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Mercatus Center

George Mason University

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Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1125 21st Street, NW
Washington, DC 20581

COMMENT

Reference: Release: 65 Fed. Reg. 38986; 65 Fed. Reg. 39008; 65 Fed. Reg. 39027; and 65 Fed. Reg. 39033 (June 22, 2000)

Dear Secretary:

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University offers the enclosed comments on proposed regulations by Commodity Futures Trading Commission (CFTC). RSP is dedicated to advancing knowledge of regulations and their impacts on society. As part of its mission, this program produces careful and independent analysis of agency rulemaking proposals from the perspective of the public interest. Thus, these comments do not represent the views of any particular affected party or special interest group, but are designed to protect the interests of American citizens.

The Regulatory Studies Program appreciates the opportunity to comment on CFTC's proposed regulations. We hope that consideration of these comments will enhance the quality of these regulations, and the underlying analysis.

Sincerely,

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Distinguished Scholar and
Director, Regulatory Studies Program

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REGULATORY STUDIES PROGRAM

Public Interest Comment on

The Commodity Futures Trading Commission's Proposed Rules Relating to a New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations, and Exemption for Bilateral Transactions[1]

Release: 65 Fed. Reg. 38986; 65 Fed Reg. 39008; 65 Fed. Reg. 39027; and 65 Fed. Reg. 39033 (June 22, 2000).

The Regulatory Studies Program ("RSP") of the Mercatus Center at George Mason University is dedicated to advancing knowledge of the impact of regulation on society. As part of its mission, RSP produces careful and independent analyses of agency rulemaking proposals from the perspective of the public interest. Thus, our response to the Commodity Futures Trading Commission's ("CFTC" or "Commission") request for comment on issues related to its proposed new regulatory framework do not represent the views of any particular affected party or special interest group, but are designed to evaluate the effect of the Commission's proposals on overall consumer welfare.

The CFTC has published for public comment proposed rules and rule amendments ("Proposals") that address legal certainty[2] for derivative transactions and regulatory relief for futures exchanges under the Commodity Exchange Act ("CEA"). The Proposals are set forth in a series of Federal Register releases, each addressing a different part of the regulatory structure, and contemplate "far reaching and fundamental changes to modernize regulation of commodity futures and options markets." The Proposals follow the CFTC's issuance on February 22, 2000 of a staff report entitled "A New Regulatory Framework," in which many of the proposals were first made public ("Staff Report"). The Staff Report was made in response to a request from the chairmen and other members of the House and Senate Committees on Agriculture in a letter dated November 30, 1999 that the CFTC "use the exemptive authority granted it by the Commodity Exchange Act to lessen regulatory burdens on United States' futures markets so that they may compete more effectively."

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[1] Comment prepared by Wendy L. Gramm, Regulatory Studies Program, Mercatus Center at George Mason University and Jane K. Thorpe, Brown & Wood, LLP. This comment is one in a series of Public Interest Comments from Mercatus Center's Regulatory Studies Program and does not represent an official position of George Mason University.

[2] The term legal certainty (or uncertainty) not only refers to the concept of contract enforceability, but includes the concept of regulatory certainty, which refers to actions of regulatory authorities.

I. CFTC Proposes a New Framework for Futures Exchanges and Over-the-Counter Markets

The CFTC's Proposals are set forth in four separate releases: (1) "A New Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations;" (2) "Rules Relating to Intermediaries of Commodity Interest Transactions;" (3) "A New Regulatory Framework for Clearing Organizations;" and (4) "Exemption for Bilateral Transactions." The CFTC Proposals would:

- Expand the existing Swaps Exemption to cover all transactions between eligible participants that are not conducted on a multilateral trade execution facility or "MTEF." Part 36 of the Proposals defines MTEF as an electronic or non-electronic facility through which persons enter into binding transactions by accepting bids and offers made by one person that are open to multiple persons who conduct business through the facility. The definition would not include systems that merely facilitate the bilateral negotiation of transactions.

- Establish a category of trading facility identified as an Exempt MTEF to permit transactions involving certain categories of financial products entered into between eligible participants that are conducted on a multilateral trade execution facility.[3] Transactions on an Exempt MTEF could be cleared on a Recognized Clearing Organization ("RCO") as set forth below.

- Create two new categories of regulated trading facilities: (1) recognized futures exchanges ("RFEs"), which would be governed under fifteen Core Principles, and (2) derivatives transaction facilities ("DTFs"), which would be subject to intermediate regulation pursuant to seven Core Principles. The basis for reduced regulation at DTFs is that access is limited to eligible commercial participants or through certain registered futures commission merchants ("FCMs").

- For the first time, require the separate recognition of clearing houses as RCOs subject to fourteen Core Principles and permit bilateral transactions and transactions on Exempt MTEFs to clear on such RCOs.

- Reduce the level of regulation for FCMs and other intermediaries.

II. While the Objectives Underlying the Proposals are Sound, the Proposed Approach May Have Unintended Consequences

The CFTC has stated its belief that its Proposals governing MTEFs will promote innovation, maintain U.S. competitiveness, reduce systemic risk and protect customers.[4] In its release on

[3] The current swaps exemption in Part 35 of the CFTC's regulations interprets Section 4(c) as not being applicable to swap transactions that are entered into or executed on a multilateral trade execution facility.

[4] 65 Fed. Reg. 38986

bilateral transactions, the CFTC's stated purpose is to expand and to clarify the operation of the current Swaps Exemptions in order to "provide greater legal certainty to the OTC [over-the-counter] markets and reduce systemic risk."[5]

We endorse these stated regulatory objectives and commend the CFTC for seeking to make the Commission a more effective and efficient regulator in the global marketplace. The rapid technological and financial innovations that have occurred since 1974, when the modern CEA was enacted and the CFTC created, will require a structure that can easily adapt itself to, and accommodate, new market entrants, new products, new kinds of trading facilities, and new business structures. However, for the reasons set forth below, we are concerned that the means proposed to achieve these objectives may have the opposite effect of creating more legal uncertainty without significant regulatory relief.

A. Flawed Presumption Could Increase, Not Diminish, Legal Uncertainty

The proposed changes to Part 35 on bilateral transactions is intended to implement the recommendations of the Report of the President's Working Group on Financial Markets, "Over-the-Counter Derivative Markets and the Commodity Exchange Act" ("PWG Report").[6] The PWG Report recommended, among other things, legal certainty for certain OTC derivatives by creating an exclusion from the CEA for such products.

We support strongly the goal of increasing legal certainty and the objective of crafting the Proposals to address the enforceability issue. However, in any effort to provide legal certainty, the Commission is limited by the terms of the Commodity Exchange Act itself. By including transactions that are not governed by the CEA, these Proposals can exacerbate uncertainty rather than reduce it.

1. The Proposals Reach Beyond CFTC's Statutory Mandate and Jurisdiction

Section 2 of the CEA states that the CFTC has jurisdiction over "contracts of sale of a commodity for future delivery, traded or executed on a contract market...or any other board of trade, exchange or market, and transactions subject to...Section 19 of this Act." Elsewhere the Commission is also given jurisdiction over leverage transactions and most commodity options.

Section 4(c) of the CEA permits the CFTC to exempt "any agreement, contract or transaction (including any class thereof) that is otherwise subject to subsection (a)." Subsection (a) contains what is called the "exchange trading requirement," which is the requirement that it is unlawful for any person to enter into a contract for the purchase or sale of a commodity for future delivery unless it is conducted on or subject to the rules of a board of trade which has been designated by the Commission as a contract market.

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[5] 65 Fed. Reg. 39033, 39034

[6] Issued in November 1999. Among other things, the PWG Report at page 2 recommended "An exclusion from the CEA for bilateral transactions between sophisticated counterparties (other than transactions that involve non-financial commodities with finite supplies)..."

The Commission's exemptive authority is clear: the CFTC can exempt contracts that are subject to the exchange trading requirement. And, since the exchange trading requirement applies only to "a contract for the purchase or sale of a commodity for future delivery," the Commission's exemptive authority is limited to futures contracts.

However, in an effort to provide legal certainty within the scope of the CFTC's current exemptive authority, the Proposals expand the category of products to which the exemption applies to "all contracts, agreements and transactions" entered into between eligible participants and further provide for non-repudiation of such contracts entered into by such persons or persons reasonably believed to be an eligible participant. While the non-repudiation aspect of the Proposals is beneficial, it is overshadowed by the implications of the broad definitions used.

Throughout the Proposals, reference is made to "derivatives transactions" and "contracts, agreements and transactions." The CFTC never specifies that the transactions it is proposing to exempt are only those transactions it has the legal authority to exempt—futures contracts ("contracts of sale of a commodity for future delivery") subject to the exchange trading requirement. Even more troubling, the Commission extends antimanipulation and antifraud authority over all transactions covered by the Proposals.

The Commission's Proposals rely on language in the Conference Report accompanying the Futures Trading Practices Act of 1992 that "...the Conferees do not intend that the exercise of exemptive authority... would require any determination beforehand that the agreement, instrument or transaction for which the exemption is sought is subject to the [CEA]."[7] While it may be appropriate for the CFTC to avoid such a determination in granting an exemption from regulation, it is not clear that the CFTC can exercise its antifraud authority in relation to a particular transaction without determining that the CFTC is authorized to exercise jurisdiction in the first instance.[8]

If adopted as proposed, the CFTC could attempt to exercise its antifraud authority not only over products such as "total return swaps" and "credit swaps," as enumerated in Part 36.2, but also over the broad range of contracts covered by these Proposals, namely, "all contracts and transactions" entered into between eligible participants. While a party could contest the CFTC's assertion of jurisdiction in a disciplinary proceeding or in a rulemaking proposal that would impose additional regulations, it is the mere assertion of regulatory jurisdiction by the CFTC that in the past has created the legal uncertainties that these Proposals attempt to address.

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[7] See H.R. Rep. No. 978, 102d Cong., 2d Sess. 82-83 (1992).

[8] We note in this regard that in issuing the Exemption for Certain Contracts Involving Energy Products in 1993, the CFTC, based on public comments, determined not to reserve antifraud jurisdiction under Section 4b of the CEA. 58 Fed. Reg. 21286 (April 20, 1993). Contrary to the views of some who argued that such action would establish a dangerous precedent with implications for the markets, the failure to include an antifraud provision has not proven to be of concern.

2. The Proposals Would Create Greater Uncertainty

Enhancing legal certainty is a worthwhile goal. However, as described above, expanding the reach of the Commission, or at least the antifraud authority of the agency to the broad range of contracts and transactions contemplated by the Proposals, will not promote this objective. The ability to exempt presumes the ability to regulate in the first instance. If the CFTC is serious about providing legal certainty to OTC transactions, it is this presumption that it must reverse.

By reinforcing the presumptions and approach of current Part 35 that led to the two previous attempts to regulate swaps as futures, and indeed by broadening the coverage, these Proposals may exacerbate rather than reduce legal uncertainty. Expanding the reach of its antifraud authority does little to rebut the presumption that the agency reserves its right to regulate these contracts in the future.

The CFTC may miss an important opportunity (1) to exclude affirmatively from the scope of the CEA bilateral transactions that are outside the scope of Section 4(a), an act for which no legislative action is required, and (2) to delineate those areas where it is necessary to exercise its exemptive authority until such time as Congress takes action to exclude all such products from the CEA. Such action would be more consistent with the CFTC's stated objectives and the spirit of the recommendations of the President's Working Group on Financial Markets.

We question whether the means used by the CFTC in the Proposals are consistent with the CEA and the recommendations of the PWG Report, and whether they advance the cause of legal certainty. We recommend that the CFTC consider our recommendations for change as set forth below to address these concerns.

B. The Proposals Create Legal Uncertainties for Certain MTEFs

In Section C below, we describe our concerns that the Commission's Proposals for regulatory relief for regulated futures exchanges may not lessen burdens on U.S. futures exchanges in the fundamental manner contemplated by Congressional leaders in their November 30, 1999 letter. In this section, we explain our concern that the interplay of the broad scope of products covered by the Proposals and the proposed structure for regulating MTEFs appears to expand CFTC jurisdiction over commercial markets. This approach will not reduce questions about the legality of certain products and transactions. Rather, it raises a whole new area for legal uncertainty in that the broad definition of MTEF in Proposed Rule 36.1(b) would appear to cover auction markets such as eBay and all other forms of B2B trading facilities, whether electronic or not.

The Proposals establish a category of trading facility identified as an Exempt MTEF to permit transactions on MTEFs involving "contracts, agreements, and transactions" based on certain categories of financial products that are entered into between eligible participants. The underlying products are limited to financial products with a nearly inexhaustible supply. MTEFs that trade "contracts, agreements, and transactions" involving any other underlying product must seek recognition as a DTF or an RFE if participants do not qualify as eligible commercial participants. Even Exempt MTEFs can be subject to requirements to disseminate to the public trading volume, price ranges, and other trading data on a daily basis, if the Commission

determines that the facility is a significant source for price discovery for an underlying commodity.

As noted below, the DTF category appears to be designed to provide an intermediate level of regulation for existing futures exchanges, and the issues addressed by the Core Principles and related Appendix reinforce this view. Any contract, agreement or transaction except those subject to Shad/Johnson and agricultural products enumerated in the CEA can be traded among eligible commercial participants on a DTF.

We have the following concerns with this approach. First, this structure of Exempt MTEFs, DTFs, and RFEs, when coupled with restrictions on the kinds of products that they may (or may not) trade, and by whom, is extremely complex. Second, the Proposals make no attempt to explain why certain transactions *between* eligible participants are exempt under Part 35 but those same transactions *among* eligible participants are subject to exchange-style regulation. Third, the approach does provide more comprehensive relief to Exempt MTEFs but restricts the types of products Exempt MTEFs may trade without providing any empirical evidence that a method of trading that permits interaction among participants is more likely to facilitate manipulative activity than automated bilateral trading of the same contract. Fourth, while the Proposals identify three categories of exclusions from the definition of an MTEF,[9] they do not otherwise provide any guidance on the types or scope of B2B markets that would be captured by this regulation. Many business-to-business trading facilities do not trade financial products with a nearly inexhaustible supply, and would not qualify as an Exempt MTEF. If such B2B facility sought legal certainty, the only recourse would be to qualify as a DTF. It is not clear how commercial markets for physical commodities would be treated in this regime. We are concerned that this aspect of the Proposals raise more questions than it answers and that its effect may be to stifle the development and growth of new and innovative ways of trading and doing business.

Technology is permitting commercial market participants to interact between and among themselves more efficiently and cost-effectively. The broad scope of the current Proposals create greater legal uncertainty and will require such markets to choose between exchange-style regulation or legal uncertainty. The CFTC should provide further guidance on the reach of its Proposals in this area.

C. Regulatory Reform is Suggested But Not Actualized in Proposals

1. RFEs

The fifteen Core Principles applicable to RFEs address the following areas: rule enforcement, products, position monitoring and reporting, position limits, emergency authority, public information, transparency, trading system, audit trail, financial standards, customer protection, dispute resolution, governance, recordkeeping and competition. The seven Core Principles that

[9] Under proposed Rule 36.1(b), the term MTEF would not include: (1) a facility whose participants individually negotiate the terms of a transaction which are subject to subsequent acceptance; (2) any electronic communication system for the bilateral negotiation of transactions; and (3) any facility on which only a single firm may participate as market maker and other participants may not accept bids or offers of non-market participants.

apply to DTFs cover enforcement, market oversight, operational information, transparency, fitness, recordkeeping, and competition. We have analyzed these principles and have concluded that the subjects addressed by the Core Principles for RFEs in their totality are similar, if not identical, to the current regulatory standards for recognition of contract markets under the CEA.

Indeed, it is unclear what current requirement on U.S. exchanges would be eliminated under the structure set forth above. Moreover, except for issues related to customer class, the seven principles applicable to the less-regulated DTFs could otherwise be broken down into subcategories that would encompass most of the Core Principles applicable to RFEs. Specifically, while the Core Principles for DTFs contain modifications to address the institutional nature of participants, it is not clear that any specific relief has been or, more importantly, will be provided to exchanges or participants.

We have identified only two situations where relief for RFEs would be provided by the Proposals:[10] (1) the CFTC would not require that it approve an RFE's new contracts prior to listing; and (2) the CFTC would not require its approval of an RFE's rules and rules amendments prior to implementation, except for the terms and conditions of agricultural commodities enumerated in Section 1a(3) of the CEA. Instead, the rules would be implemented and the contracts traded subject to exchange certification of compliance with relevant CFTC standards.

These do not constitute major relief, particularly as past Commissions have worked to reduce regulatory delays involved in approving contracts and exchange regulations. There is little in these Proposals to ensure that significant regulatory relief will be provided to exchanges.

Furthermore, the Proposals do not delineate the process, including the limitations on the Commission's actions, which would be used in implementing the Proposals or in disciplinary proceedings. Discussion of process occurs only in Appendices to Proposed Parts 37, 38 and 39. These Appendices are provided as guidance on meeting the conditions for approval under the relevant parts and include acceptable practices for some of the Core Principles. The CFTC notes that these practices are not meant to be the only method for meeting the Core Principles but should be viewed as safe harbors.

We are concerned that the characterization of these specific practices as safe harbors rather than guidance or examples could shift the burden of proof to the regulatee to demonstrate why the failure to comply with the safe harbor is not a violation of the particular Core Principle. Instead, the CFTC should be in the position of demonstrating why the method or means selected by the regulatee or applicant fails to meet the regulatory objective, an approach which we believe will be more conducive to fostering innovation. This approach could also prevent increasing workloads and regulatory delay, which would occur if regulatees must petition the Commission on a case-by-case basis to establish the limits of the safe harbors.

[10] The relief referred to herein would not apply to designated contract markets that trade products subject to Section 2(a)(1)(B) of the CEA, the Shad/Johnson Accord.

In order to avoid this certain gridlock, the Core Principles should be accompanied by general guidance, rather than specific or detailed safe harbors, along with procedures that guarantee accountability and transparency in the decision-making process. These procedures should apply both to regulatees, who should be able to choose the methods and means for compliance and be held accountable for their decisions in this regard, and to regulators, to ensure that their determinations concerning what methods and means are appropriate are consistent with agreed principles of good government and that differences of views can be resolved by means other than enforcement action.

For example, while the Proposals contain timeframes for recognition, the clock stops running based on the CFTC's sole discretion. In this connection, we note the recent example of SwapClear, which the CFTC exempted from most provisions of the CEA and CFTC regulations under its authority in Section 4(c). The initial petition was dated June 15, 1998 and the CFTC order under Section 4(c) was not issued until March 23, 1999.

Finally, we are concerned that an approach that forces MTEFs to seek approval as an RFE, DTF or even an Exempt MTEF and that contains design requirements to the extent of specifying the products and participants that may be the subject of trading on each may have unintended consequences, including stifling innovation in market design and structure. Even the category of Exempt MTEFs may be unduly narrow, given the pace of innovation not only in products but also in methods of trading. We urge the CFTC to be mindful of this concern and to consider whether this design-based approach best achieves its regulatory objectives.

2. Intermediaries

While the Proposals hold a promise of regulatory relief for exchanges, they do not provide for the possibility of fundamental regulatory relief or flexibility for intermediaries. The CFTC proposes to approve different categories of markets depending on the product and nature of the participant. The CFTC could instead replace prescriptive rules with a set of Core Principles and interpretations of acceptable business practices. It is important to note that failure to provide regulatory relief for intermediaries could limit the ability of exchanges to implement true regulatory reform.

III. Conclusions and Recommendations

The CFTC is to be commended for its willingness to undertake a fundamental review of its regulatory approach to more easily accommodate new market entrants, products and business structures and to promote competition and innovation.

As discussed above, however, the Proposals as currently drafted may have the unintended consequences of reducing legal certainty and inhibiting innovation in these markets. The Proposals also do not appear to provide significant regulatory relief to existing futures exchanges or intermediaries. We make the following recommendations to minimize those negative effects.

A. Modify Text to Reverse Presumption of Proposed Part 35

We strongly urge the CFTC to conform its approach to the recommendations of the PWG Report and modify the text of Part 35 to reverse the current presumption that the CFTC has jurisdiction over the products exempted, to clarify that the exemption in the Proposals applies only to bilateral transactions that are subject to Section 4(a) and to modify the rules accordingly. While the approach of these Proposals may appear to be a pragmatic solution to mitigating the enforceability issue faced by market participants, it does nothing to mitigate the future assertion of regulatory jurisdiction by the CFTC over a broader category of products. Absent specific changes, we fear that the Proposals will extend the presumption that the power to exempt is the power to regulate, regardless of whether a determination is made that jurisdiction exists in the first instance.

While the exemptive authority in Section 4(c) represented an important compromise during the 1992 CFTC reauthorization, it has been used as the basis for the assertion of jurisdiction over swaps as futures by the CFTC. In the current dynamic market environment, and particularly in view of the recommendations of the PWG Report that such products be excluded from the CEA, the CFTC should focus on advancing the discussion rather than creating the circumstances for more legal uncertainty.

The agency can and should clarify what is not under its jurisdiction, rather than propose regulations to exempt contracts it has no authority to regulate in the first place, even as it expands its antifraud authority over these same contracts. Given the CFTC's history in this area, providing a "self-effectuating exemption" is not credible or appropriate unless it is "self-effectuating" for transactions that are within the Commission's jurisdiction.

In the absence of legislation that excludes certain bilateral transactions from the CEA, we believe the most effective exercise of the CFTC's exemptive authority in Section 4(c) would be to redraft the Proposals:

> (1) to state clearly that, except for CEA Section 2(a)(1)(B), futures contracts ("contracts for sale of a commodity for future delivery") that are entered into by eligible participants other than on an MTEF are exempt from all the requirements of the CEA, including the exchange trading requirement, antifraud provisions, and private right of action sections of the CEA (Sections 4(a), 4b, 4o, and 22(a)(1));
>
> (2) to state that transactions that have characteristic(s) of futures contracts, that are entered into between eligible participants other than on an MTEF are not intended to be regulated by the CFTC, and are not subject to any requirement of the CEA, including the exchange trading requirement, antifraud provisions, and private right of action sections of the CEA (Sections 4(a), 4(b), 4(o), and 22(a)(1)); and
>
> (3) subject to our concern regarding the broad reach of the term MTEF, to clarify that such transactions conducted on an MTEF are permitted pursuant to other provisions of the Proposals.

By exercising its authority in this manner, the CFTC would clarify that the scope of its authority extends only to transactions that are futures contracts and that it is exercising its authority under Section 4(c) to exempt futures transactions entered into between eligible participants from the exchange trading requirement. This approach would enhance legal certainty as any transaction between eligible participants that might be characterized as a futures contract would not be subject to the CEA, and a procedure to determine whether the transaction in fact is a futures contract would not be required. While this approach is less preferable than a legislative solution that excludes such transactions from the CEA, it is more preferable than the approach of the Proposals in this regard.

We see no reason why the CFTC should extend its antifraud authority over the broad range of contracts covered in these Proposals. Indeed, reserving antifraud authority suggests that the Commission may in the future seek once again to assert jurisdiction inappropriately.

B. Amend Part 36 to Clarify Which Commercial Markets are MTEFs and to Eliminate the Product Restrictions Proposed for Exempt MTEFs

For the reasons stated above, the CFTC should amend Part 36 to clarify the types of MTEFs that are *required* to seek recognition under Part 36, expand the types of products that can be traded on an Exempt MTEF and to confirm that other MTEFs are outside the scope of the CEA (unless they qualify as RFEs or DTFs). Absent these amendments, the Proposals could create yet another area of legal uncertainty whose effect could be to stifle the development and growth of new and innovative ways of trading and doing business.

C. Codify the Specific Relief Provided and Create the Regulatory Framework to Ensure Transparency and Procedural Due Process in the Implementation of the New Approach

Notwithstanding our concern noted above concerning the mandated design requirements imposed on MTEFs, the proposed framework has the potential to streamline regulation or create inefficiencies and more legal uncertainties. Whether it accomplishes the desired regulatory objectives will be based in large measure on the procedures adopted to implement the approach.

We are concerned that the generality of the Core Principles and the characterization of the Appendices as specific safe harbors rather than general guidance (with examples), without safeguards to ensure that the CFTC itself complies with certain principles and objectives in the procedures it takes to implement the Core Principles, could undermine the goal of regulatory reform. In fact, the current Proposals could permit the CFTC and its staff to make regulatory determinations that have important market ramifications without the benefit of public discourse. Moreover, the safe harbors can, by default, become rules, and stifle innovation by encouraging firms to elect the certainty of current procedures, or to seek regulatory approval on a case-by-case basis.

Absent procedural due process and safeguards to ensure that determinations concerning compliance with recognition standards are made transparently, efficiently, and fairly, the new regulatory approach has the potential not only to stifle innovation but also to undermine the purpose of the Administrative Procedure Act. If the CFTC is not prepared at this time to propose

explicit relief from specific regulatory requirements on which public comment can be made, it must at a minimum take the following steps. First, it should state clearly that the Appendices in the Proposals are provided as guidance with the burden on the CFTC to demonstrate that any other approach taken is inappropriate. Second, it should offer a framework for ensuring transparency, fairness, and efficiency in its decision-making process. While we are not offering a particular framework at this time, the CFTC should ensure that its proposed approach to implementation: (1) promotes efficiency and economy; (2) ensures that regulatory actions maximize net social benefits; and (3) facilitates innovation and competition.

Finally, in order to ensure that existing futures exchanges obtain regulatory relief, the Commission should consider specifying the relief it expects to provide or at least outline how it plans to reduce regulatory burdens. Since traditional futures exchanges cannot currently qualify as DTFs, the Commission should explain how any regulatory relief will occur. Even the best procedures will not provide relief if all the exchanges' regulations must be retained under the Core Principles.

D. Provide Specific Proposal for Relief for Intermediaries

The CFTC should publish specific proposals that would provide intermediaries with greater flexibility regarding regulatory compliance.

Appendix I

RSP Checklist

CFTC's New Regulatory Framework

Element	Agency Approach	RSP Comments
1. Has the agency identified a significant market failure?	These Proposals were made in response to perceived failures in the ability of the existing regulatory framework to respond to innovation in derivative markets. **B: Good**	Important technological and financial innovations have occurred since 1974, when the modern Commodity Exchange Act was enacted and the CFTC was created. The existing regulatory framework fails to accommodate such changes, and serves to inhibit successful risk management innovations in private markets. Changes are necessary to correct this regulatory failure and allow private markets to flourish.
2. Has the agency identified an appropriate federal role?	Congressional committees directed the CFTC to "use the exemptive authority granted it by the Commodity Exchange Act to lessen regulatory burdens on United States futures markets so they may compete more effectively." **A: Excellent**	Since the Commodity Exchange Act is a federal statute, and the existing regulations and interpretations are federal, changes to the federal regulatory scheme are necessary to accomplish the objectives of the Proposals.
3. Has the agency examined alternative approaches?	The Proposals do not examine the merits of alternative approaches to meet the stated objectives. **F: Unsatisfactory**	The CFTC should consider other alternatives that could more effectively achieve its stated goals. For example, the CFTC could: clarify what is not under its jurisdiction; analyze proposals granting specific regulatory relief to futures exchanges; provide intermediaries with greater flexibility regarding regulatory compliance.

Element	Agency Approach	RSP Comments
4. Does the agency attempt to maximize net benefits?	The Proposals do not discuss the benefits and costs of these approaches compared to others. **F: Unsatisfactory**	While the goal of the Proposals is to "modernize regulation of commodity futures and options markets," and "lessen regulatory burdens" so U.S. markets can "compete more effectively," they may actually create more legal uncertainty and regulatory gridlock.
5. Do the Proposals have a strong scientific or technical basis?	The Proposals do not contain empirical or technical information to support the Proposals. **F: Unsatisfactory**	The Proposals are based on the presumption that flexibility and choice will reduce regulatory burdens. However the Proposals do not provide evidence of how that will be achieved. Furthermore, the Proposals may not in fact provide the flexibility that is asserted.
6. Are distributional effects clearly understood?	The CFTC recognizes that regulations are costly to U.S. futures exchanges and intermediaries and that legal uncertainty regarding certain transactions has hampered innovation. However the Proposals fall short of providing the relief needed. **D: Poor**	While the CFTC recognizes that the participants are sophisticated large institutions, the Proposals continue to limit their ability to respond to new risks with new products or methods of doing business. In addition, while the CFTC recognizes the need for regulatory relief for U.S. futures exchanges and intermediaries, it is not clear that the needed relief will be obtained.
7. Are individual choices and property impacts understood?	The CFTC recognizes the importance of regulations and their general impact. However the Proposals may result in less choice and little regulatory relief. **D: Poor**	The CFTC could enhance individual choice and reduce the unnecessary intrusion into business decision making by explicitly stating what it does not regulate; by explaining exactly how it will reduce the regulatory burden on futures exchanges and intermediaries; and by establishing a regulatory reform process that is transparent, fair, and efficient.