA will monitor for, among other things, trading ahead of customers (direct and indirect), front running, direct and indirect crossing, taking the other side (direct and indirect), prearranged trading, wash trading, money passing (direct and indirect), counterparty trade percentages, marking the close, error account and transfer trade activity, and off-exchange transactions such as block trading, EFPs, EFSs, EFFs, and EFRs.</p> <p data-bbox="1029 1142 1414 1226">The NFA will also review trader profiles to detect aberrations from a trader's normal pattern of trading.</p> <p data-bbox="1029 1264 1414 1499">NFA's functions will be supported by ELX's technology, which will collect, array and transmit bid, offer and trade data to NFA. The ELX Compliance Director will supervise these functions and will act as the NFA liaison, all with oversight by ELX's ROC.</p> <p data-bbox="1029 1537 1414 1808">The Control Desk, under the direction of a Control Desk Supervisor, will be responsible for market supervision and will monitor trading on a real-time basis. Control Desk personnel will coordinate with NFA to ensure such real-time monitoring is integrated with the NFA's surveillance functions.</p> <p data-bbox="1029 1845 1390 1871">Based on its review, Commission</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
		staff has determined that ELX adequately demonstrates compliance with Core Principle 12.
<p>Core Principle 13 <i>Dispute Resolution</i> – “The board of trade shall establish and enforce rules regarding [sic] and provide facilities for alternative dispute resolution as appropriate for market participants and any market intermediaries.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 18; Attachment C-2 (ELX Rulebook): Chapter VIII (Arbitration); Regulatory Services Agreement between ELX and NFA.</p>	<p>Acceptable.</p> <p>Chapter VIII of the Rulebook provides for the resolution of disputes involving Participants, or Participants and their Customers, through arbitration conducted by the NFA. Controversies that involve Participants or any of its Supervised Persons and that Participant’s customers will be arbitrated under the NFA’s customer arbitration rules. All other controversies between or among Authorized Customers or an Authorized Customer and a Participant other than the Participant who authorized the Customer’s trading will be arbitrated under the member to member arbitration rules (an Authorized Customer means “with respect to any Participant that is an FCM, any Customer of such Participant that uses a User ID to access the ELX System directly”). The submission of such disputes to arbitration is voluntary on the part of any customer who is not an eligible contract participant, in accordance with Commission Regulation 166.5. However, members must agree to arbitrate all controversies arising in connection with their Exchange business or among them.</p> <p>NFA rules provide parties with all the rights included in the guidance to this core principle, including the right to have claims decided by an objective and impartial decision maker, the right to be represented by counsel, notice and an opportunity to be heard, the option to settle claims and notice of fees and costs.</p> <p>With respect to the rule enforcement requirement of Core Principle 13, ELX Rule VIII-5(b) allows the</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
		<p>Exchange to summarily suspend a Subject Person that fails to satisfy an arbitration award.</p> <p>Based on its review, Commission staff has determined that ELX adequately demonstrates compliance with Core Principle 13.</p>
<p>Core Principle 14 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).”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 14-15; Attachment C-2 (ELX Rulebook); Chapter II, (Governance of the Exchange), Chapter III (Trading Privileges); Attachment C-4 (Analysis of ELX Futures L.P. Corporate Structure and Governance for Compliance with the Act’s Core Principles); Regulatory Services Agreement between ELX and NFA; Attachment C-5 (ELX Representations to the Commission).</p>	<p>Acceptable.</p> <p>ELX Rule II-7(a) sets forth the eligibility criteria for persons serving as an officer or member of the Board of ELX, a member of any disciplinary committee, a member of arbitration or oversight panel of ELX, or as Compliance Director. Similar to the guidance provided under Commission Regulation 1.63, ELX’s eligibility standards require a person be in good standing, free of suspensions from trading, disciplinary offenses committed within the previous three years, or any other restrictions related to serving in such capacities of any self-regulatory organizations.</p> <p>ELX provided a certification of fitness for all directors on its management Board verifying that they meet the minimum fitness standards of Core Principle 14.</p> <p>ELX will require that persons subject to fitness standards notify ELX of any change in status. The fitness determination provided in the rules will be repeated on an annual basis for each member of the Board and relevant committees.</p> <p>ELX Rule II-7(b) addresses the fitness standards for ELX’s Public Directors. Specifically, ELX’s Board must find that a Public Director is a person who has no conflict of interests with the Exchange or the General Partner that</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
		<p>could reasonably affect the independent judgment or decision making of the person as a Public Director. Further, this Rule provides for modification to conform to any change to the Commission’s definition of “Public Director” as set forth in Core Principal 15.</p> <p>ELX Rule II-5 provides the criteria for persons serving on the ROC of the Board. This committee shall consist only of Public Directors, who shall be members of the Board.</p> <p>ELX Rule III-6 sets forth fitness eligibility standards for “Participants” that have direct access to trade. Each applicant must be a natural person who has attained the age of majority in the individual’s state of residence, and satisfy any other requirements or criteria of ELX. Each applicant not a natural person must be duly organized, be in good standing, have the legal authority to become a Participant and effect transaction, and satisfy any other ELX requirements.</p> <p>ELX Rule III-7 pertains to trading privileges. This rule provides that each applicant must submit a complete application, agree in writing to abide by the rules of the Exchange and applicable law, and furnish all documents and answer all questions required by ELX. (As noted above, ELX Rule IV-23 provides that no Order may be submitted to the ELX System except using a User ID that has been guaranteed by a Primary Clearing Privilege Holder Authorization). At ELX’s request, NFA will provide disciplinary background checks for new trader applications and will analyze financial statements submitted by ELX member firms to ensure that they maintain the minimum financial requirements set</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
		<p>by ELX.</p> <p>Counsel for ELX also represented in a May 5, 2009 e-mail, that ELX is not currently subject to or a party to any legal proceedings.</p> <p>Based upon the above, Commission staff has determined that ELX adequately demonstrates compliance with Core Principle 14.</p>
<p>Core Principle 15 <i>Conflicts of Interest</i> – “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.”</p>	<p>Attachment C-1 (Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 15; Attachment C-2 (ELX Rulebook); Chapter II (Governance of the Exchange), Rule III (Trading Privileges); Attachment C-5 (ELX Representations to the Commission); Attachment C-3 (Amended and Restated Limited Partnership Agreement); Amended and Restated Limited Liability Company Agreement.</p>	<p>Acceptable.</p> <p>Under ELX Rule II-1(a), at least 35 percent of the members of the Board are required to be Public Directors. This proportion tracks the acceptable practices adopted by the Commission in 2007 for Core Principle 15. ELX’s Rule II-7(b) sets forth eligibility criteria to determine if an individual has any relationship with the Exchange or the General Partner that reasonably could affect the independent judgment or decision making of such individual as a Public Director.</p> <p>In addition, ELX Rule II-5 establishes a ROC that will oversee the Exchange’s regulatory program on behalf of the Board. To ensure its independence, the ROC will consist only of Public Directors, who shall be members of the Board. Among other things, the ROC will oversee all facets of the Exchange’s regulatory program, including trade practice and market surveillance;</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
		<p>audits, examinations, and other regulatory responsibilities with respect to Participants and their Authorized Traders and other Supervised Persons and Authorized Customers, and the conduct of investigations and review of disciplinary actions.</p> <p>Core Principle 15 guidance also points out that the contract market should include methods to make decisions in the event of a conflict. ELX meets this objective in Rule II-10 by excluding persons from deliberations or voting in any matters, such as disciplinary actions and appeals, where there is a conflict with a named party in interest or there is a conflicting financial interest. ELX’s Rule II-11(b)(i) excludes certain persons from deliberations or voting where such a person is a <i>named party in interest</i>; an employer, employee or fellow employee of a <i>named party in interest</i>; is associated with a <i>named party in interest</i> in a broker association; has a family relationship with a <i>named party in interest</i>; or has any other significant, ongoing business relationship with the named party. In addition, under ELX Rule II-11(b)(ii), ELX’s Compliance Director is required to recuse him or herself from deliberations or decision making if he or she has a relationship identified in Rule II-11(b)(i) <i>or</i> if he or she believes that he or she possess a relationship that is likely “to be materially affected by any significant action on which the Compliance Director would participate in deliberations or decision making.”</p> <p>Where there might be a financial conflict, ELX has set forth standards to identify the conflicted person and financial interest. ELX bars persons from deliberations or voting if “such person knows or reasonably should</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
		<p>know that he or she has a direct or indirect substantial financial interest in the result of the vote based upon either Exchange or non-Exchange positions that could be reasonably expected to be affected by the significant action under consideration.” See ELX Rule II-11(c)(i). Before deliberations, persons must disclose to the CEO their trading positions information. See ELX Rule II-11(c)(ii), (iii).</p> <p>Under ELX Rule II-11(b)(iii) and (c)(ii), ELX also seeks to minimize the impact of conflicts by having decision makers identify conflicts in advance of any deliberations or voting on signification action is taken.</p> <p>ELX has taken measures to protect the confidentiality of information. Under ELX Rule III-3 (c),(d), ELX places limits on the use, disclosure and trading based on non-public information by Board and committee members and employees and consultants of the Exchange, , for any purpose other than the performance of his or her official duties. Rule III-3 (c) prohibits employees, members of the Board, members of any committee or consultants from trading directly or indirectly in any commodity interest on the basis of any material, non-public information obtained in connection with the performance of his or her official duties.</p> <p>ELX rules provide that the terms “material information,” “non-public information,” and “commodity interest” (a phrase used in Rule II-10) possess the same meanings identified in CFTC Regulation 1.59. ELX Rule 11-10(c). And ELX Rule III-3(f) states that the definition of employee includes salaried and contract employees, which also is</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
		<p>consistent with Commission Regulation 1.59(d).</p> <p>One potential conflict may arise due to ELX’s corporate structure and ownership by dealers, banks and trading firms. This conflict would be if owners who were also traders (or affiliated with traders) had access to material non-public information on trading. However, since the only body with authority to oversee the ELX regulatory program is the ROC consisting of only Public Directors, such a conflict is minimal or not present in the current structure.</p> <p>Based on the above, Commission staff has determined that the ELX’s conflicts procedures adequately demonstrate compliance with Core Principle 15.</p>
<p>Core Principle 16 <i>Composition of Boards of Mutually Owned Contract Markets</i> – “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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 19; Attachment C-3 (Amended and Restated Limited Partnership Agreement); Amended and Restated Limited Liability Company Agreement; Attachment C-4 (Analysis of ELX Futures L.P. Corporate Structure and Governance for Compliance with the Act’s Core Principles).</p>	<p>Not Applicable</p> <p>As represented, ELX Futures, L.P. is a limited liability partnership, formed under the laws of Delaware. ELX is 99.75% owned directly by the members of its general partner, ELX Futures Holdings, LLC (“Holdings”). The remaining 0.25% of the equity interests of ELX is owned indirectly by the members through Holdings in the form of a general partnership interest. ELX will not make trading on the ELX system contingent on having an equity interest in ELX. Thus, ELX is not considered a mutually-owned entity subject to Core Principle 16.</p> <p>Based on the above, Commission staff has determined that Core Principle 16 is inapplicable to ELX.</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
<p>Core Principle 17 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.”</p>	<p>Attachment C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 19; Attachment C-2 (ELX Rulebook): Rule IV (Books and Records; Cooperation in Proceedings); Regulatory Services Agreement between NFA and ELX; Attachment C-5 (ELX Representations to the Commission); IOSCO Questionnaire</p>	<p>Acceptable.</p> <p>The ELX database maintains records of all details for all orders and executed trades. The records for the ELX System will be kept separate from any other system’s records, are duplicated at ELX’s backup site in near-real-time, copied to tape nightly and moved to a third party secure storage location where they will be retained for 5 years. Additionally, the same data is transferred to NFA each night for its surveillance activities. ELX has also represented that it will maintain all data on Write-Once-Read-Many (WORM) tapes in accordance with Commission regulations. To clarify what types of information will be retained, ELX states: “We provide non-repudiation with extensive, verbose logging at all levels of the trading system: keystroke logs on the client; connection and transaction logs on session managers and gateways and trading systems; and transaction logging on the databases. All trading system logs are backed up daily and stored offsite indefinitely by our storage vendor.”</p> <p>As previously noted, Exchange rules require that each Participant, Authorized Trader, other Supervised Person and Authorized Customer keep current all books, ledgers and similar records required under the CEA, Commission Regulations and the Rules of the Exchange. These books and records will be kept for a period of 5 years and will be made available to the Exchange, the Commission and DOJ upon request.</p> <p>As stated in Section VII-B of Appendix A of ELX’s agreement with NFA, NFA will maintain for the time period specified in Commission Regulations all records created in conjunction with providing ELX the</p>

CONTRACT MARKET CORE PRINCIPLES	ELX PROPOSAL	STAFF ANALYSIS
		<p>regulatory services provided in the RSA. NFA will provide data and reports to the Exchange and the Commission as necessary for the Exchange to fulfill its obligations under the CEA and the Commission’s regulations.</p> <p>Rule III-10 provides that the Exchange may retain any recorded conversations or electronic communications for such periods of time as the Exchange may deem necessary or appropriate. The Exchange will retain such records for the retention periods necessary to comply with Commission Regulations. Rule IV-29(c) provides that all memoranda reflecting Orders for a Customer Account shall be retained in accordance with Rule V-1; Rule IV-29(d) provides that all order related information entered into the ELX System will be retained by the Exchange for the time period set forth in Rule V-1</p> <p>ELX is aware of the DMO’s February 5, 2009, Advisory that explains that the recordkeeping provisions of the Commission’s regulations apply to records that are created or retained in an electronic format, including email, instant messages, and other forms of communication created or transmitted electronically for all trading. Based upon the above, Commission staff has determined that ELX’s recordkeeping procedures adequately demonstrate compliance with Core Principle 17.</p>
<p>Core Principle 18 <i>Antitrust Considerations</i> – “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</p>	<p>Appendix C-1 (ELX Regulatory Chart Demonstrating Compliance with Designation Criteria and Core Principles) at 19-20.</p>	<p>Acceptable.</p> <p>ELX represents in its regulatory chart that its Rules and business plan have been designed to avoid unreasonable restraints of trade or the imposition of any material anticompetitive burden on trading.</p>

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(B) imposing any material anticompetitive burden on trading on the contract market.”		<p>In particular, ELX states that access to ELX will not require the acquisition of any equity interest but will be available to a broad range and potentially unlimited number of participants on a fair, equitable and timely basis. The ELX system will operate through a precise and predetermined electronic algorithm, without discrimination among different users or user groups. Trade information will be disseminated both to Participants and to the public on a continuous basis.</p> <p>Staff’s review did not include service agreements for compliance with Core Principle 18.</p> <p>Based on the above, Commission staff has determined that ELX adequately demonstrates compliance with Core Principle 18.</p>

IV. Public Comments

Current Commission policy is to release portions of applications for contract market designation on the CFTC website for public comment pursuant to Commission Regulation §40.8.⁵ Those portions of the ELX application have been posted on the Commission website since January 9, 2009. Two comments have been received regarding the ELX application.

One comment was received on January 16, 2009, from the general manager of a grain elevator, contending that ELX should not be designated as an exchange as long as some of the owners are banks, unless those banks are prohibited from trading. The commenter implies that as a result of bank speculation in the oil and grain markets, the futures markets were destroyed as there is no longer a tie to the cash markets. ELX responded to this comment on April 7, 2009, challenging the comment as opinion and stating that futures markets have a long history of providing great economic value, including in 2008. ELX claims that its investors will provide liquidity and customer flow order to ELX. ELX notes that the banks, referenced by the commenter, are major participants on exchanges around the world and, thus, it is unfair to single out ELX as an exchange on which banks cannot participate.

Staff believes that the commenter's opinion about speculation cannot serve as a basis to deny ELX owners the right to trade. Notably, the commenter's objection to bank ownership of ELX was not premised on some concern that the banks might take advantage of their ownership status while trading on the exchange. Nonetheless, staff notes that ELX's regulatory program will be under the oversight of the ELX ROC, consisting only of Public Directors, as well as the Commission. Under ELX's Public Director definition in its Rules, ELX owners would not qualify as Public Directors. In addition, the "banks" referred to in the comment should not have access to material, nonpublic information by virtue of their ownership status. Furthermore, ELX's rules specifically prohibit the trading, either directly or indirectly, on the basis of any material, non-public information obtained in connection with the performance of official duties. In any event, banks are, and will be, the major participants for trading U.S. Treasuries (both in cash and futures) on other exchanges and, therefore, it is not only arbitrary, but it also makes little economic or regulatory sense to restrict or prohibit banks from trading U.S. Treasuries on ELX. Moreover, even on other exchanges, these same banks are not prohibited under the CEA from obtaining an ownership interest. Finally, it is not evident that there is a connection between ownership and speculation.

A second comment filed by the CME Group Inc. ("CME") on February 9, 2009 addressed proposed ELX Rule IV-16, which provides, in part, that "[i]n determining the minimum size threshold [for block trades], the Exchange shall take into consideration (to the extent available) the size distribution of transactions in the Contract, the size distribution of transactions in the related cash or over-the-counter markets, and all other information relevant to transaction size in the relevant Contract." CME contends that ELX should also take into consideration the sizes of transactions in substantially identical futures markets on the other DCMs. CME contends that unless ELX takes this into consideration, the "integrity of prices and

⁵ See 69 FR 44981. The Commission releases those portions of the designation application that have been determined not to cause competitive harm to the applicant or regulatory concerns for the Commission.

price discovery in such substantially identical futures markets may be compromised.” In its February 23, 2009 response, ELX disagreed with CME’s position stating that it is anti-competitive and contrary to the principles advanced by the Commission and the Commission’s recent proposed rules on block trading and related matters. ELX states that the Commission’s proposed guidance directs a DCM to the factors to be considered in making the threshold size determination and that ELX fully intends to comply with the Commission’s final rules at the time they are adopted.

Currently, in the determination of the minimum block size threshold, the Commission has not required an exchange to take into consideration the sizes of transactions in substantially identical futures markets on the other DCMs. Moreover, the proposed guidance in the proposed rules on block trading and other matters does not list this as a factor in determining the threshold size of the block trade.⁶ There is thus nothing in the current rules or regulations that would require ELX to take into consideration CME’s block size in determining its size threshold. The Division notes, however, that whatever the Commission’s final response on this issue, ELX has stated that it intends to fully comply with the Commission’s final rules once they are adopted.

V. Noteworthy Matters

Staff believes that ELX’s Application complies with the Act and the regulations thereunder, however, staff had a few remaining concerns based upon ELX’s corporate structure and composition of its regulatory staff. In response, ELX represented to the Commission to undertake certain actions to alleviate those concerns and those representations are part of the Order of Designation. In addition to those matters, there are certain outstanding technical matters that will not be ready on day one upon designation. Although staff believes that these are essential matters required for the long-term operation of a designated contract market, it recognizes that with timely resolution, proper monitoring, and the necessary representations, such matters do not have to be in place on day one, but rather within specified time periods as represented by ELX. The outstanding matters and specific representations made by ELX to address those matters are described below in greater detail.

1. FIXML Standard

The Commission is transitioning to a new data standard for purposes of collecting trade data from exchanges. Adopting the FIXML standard would require changes to both the content and format of transmission. The FIXML transition is ongoing and the Commission is not prepared to receive trade data in FIXML from the Exchange at the time of this designation.

Accordingly, staff requested, and ELX has provided, a representation that the Exchange will provide the Commission with trade data on a T+1 basis in a form, content, and manner acceptable to the Commission. Additionally, ELX agreed to commit to the use of the FIXML standard within 60 days of the Commission staff’s formal written request for such data. The Commission may extend the 60 day deadline upon a reasonable showing of need by ELX.

⁶ Execution of Transactions: Commission Regulation 1.38 and Guidance on Core Principle 9, 73 FR 54097 (Sept. 18, 2008).

Staff is satisfied with the representation concerning the FIXML standard and will work closely with ELX staff to assist the Exchange in transitioning to the new standard.

2. Commission Jurisdiction over Board Actions

As noted herein, ELX is 99.75% owned directly by the members of its general partner, Holdings. The remaining 0.25% of the equity interests of ELX is owned indirectly by the members through Holdings in the form of a general partnership interest. The management of ELX and Holdings is exercised through a management board (“Management Board”), which is the Management Board of the Exchange and of Holdings. There is also a supervisory board (“Supervisory Board”) at the Holdings level and not at the Exchange level. All actions of the Management Board will, among others, be subject to the review, and will require the approval, of the Supervisory Board, with the exception of actions of the ROC. The Management Board will appoint and oversee a ROC to oversee ELX’s regulatory program on behalf of the Management Board. Actions of the ROC and any action of the Management Board in connection with the oversight, review or recommendations or actions of the ROC are not subject to the review or approval of the Supervisory Board. However, the ROC’s budget, including regulatory costs to be incurred at the discretion of the ROC, is subject to review by the Supervisory Board to ensure its reasonableness.

In light of the fact that the Supervisory Board resides at the Holding Company, rather than the Exchange level, staff raised a concern regarding the Commission’s jurisdiction over that Board. In response, ELX represented that it will require that each member of the Supervisory Board of Holdings consent to be subject to the Commission’s jurisdiction and be accountable to the Commission to the same extent as if the Board was maintained at the Exchange level. Given the fact that the Supervisory Board can review the ROC’s budget, ELX also represented that it will, upon the Commission’s request and within ten business days, provide the Commission’s staff with access to minutes and documentation related to the decisions of ELX Holdings’ Supervisory Board and the reasons for those decisions, and will provide the Commission’s staff with notification and the minutes of any Supervisory Board meetings at which a budget recommendation of the ROC is overturned by the Supervisory Board.

Further, although ELX, the Exchange, was formed under and primarily managed and controlled by the Amended and Restated Limited Liability Partnership Agreement, there are two provisions in the Amended and Restated Limited Liability Company Agreement of Holdings (the “LLC Agreement”) that implicate ELX: Article V (Management and Operation) and Article XII (Fiduciary Duties). ELX has incorporated those provisions in its rules and has represented that in the event those articles are amended, the changes to those Articles and any revision to the Rules will be submitted to the Commission. In addition, ELX represented that if amendments to other Articles of the LLC Agreement result in other provisions of the LLC Agreement implicating ELX, such provisions similarly will be incorporated into the ELX Rules and the changes to such provisions of the LLC Agreement and revised Rules will be submitted to the Commission.⁷

⁷ Finally, in its initial filing ELX stated that its Chief Executive Officer would be a member of the ROC. Staff expressed its concern with this and ELX agreed not to have the CEO on the ROC. ELX has provided a representation to staff that its ROC will consist solely of Public

Staff is satisfied with these representations.

3. Regulatory Compliance

Currently, ELX Compliance Department consists of a Compliance Director and Deputy Director. ELX has established a Control Desk that is responsible for Exchange market operations, real-time market monitoring, customer support and surveillance. ELX is in the process of hiring staff for the Control Desk. ELX represented to staff that prior to commencement of ELX's operations as a Designated Contract Market approved by the Commission, ELX will hire four new employees, each having appropriate experience in exchange or futures commission merchant control functions (i.e., compliance, operations or risk management), to staff its Control Desk and to conduct regulatory surveillance of the ELX electronic trading system (the "ELX System") at all times during which the ELX System is open for trading. The Control Desk will be supervised at all times during which the ELX System is open for trading by a Control Desk Supervisor who will have employment experience with a Designated Contract Market, including compliance-related experience in the areas within the responsibility of the Control Desk, and will have the requisite background and understanding of the relevant Exchange and Commission rules and regulations in order to conduct and supervise real-time market monitoring and surveillance as well as a comprehensive understanding of futures markets and futures trading.

While the electronically-recorded data in the ELX System ensures that ELX will have complete audit trail capabilities on day one, ELX represented to the Commission that within one year following the commencement of ELX's operations as a Designated Contract Market approved by the Commission, ELX will ensure that ELX has an appropriate audit trail and recordkeeping enforcement program in place to enforce compliance with all entities subject to the electronic audit trail and recordkeeping requirements for each trade executed on the ELX System in full compliance with the requirements of ELX and the Commission. ELX also represented that the Commission staff will be provided updates throughout the year by ELX with respect to the status of the enforcement program and the Commission staff will be given the opportunity to review the audit trail and recordkeeping enforcement program before its implementation.

ELX explained that the one-year delay in having a robust audit trail and recordkeeping enforcement program is based on business reasons. Because ELX is a new exchange, it must determine the nature of its trading and establish and establish a baseline for the amount of orders generated and trades executed to design and implement an appropriate program. Once these items are ascertained, ELX will be able to develop an audit trail and recordkeeping enforcement program that fits the business. Furthermore, the Commission has not required fully designed and implemented electronic audit trail and recordkeeping programs in the past for designation. However, this delay does not relieve ELX from full compliance with Core Principle 10 (Trade

Directors, as defined by the Commission's regulations, and that the Chief Executive Officer of ELX will not be a member of the ROC.

Information). In fact, as noted above, based upon information provided and demonstrations received, staff believes that ELX complies with Core Principle 10.

Staff is satisfied with the regulatory compliance representations made by ELX and will confirm that the appropriate staff has been hired by the Exchange before it commences operations. Commission staff will continue to monitor the status of ELX's audit trail and recordkeeping enforcement program and provide periodic updates to the Commission.

4. Delivery Procedures

The US Treasury futures traded on ELX will be settled by physical delivery. Because the OCC has not previously cleared contracts settled by physical delivery, it is necessary for the OCC to adjust its automated delivery processing system to match long and short market participants and provide notices for processing via physical delivery.

Although not all of those procedures will be completed by the date of designation, ELX and the OCC have represented to the Commission that those procedures will be adopted and implemented well in advance of the contracts' first notice day. The OCC plans to automate its procedures for handling contract deliveries, but stands ready to follow its manual procedures if it determines by a certain date that it would not be able to complete its automation of the delivery procedures. The OCC will train clearing members in the use of either (or both) the manual or automated delivery processing system.

Specifically, it is represented that the timeline as stated below will be followed:

- (i) By the end of July, 2009, the OCC will ensure that all of its clearing members clearing ELX products have established approved delivery banking arrangements.
- (ii) By July 15, 2009, the OCC will have the ability to process deliveries on a manual basis, based on ELX's Delivery Procedures, and will provide the Commission with copies of its policies and procedures for the manual processing of deliveries.
- (iii) By July 15, 2009, OCC will also determine whether automated delivery system functionality for the processing of deliveries in connection with ELX products will be fully operational by August 31, 2009.
 - a. If the OCC determines by July 15, 2009, that such functionality will not be fully operational, it will take all necessary steps to process deliveries in connection with ELX products on a manual basis, including but not limited to notifying all market participants of the manner in which deliveries will be processed, and will continue to process such deliveries on a manual basis until such time as the automated delivery system functionality is fully operational. As necessary, during July 2009, OCC will train clearing members on manual processing of deliveries.
 - b. If during July, 2009, OCC determines that automated delivery system functionality will be fully operational by August 31, 2009, it will train clearing members on such functionality during August, 2009.

- (iv) By the end of August, 2009, ELX's Delivery Procedures for the U.S. Treasuries traded on ELX will be fully incorporated into the OCC delivery system functionality;

Staff is satisfied with these representations. Regardless of whether the OCC delivery system is fully updated to handle physically delivered contracts or if the OCC processes the deliveries manually, as long as the ELX Delivery procedures are followed, Commission staff does not have concerns that the delivery system will create any delivery problems or concerns about default.

5. ELX Financial Resources

In evaluating the application submitted by ELX, staff considered whether ELX would have sufficient financial resources, as of the estimated designation date, to comply with the obligations of a contract market under the Act and Commission Regulations. Staff believes that ELX does have sufficient financial resources, as of the estimated designation date, because ELX has demonstrated to staff that: (i) the value of its financial resources, calculated as of the estimated designation date, would enable ELX to cover its operating costs, calculated for the period beginning on the estimated designation date and ending one year thereafter (such period, the "Evaluation Period"); and (ii) such financial resources include unencumbered, liquid assets equal to at least 6 months of such operating costs. Specifically, ELX has demonstrated to staff that, as of the estimated designation date, it will be able to access, during the Evaluation Period, an aggregate amount of financial resources that is in excess of the amount of operating expenses it reasonably expects to incur over that period, that a sufficient proportion of those financial resources will be held in cash at the time of designation, and that for each month in the Evaluation Period, it will be able to access sufficient financial resources in sufficiently liquid instruments to cover its expenses.

Although ELX has demonstrated, as of the estimated designation date, that it has sufficient financial resources, staff recommends that the Commission require, in the Order of Designation, that ELX again demonstrate to Commission staff the sufficiency of its financial resources at the end of every fiscal quarter (the "Demonstration Date"). Staff believes that such requirement is appropriate because ELX is a start-up entity, which does not yet have a steady stream of revenue, and which does not have a corporate parent willing to provide additional funding. If the financial resources of ELX ever become insufficient to enable it to comply with the obligations of a contract market under the Act and Commission Regulations, such requirement would enable staff to learn of such insufficiency in a timely manner, and to take action to ensure an orderly wind down of ELX if necessary.

Staff further recommends that the Commission require, in the Order of Designation, that ELX demonstrate the sufficiency of its financial resources, as of the Demonstration Date, in the same manner that ELX demonstrated the sufficiency of its financial resources, as of the estimated designation date – namely, by providing evidence that (i) the value of its financial resources, calculated as of the Demonstration Date, equals or exceeds its operating costs, calculated for the period beginning on the Demonstration Date and ending one year thereafter, and (ii) such financial resources include unencumbered, liquid assets equal to at least six (6) months of such operating costs.

Staff has discussed the rationale of its recommendations with the Chief Executive Officer of ELX, who has not indicated that he is opposed to the incorporation of such recommendations in the Order of Designation.

Attachments

- A ELX Order of Designation
- B ELX Letter
- C ELX Application for Designation**
 1. Chart Demonstrating Compliance
 2. ELX Futures, L.P. Rulebook
 3. Amended and Restated Limited Partnership Agreement
 4. Analysis of ELX Futures L.P. Corporate Structure and Governance for Compliance with the Act's Core Principles.
 5. ELX Representations to the Commission
 6. ELX Application Index

** Due to the volume of material submitted with the ELX application, the other application materials are available upon request.